

Kitanotatsujin Corporation

(2930, TSE 1st Section/Sapporo Securities Exchange)

December 3, 2019

Sales Growth in New Products will Accelerate Sales Expansion in the Second Half

Update Report

 QUICK Corp.
Daisuke Harada

 Key benchmarks as of
November 25, 2019

Share price	¥694
Year-to-date high	¥794 (October 16, 2019)
Year-to-date low	¥341 (January 15, 2019)
Shares outstanding	141,072,000 shares
Trading units	100 shares
Market capitalization	¥97,904 million
Projected dividend (Company)	¥4.20
Projected EPS (Analyst)	¥13.67
PBR (Results)	26.70

Issuance date of preceding reports

Basic	June 21, 2019
Update	August 29, 2019

Slow growth in the second quarter due to reduced advertising in light of shipping delays of a popular product

Net sales grew by 28% year-on-year to ¥5,055 million, while operating profit rose by 46% to ¥1,390 million in the non-consolidated financial results for the first half of the fiscal year ending February 29, 2020. Revenue increased significantly due to the acquisition of new customers and the contribution from regular purchases by customers acquired in the previous fiscal year. In profits, the gross profit margin declined due to growing sales of relatively unprofitable products. However, operating profit increased significantly on the back of an improved ratio of selling, general and administrative expenses resulting from a reduction in advertising expenses. Meanwhile, net sales for the three months of the second quarter is estimated to have recorded only a 1% rise, compared to the previous quarter, excluding the contribution from the recording of net sales of the popular product, HYALO DEEP PATCH, which was postponed due to shipping delays in the first quarter. Acquisition of new customers slowed due to the effect of reduced advertising, in light of shipping delays.

The Corporate Valuation Research Center maintained its forecast. Steadily strengthening the customer acquisition system

The QUICK Corporate Valuation Research Center (“the Research Center”) forecasts non-consolidated financial results for the fiscal year ending February 29, 2020 to yield a 32% year-on-year rise in net sales to ¥11,000 million and a 45% rise in operating profit to ¥2,700 million. We maintain our forecast as of June 2019. As production capabilities for HYALO DEEP PATCH had not been enhanced, we initially expected that sales expansion would not accelerate greatly, except for the contribution from the postponed recording of net sales due to shipping delays. There is no significant delay in progress for the first half. In the second half, we expect sales growth to accelerate compared to the first half, driven by active advertising for HYALO DEEP PATCH, for which shipping delays have been reduced, as well as new products that are to follow. These new products are in the same series as HYALO DEEP PATCH. We believe that it is possible to deploy effective advertising, as it is easy to utilize the advertising know-how used to make HYALO DEEP PATCH a hit product. In addition, the customer acquisition system is being steadily strengthened to advertise as many products as possible. Going forward, the key point is whether these efforts will lead to a further acceleration of sales growth, as well as sustainable achievements.

Results			Net sales Millions of yen	YoY %	Operating profit Millions of yen	YoY %	Ordinary profit Millions of yen	YoY %	Profit Millions of yen	YoY %	EPS Yen
FY2018	2nd quarter (March to August)	Results	3,950	88.0	953	146.9	954	147.1	663	149.0	4.77
FY2019	2nd quarter (March to August)	Results	5,055	28.0	1,390	45.8	1,390	45.8	947	42.8	6.82
FY2018	Full year	Results	8,312	57.1	1,861	32.6	1,861	32.6	1,293	36.4	9.30
FY2019	Full year	Company estimates (Announced in April 2019)	10,939	31.6	2,702	45.2	2,703	45.2	1,890	46.2	13.60
		Analyst estimates (Announced in June 2019)	11,000	32.3	2,700	45.0	2,700	45.0	1,900	49.9	13.67
FY2020	Full year	Analyst estimates (Announced in June 2019)	14,000	27.3	3,500	29.6	3,500	29.6	2,400	26.3	17.27

Results

Operating profit rose by 46% due to reduced advertising expenses in the first half.

- Results for the first half of the fiscal year ending February 29, 2020 (March 1, 2019 to August 31, 2019)

Net sales grew by 28% year-on-year to ¥5,055 million, while operating profit rose by 46% to ¥1,390 million in the non-consolidated financial results for the first half of the fiscal year ending February 29, 2020 (see Table 1). This was mainly due to a strengthening of the system of the customer acquisition department, which is responsible for advertising. Revenue increased significantly due to the acquisition of new customers and the contribution from regular purchases by customers acquired in the previous fiscal year. In profits, the gross profit margin declined due to growing sales of relatively unprofitable products. However, operating profit increased significantly on the back of an improved ratio of selling, general and administrative expenses resulting from a reduction in advertising expenses, which account for the majority of selling, general and administrative expenses.

Table 1. Non-consolidated financial results for the first half
(Millions of yen)

	FY2018 1st half	FY2019 1st half		
	Results	Results	YoY	
			Changes	%
Net sales	3,950	5,055	+1,105	+28.0%
Gross profit	3,080	3,851	+771	+25.0%
(Gross profit margin)	(78.0%)	(76.2%)	-	-
Selling, general and administrative expenses	2,127	2,461	+334	+15.7%
(Ratio of selling, general and administrative expenses)	(53.8%)	(48.7%)	-	-
Operating profit	953	1,390	+437	+45.8%
(Operating profit margin)	(24.1%)	(27.5%)	-	-
Ordinary profit	954	1,390	+437	+45.8%
Profit	663	947	+284	+42.8%

(Note 1) The first half is from March 1 to August 31.

(Note 2) Amounts less than one million yen are rounded down. Ratios to net sales and year-on-year changes are calculated in thousands of yen.

(Note 3) Gross profit includes provision for sales returns.

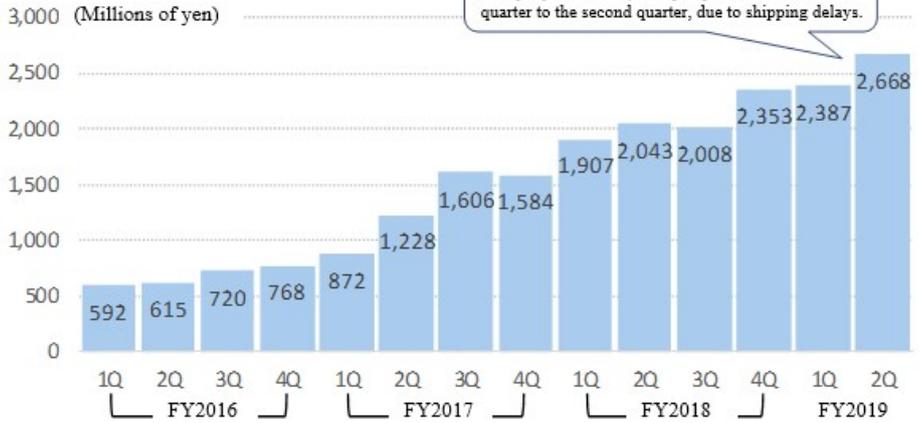
(Source) Prepared by the Research Center based on the Company's materials

Slow growth in the second quarter, excluding the recording of net sales, which was postponed due to shipping delays

Looking at quarterly net sales, the first quarter showed a growth of only 1% compared to the previous quarter, while in the second quarter, the sales growth rate rose to 12% compared with the previous quarter (see Figure 1). In the first quarter, there were shipping delays of cosmetic HYALO DEEP PATCH, which is currently experiencing a significant growth in sales, due to the inability of production to keep pace with orders. The recording of ¥247 million in net sales (the Company's estimate), which is equivalent to orders received by new customers for which products were not shipped, was postponed to the second quarter onward. Meanwhile, the second quarter showed a higher sales growth rate, as net sales for which recording had been postponed due to shipping delays in the first quarter, were recorded. On the other hand, assuming that all net sales for which recording was postponed were recorded in the second quarter, and excluding such effects, the sales growth rate in the second quarter was only 1%.

Results

Figure 1. Quarterly net sales

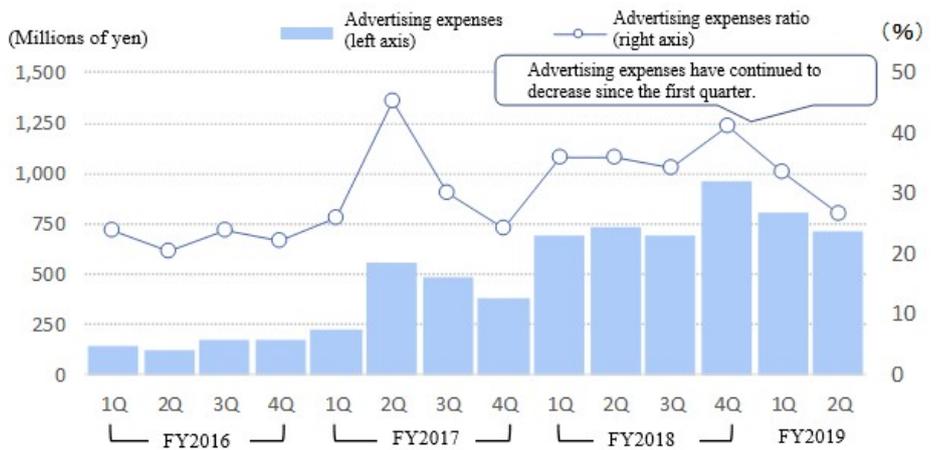


(Note) Amounts less than one million yen are rounded down.
 (Source) Prepared by the Research Center based on the Company's materials

Reduced advertising resulted in lower growth.

Quarterly advertising expenses have decreased relative to the previous quarter, since the first quarter (see Figure 2). This was due to reduced advertising for HYALO DEEP PATCH, in light of shipping delays. Specifically, advertising expenses were reduced by lowering the upper limit (placing stricter standards) on the advertising expenses per customer to be newly acquired. As a result, advertising expenses decreased, and the advertising expenses ratio to net sales improved. Meanwhile, the reduced advertising resulted in a slowdown in the acquisition of new customers, leading to a slower growth of quarterly net sales in the second quarter.

Figure 2. Quarterly advertising expenses and the advertising expenses ratio



(Source) Prepared by the Research Center based on the Company's materials and information obtained by interviews

Results

The Company has maintained the full-year forecast. Active advertising will be promoted in the second half.

- The Company's plan for the fiscal year ending February 29, 2020 (March 1, 2019 to February 29, 2020)

The Company's plan for the non-consolidated financial results for the fiscal year ending February 29, 2020 is a 32% year-on-year increase in net sales to ¥10,939 million and a 45% year-on-year increase in operating profit to ¥2,702 million (see Table 2). Regarding the financial results in the first half, net sales were below the forecast for the first half announced at the beginning of the fiscal year by ¥240 million, due mainly to the reduced advertising associated with shipping delays of HYALO DEEP PATCH. Meanwhile, operating profit exceeded the forecast by ¥102 million. The Company has maintained its forecast announced at the beginning of the fiscal year. Going into the second half, the Company aims to achieve its full-year plans by accelerating sales growth through active advertising for HYALO DEEP PATCH, for which shipping delays have been reduced, as well as new products that have recently been launched.

The Research Center also maintained its forecast. No significant delay in progress

- The Research Center's forecast for the fiscal year ending February 29, 2020

The QUICK Corporate Valuation Research Center forecasts the non-consolidated financial results for the fiscal year ending February 29, 2020 to be ¥11,000 million of net sales, up 32% year-on-year, and ¥2,700 million of operating profit, up 45% year-on-year (see Table 2). We maintain our forecast as of June 2019, which is on the same level as the Company's plan. As production capabilities for HYALO DEEP PATCH had not been enhanced, we initially expected that sales expansion would not accelerate greatly, except for the contribution from the postponed recording of net sales due to shipping delays. Net sales showed a progress of 46% in the first half against our full-year net sales forecast. There was no significant delay compared with the progress of 48% in the same period of the previous fiscal year. We believe sales will recover in the second half.

Table 2. Forecast of non-consolidated financial results for the full year

(Millions of yen)

	FY2018 full year		FY2019 full year			FY2020 full year	
	Results	YoY %	The Company's plan	The Research Center's forecast	YoY %	The Research Center's forecast	YoY %
Net sales	8,312	57.1%	10,939	11,000	32.3%	14,000	27.3%
Gross profit	6,451	52.6%	-	8,300	28.6%	10,600	27.7%
(Gross profit margin)	(77.6%)	-	-	(75.5%)	-	(75.7%)	-
Selling, general and administrative expenses	4,590	62.6%	-	5,600	22.0%	7,100	26.8%
(Ratio of selling, general and administrative expenses)	(55.2%)	-	-	(50.9%)	-	(50.7%)	-
Operating profit	1,861	32.6%	2,702	2,700	45.0%	3,500	29.6%
(Operating profit margin)	(22.4%)	-	(24.7%)	(24.5%)	-	(25.0%)	-
Ordinary profit	1,861	32.6%	2,703	2,700	45.0%	3,500	29.6%
Profit	1,293	36.4%	1,890	1,900	46.9%	2,400	26.3%

(Note 1) The full year (fiscal year) is from March 1 to the end of February of the following year.

(Note 2) Amounts less than one million yen are rounded down. Ratios to net sales and year-on-year changes are calculated in thousands of yen.

(Note 3) Gross profit includes provision for sales returns.

(Source) Prepared by the Research Center based on the Company's materials. Forecasts by the Research Center

Results

Accelerated growth is expected in the second half through sales expansion of new products.

In the second half, sales expansion is expected through active advertising for HYALO DEEP PATCH and the new products that are to follow. The Company launched MIKEN DEEP PATCH in July 2019, followed by ODEKO DEEP PATCH in September 2019. Like HYALO DEEP PATCH, these products are part of the Company's so called "injectable cosmetics" series. Thus, we believe that it is possible to deploy effective advertising, as it is easy to utilize the advertising know-how, etc., used to make HYALO DEEP PATCH a hit product. In fact, MIKEN DEEP PATCH had a strong start, with the volume of advance purchase reservations at the time of its launch date exceeding 20,000 units (approximately ¥75 million in net sales, calculated based on a price of ¥3,759 for the "basic course, with delivery once every three months"). We expect sales expansion to accelerate in the second half compared to the first half, driven by the steady sales growth of these products through active advertising.

As for profits, the operating profit margin is expected to decline in the second half compared to the first half, as a result of active advertising. For the full year, the operating profit margin is expected to improve compared to the previous fiscal year, due to the elimination of the effects of unprofitable advertisement placement resulting from operational problems with the in-house advertisement system (a system developed by the Company to analyze advertisement effects and improve operational efficiency) in the previous fiscal year, as well as reduced advertising in the first half.

Figure 3. Three products of the "injectable cosmetics" series



(Source) The Company's website

The impact of the rise in the consumption tax rate is estimated to be small.

We expect the rise in consumption taxes in October 2019 to have little impact on the Company's sales. In particular, as regular purchases account for approximately 70% of the Company's sales, and its products specialize in supporting the body-related problems that consumers find most concerning, cancellations of regular purchases and purchase delays are expected to be unlikely.

Results

- The Research Center's forecast for the fiscal year ending February 28, 2021 (March 1, 2020 to February 28, 2021)

No changes in the forecast for the fiscal year ending February 28, 2021

The Research Center forecasts the non-consolidated financial results for the fiscal year ending February 28, 2021 to yield a 27% year-on-year rise in net sales to ¥14,000 million and a 30% year-on-year rise in operating profit to ¥3,500 million (see Table 2). There are no changes in the forecast, as of June 2019. We expect revenues to increase due to the contribution from regular purchases by customers acquired in the fiscal year ending February 29, 2020, as well as the acquisition of new customers in the current fiscal year. As for expenses, we continue to expect a rise in personnel expenses associated with an enhancement of staff, primarily in the customer acquisition department, and an increase in advertising expenses. The operating profit margin is not expected to improve significantly from our forecast for the fiscal year ending February 29, 2020.

Progress has been made in strengthening the customer acquisition system, such as by enhancing staff and improving operational efficiency.

The Research Center believes that it is necessary for the Company to shift its growth strategy from the current reliance on sales expansion of certain products to sales expansion of more products, in order to achieve an early net sales of ¥30.0 billion, which is the Company's medium- to long-term growth target. Shipping delays of HYALO DEEP PATCH in the first quarter and the subsequent slow growth were partly attributable to the concentration of orders resulting from focused advertising of the product. This exposed an adverse effect of growth that is dependent upon sales expansion of certain products.

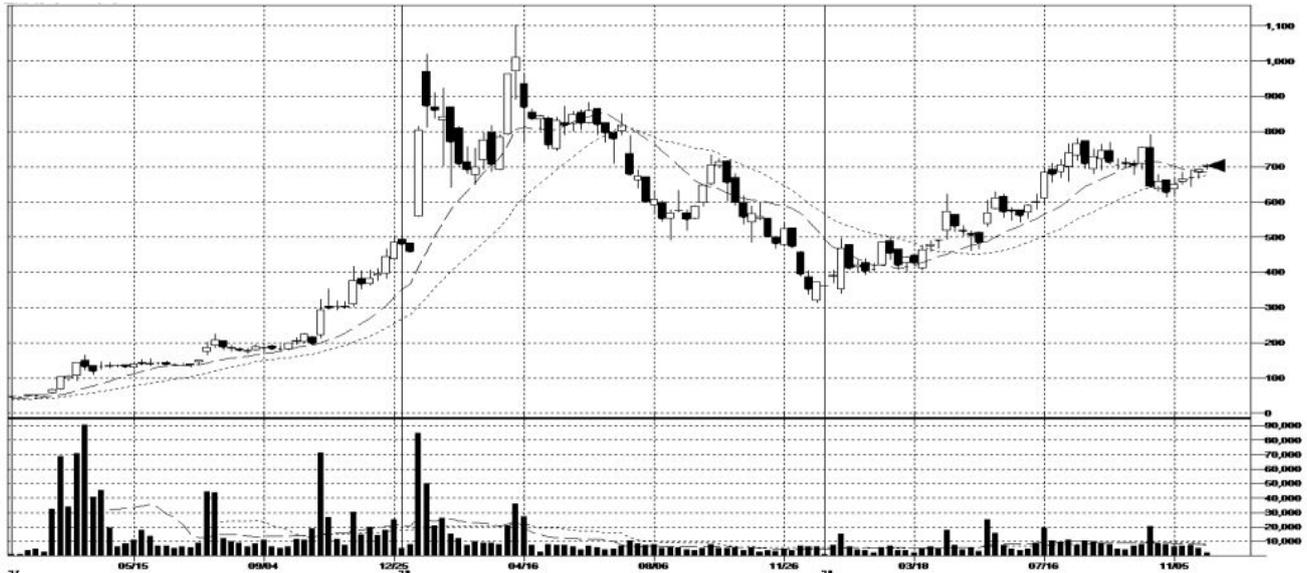
Meanwhile, the customer acquisition system has been steadily strengthened, with an eye toward shifting the strategy. The Company is currently enhancing its human resources for advertisement production, etc., and is also improving operational efficiency. In addition, the Company is continuing to improve the functions of the in-house system, which was introduced with the aim of increasing the efficiency of operations and analyses of online advertising, as well as promoting the utilization of RPA (robotic process automation). As a result, the number of products for which advertising can be utilized is steadily increasing. Going forward, the key point is whether these efforts will lead to a further acceleration of sales growth, as well as sustainable achievements.

Results

Table 3. Products available on the online shopping site, “J NORTH FARM” (as of September 30, 2019, excluding discontinued products)

Launch	Item	Description
Before FY2013	KAITEKI OLIGO	A food with functional claims, which contains five types of ingredients that improve bowel movements
	MINNANO HADAJUNTO~ATO CARE TYPE~	A 100% plant-derived moisturizing-care product, with sugar made from sugar beet produced in Hokkaido as its main ingredient
	KOJUKAN	A health food containing low molecular weight polyphenols as its main ingredient, and supplemented with hyaluronic acid, vitamin C, and L-citrulline (the Company’s first food with functional claims)
	KAITEKI DOKA SLIM CHA	A health food formulated using a unique blend of natural herbs developed by researching the peristaltic motion of the intestine, along with other natural plant-derived ingredients
	20NEN HOIPPU	A facial cleanser that removes skin dullness, with whey as the moisturizing compound; Made using a manufacturing method called direct flame pot kneading.
	MINNANO HADAJUNTO~CLEAR TYPE~	An acne-prevention skin care product with sugar made from sugar beet produced in Hokkaido as its main ingredient, and coated with plant oils including lavender oil
	EZOSHIKI SU-SU-CHA	A tea leaf-containing health food made by blending <i>kuma</i> bamboo grass and red perilla, which have long been used as traditional herbal remedies, with tea leaves of <i>tian cha</i> , a family of rose
	KITANO DAICHINO YUMESHIZUKU	A food with functional claims that increases sleep-enhancing hormones and improves sleep quality
FY2014	ZUKI SHIRAZUNO MI	A health food with a blend of feverfew, giant knotweed, and bitterm as ingredients
	MINNANO HADAJUN LOTION	A lotion with sugar made from sugar beet produced in Hokkaido as its main ingredient, with a blend of moisturizing compounds such as lipidure
FY2015	MINNANO HADAJUNBURO	A moisture-care bath additive made with an extract of the <i>yunohana</i> hot spring component, sugar made from sugar beet, and <i>Saji</i> sea buckthorn as its main ingredients
	EYE KIRARA	A cream for under the eyes made from a blend of ingredients including MGA, a derivative of vitamin C, and plant oil rich in natural vitamin K
FY2016	NO ! NO ! SMELL !	A deodorant cream that addresses foot odor (the Company’s first quasi-drug)
	CLEAR FOOT VEIL	A foot care product for those who suffer from athlete’s foot, formulated as a blend of CPL (cyclic poly lactate), which protects and smooths the skin, and bamboo pyrolygneous acid
	KUROUMEBIYORI	A health food for those who have loose passage, with <i>ume</i> plum extract, zedoary, and aronia extract as its main ingredients
	CLEAR NAIL SHOT α	A foot nail care oil with bamboo pyrolygneous acid and polyamine (which includes soybean germ extract) as its main ingredients
	CARE NANO PACK	A face pack for treating pores by simply applying a cream to the skin
	HYALO DEEP PATCH	A patch with microneedles containing hyaluronic acid, which helps to intensively replenish moisture to fine wrinkles around the eyes
	MAYME WHITE 60	A skin whitening cream-type pack containing a water-soluble placenta extract (quasi-drug)
FY2017	LUMINAPEEL	A brightening peeling gel for beautiful hands
	WRINKY FLAT	An anti-wrinkle beauty gel
	LID KIRARA	A beauty gel exclusively for the upper eyelids
	BUILD MAKE 24	Protein containing HMB (3-Hydroxy 3-MethylButyrate)
FY2018	RIMO SAVON	A laundry detergent that makes pet hair easy to remove, and also makes it difficult for pet hair to stick to clothes
	HANDPURENA	A care cream for aging hands, formulated with ingredients that enhance skin firmness
	NECK ESTHE MIST	An aging-care mist for the neck that enhances skin tightness and firmness
	MEN’s EYE KIRARA	A cream for under the eyes for men
	OKOSAMAYOU KAITEKI OLIGO	KAITEKI OLIGO with ingredients adjusted for children
FY2019	MIKEN DEEP PATCH	An aging-care cosmetic specifically for the area between the eyebrows
	ODEKO DEEP PATCH	An aging-care cosmetic specifically for the forehead

(Source) Prepared by the Research Center based on news releases and other materials



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			FY2016	FY2017	FY2018	FY2019 forecast (Analyst)
Share price	Share price (52-week high)	Yen	54.1	1,021.7	1,105	-
	Share price (52-week low)	Yen	35.2	50.9	315	-
	Average monthly volume	Hundreds of shares	52,485	975,544	317,366	-
Results	Net sales	Millions of yen	2,696	5,292	8,312	11,000
	Operating profit	Millions of yen	542	1,403	1,861	2,700
	Ordinary profit	Millions of yen	538	1,403	1,861	2,700
	Profit	Millions of yen	356	948	1,293	1,900
	EPS	Yen	2.70	7.21	9.30	13.67
	ROE	%	24.8	48.8	48.9	52.8
Main items of balance sheets	Total current assets	Millions of yen	2,203	3,406	4,019	-
	Total non-current assets	Millions of yen	86	74	220	-
	Total assets	Millions of yen	2,290	3,481	4,240	-
	Total current liabilities	Millions of yen	536	1,060	1,298	-
	Total non-current liabilities	Millions of yen	208	74	0	-
	Total liabilities	Millions of yen	744	1,135	1,298	-
	Total shareholders' equity	Millions of yen	1,544	2,344	2,942	-
Total net assets	Millions of yen	1,545	2,345	2,942	-	
Main items of statements of cash flows	Cash flows from operating activities	Millions of yen	637	1,035	1,193	-
	Cash flows from investing activities	Millions of yen	(12)	(2)	(184)	-
	Cash flows from financing activities	Millions of yen	199	(281)	(829)	-
	Cash and cash equivalents at end of period	Millions of yen	1,756	2,508	2,687	-

Risk Analysis

Business risks

- System risks

The Company's business utilizes computer systems and the Internet, and may suffer a system failure due to a temporary overload of the Company's server, etc., for any reason, unauthorized access to its server from outside of the Company, or errors made by its officers and employees. Such failures, if they occur, may affect the Company's financial results.

- Personal information management

The leakage of personal information held by the Company to outside of the Company for any reason may directly lead to a decline in creditworthiness, triggering cancellations of membership by existing customers and a decrease in the number of newly acquired customers. A leakage of personal information may also result in claims for damages and affect the Company's financial results.

Industry risks

- Intensification of competition

The online sales business is facing intensifying competition due to lower barriers to entry. The Company has been selling its own brand of products in order to avoid competition. If competitors handling similar products follow the Company's business model, as well as its product and sales strategies, the Company's financial results may be affected.

- Safety of foods and beauty products

Troubles regarding the safety, etc., of foods and beauty products, and inadequate responses to such troubles may affect the Company's financial results. In addition, a chain of reputational damage caused by the inadequacies of other companies, consumer distrust of the quality and safety of materials, and various hygiene and quality issues in society, in general may affect the Company's financial results.

- Health foods and cosmetics

Claiming effects on diseases or physical functions in product labels and advertisements of a health product is considered to represent the sale of an unapproved and unauthorized pharmaceutical under the Act on Securing Quality, Efficacy and Safety of Products Including Pharmaceuticals and Medical Devices (former Pharmaceutical Act), and may become subject to penalty. In the future, an incident such as a case that raises doubts regarding the appropriateness of articles and advertisements for a health product, as well as media reporting of such doubts may lead to a decline in creditworthiness, and affect the Company's business development and financial results.

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