

# **Kitanotatsujin Corporation**

**2930**

Tokyo Stock Exchange First Section/Sapporo Securities Exchange

22-Jul.-2020

FISCO Ltd. Analyst

**Ikuo Shibata**



FISCO Ltd.

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

## ■ Index

■ <b>Summary</b>	01
■ <b>Company profile</b>	03
1. Business description	03
2. History	05
■ <b>Company features</b>	06
1. Overwhelmingly strong product appeal	06
2. Stability from regular purchases	07
3. Effective marketing methods	07
■ <b>Financial highlights</b>	08
1. Trends in past results	08
2. FY2/20 financial highlights	09
■ <b>Topics and recognition of issues</b>	11
1. Main topics	11
2. Recognition of issues	12
■ <b>Outlook</b>	13
■ <b>Growth strategy</b>	14
■ <b>Shareholder returns</b>	15

## Summary

### **In FY2/20 sales and profits increased, driven by the “injecting cosmetics” series being a big hit The Company has positioned FY2/21 as a year for rebuilding the organization with expectations for a temporary decrease in operating results**

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 basic skin care products 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 results, sales and profits grew, with net sales increasing 21.4% year-on-year (YoY) to ¥10,093mn and operating profit rising 56.6% to ¥2,915mn, renewing record highs, with net sales surpassing ¥10,000mn. However, while net sales fell short of initial forecasts, 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 have grown at a faster-than-expected pace, and now has a larger presence in the sales mix by product. Moreover, two newly released products in the “injecting cosmetics” series have made a strong start. However, the reasons that net sales undercut the forecast were 1) production of the explosive hit product HYALO DEEP PATCH could not keep pace with demand, resulting in shipping delays (although these were completely cleared in by December 2019), and 2) there was a lull in growth in new customer acquisitions during the second half of the fiscal year. Meanwhile, profits exceeded the forecast due to the fact that the Company temporarily curbed advertising expenditure following shipping delays of HYALO DEEP PATCH. This should also be seen as a temporary factor. In addition, issues remain due to factors such as a lull in growth in new customer acquisitions and delays in the release of new products.

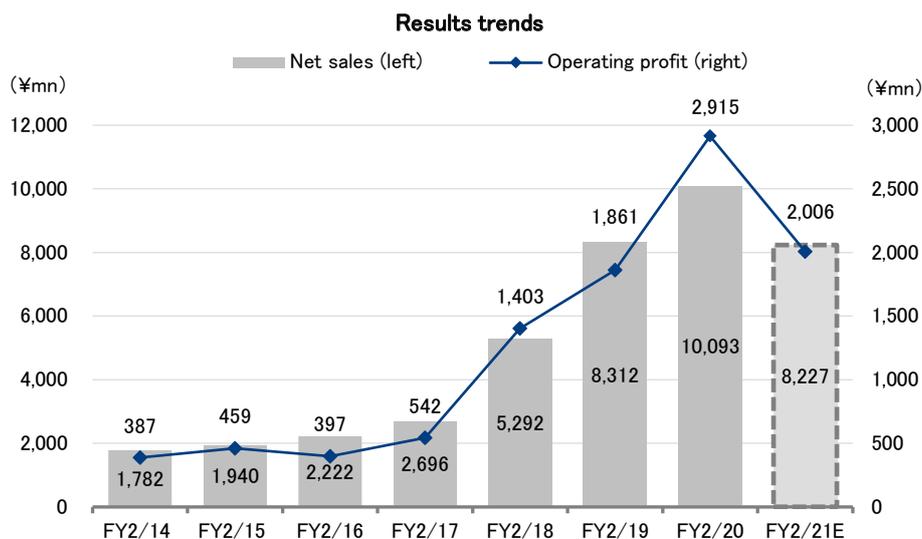
The Company’s earnings forecast for FY2/21 is for lower sales and profits, with net sales forecast to decrease 18.5% YoY to ¥8,227mn and operating profit to decrease 31.2% to ¥2,006mn, mainly due to rebuilding the organization structure. As in FY2/20, growth in the “injecting cosmetics” series and continued demand for other mainstay products can be expected; however, the Company is forecasting a temporary decrease in earnings having positioned FY2/21 as a “year for rebuilding the organization structure,” with a view to long-term growth. In other words, to help solve issues that have been shown up in FY2/20, the Company intends to strengthen its creative divisions and strengthen its product development division, but the forecast is based on conservative assumptions that do not incorporate the impacts of eliminating the two issues of the lull in growth in new customer acquisitions and delays in the release of new products and sales of new products.

Summary

Up until now, the Company has operated a business with high profit margins by developing multiple products in relatively uncontested niche markets where each product is worth between ¥1.0-2.0bn, aiming for a total business scale of around ¥10bn. As a result, in FY2/20, net sales surpassed ¥10.0bn and the Company also maintained a high operating margin. In addition, by acquiring the expertise to operate products at around the ¥5.0bn level with a high profit margin, the Company is now placed to develop multiple products at a scale of ¥5.0-10.0bn in large-scale mass markets going forward, and has laid out a strategy aiming to achieve net sales of ¥100.0bn and operating profit of ¥30.0 bin in the future. Specifically, in addition to creating new markets, such as the “injecting cosmetics” series, the Company seems also to be envisaging categories with large markets, such as all-in-one gel and shampoo. On the other hand, in terms of overseas development, the Company is eyeing further expansion, such as growth of the Taiwan business, which has already become profitable, and has adopted a policy of promoting specialization in internet sales, which are easy to roll-out horizontally. From our point of view, assuming annual growth of 30% continues over the long-term (10 years), net sales are at a level that can certainly reach ¥100.0bn, and we consider the Company to have this potential. In addition, by utilizing the economies of scale, the Company’s strategy could also involve large-scale M&As led by the Company, which could accelerate the pace of its expansion. How the Company will go about evolving without losing its distinctive character is an area for demonstrating the skill of management.

Key Points

- In FY2/20 sales and profits increased, driven by the “injecting cosmetics” series being a big hit (record high results)
- On the other hand, a lull in new customer acquisitions and delays in new product releases have been shown up as issues to be addressed
- The Company has positioned FY2/21 as a year for rebuilding the organization structure in preparation for the next stage, and is therefore expected to experience temporary decreases in sales and profits
- In the large-scale mass market, the Company aims to develop multiple products with individual scales in the range of ¥5.0bn to ¥10.0bn, aiming to be a company with net sales of ¥100.0bn and operating profit of ¥30.0bn in the future



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

We encourage readers to review our complete legal statement on “Disclaimer” page.

## ■ Company profile

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

#### 1. Business description

The Company conducts online sales of health and beauty products, etc., 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 health and beauty problems. In particular, KAITEKI OLIGO, which uses oligosaccharide as a raw material, has been driving the Company's growth so far. In addition, the hit product HYALO DEEP PATCH, the first product in the "injecting cosmetics" series, has seen a significant increase in sales. Recently, the percentage of sales from basic skin care products 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 31 products that meet purchasers' specific needs (as of the end of February 2020), 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  $\alpha$ , which is a penetrating, specialized nail care product that contributes to beautiful and healthy nails.

## Company profile

## 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-SUCHA	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 bittern (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
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 $\alpha$	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.
ASESU CARE	This specialized supplement for men provides an internal approach to addressing perspiration issues. The combination of five components that support autonomous functions are designed to address unique aspects of male physiology, and also help to control odor.

Source: Prepared by FISCO from securities reports and press releases

## Kitanotatsujin Corporation | 22-Jul.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

## Company profile

The Company itself does not have production bases for its products and it mainly consigns production to its OEM partners (a method where a company purchases raw materials and consigns the manufacturing process externally). On the other hand, at the end of December 2015 it established a Taiwan branch office as a base for strengthening online sales in local markets in Asia, followed in January 2019 by the establishment of the South Korean liaison office to promote consigned production to overseas companies.

## 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.

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 continued to achieve high 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 December 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\*<sup>1</sup>, 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\*<sup>2</sup> 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.

Kitanotatsujin Corporation | 22-Jul.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

Company profile

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 2019 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 (third selection). 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.

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 JPX Japan Stock Exchange Group 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 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.

## Kitanotatsujin Corporation | 22-Jul.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

## Company features

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.

**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. Moreover, until now it has followed a strategy of aiming for multiple products that are top of their niche market (¥1.0bn to ¥2.0bn per product), but going forward the Company intends to develop in the large-scale mass market (¥5.0bn to ¥10.0bn per product). However, it still does not intend 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\*<sup>1</sup> tools and combinations with RPA\*<sup>2</sup>.

\*<sup>1</sup> 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.

\*<sup>2</sup> Abbreviation of Robotic Process Automation. It refers to the use of robots (cognitive technologies, such as artificial intelligence) to automate operations.

## Financial highlights

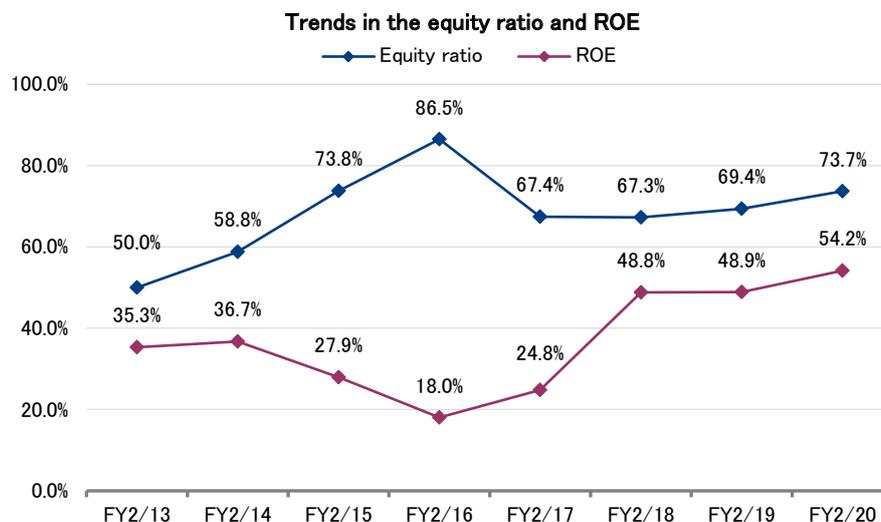
### Increasing the number of regular-purchase members and realizing strong growth through active and appropriate investments in advertising (operation)

#### 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.

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%. In FY2/19, the operating margin dropped to 22.4% at one point; however, this was due to strategically making investments in advertising at a higher level than planned to avoid opportunity losses and increase new customer acquisitions. Conversely, for FY2/20, the Company consciously suppressed advertising expenditure, and the operating margin increased significantly to 28.9%. Temporary factors have probably had a major impact in this. (Details are given below.)

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% at one point in order to secure liquidity from cash on hand through long-term borrowing, but it has been rising again since then. In addition, ROE (return on equity), which is an indicator of capital efficiency, has been around the 50% level recently, supported by the Company's high profitability, and its financial condition can be evaluated as being extremely good.



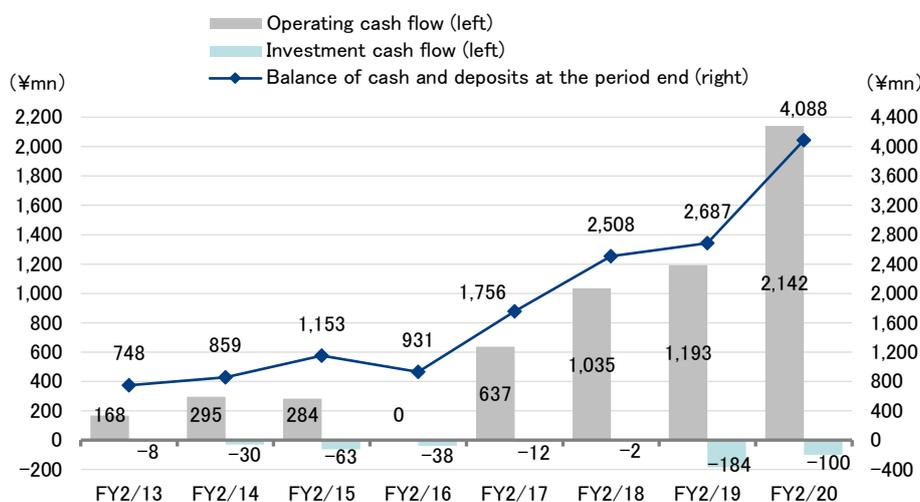
Source: Prepared by FISCO from the Company materials

We encourage readers to review our complete legal statement on "Disclaimer" page.

Financial highlights

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.

**Trends in operating cash flow, investment cash flow, and the balance of cash and deposits at period end**



Source: Prepared by FISCO from Company materials

**2. FY2/20 financial highlights**

In the FY2/20 results, sales and profits increased significantly, with net sales rising 21.4% YoY to ¥10,093mn, operating profit growing 56.6% to ¥2,915mn, ordinary profit climbing 57.1% to ¥2,923mn, and net profit increasing 52.7% to ¥1,974mn. As net sales and operating profit both reached new record highs, net sales also exceeded ¥10,000mn. However, while net sales were below the initial forecast, profits were above forecast.

The "injecting cosmetics" series has been a big hit, which contributed to the increase in sales. In particular, sales of HYALO DEEP PATCH have grown at a faster-than-expected pace, and now has a larger presence in the sales mix by product. The newly released MIKEN DEEP PATCH (second product released in July 2019) and the ODEKO DEEP PATCH (third product released in September 2019) also achieved a strong start. However, the reasons that net sales undercut the forecast were 1) production of the explosive hit product HYALO DEEP PATCH could not keep pace with demand, resulting in shipping delays (although these were completely cleared in by December 2019), and 2) there was a lull in growth in new customer acquisitions during the second half of the fiscal year (details are given below).

**Kitanotatsujin Corporation** | 22-Jul.-2020

2930 Tokyo Stock Exchange First Section/Sapporo Securities Exchange

<https://www.kitanotatsujin.com/en/>

## Financial highlights

Meanwhile, with regards to profits, the costs ratio deteriorated slightly due to the changes in the product mix\*<sup>1</sup>, 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 significantly to 28.9% (22.4% in the previous fiscal year). However, operating profit exceeded the forecast mainly due to the fact that the Company temporarily curbed advertising expenses following shipping delays\*<sup>2</sup> of HYALO DEEP PATCH, which should also be seen as a temporary factor.

\*1 The "injecting cosmetics" series has a relatively high cost ratio

\*2 Other factors behind the upturn in operating profit include the Company curbing investments in advertising for new customer acquisitions as a result of 1) reallocation of resources from the customer acquisition department for use in structural upgrades for the future and 2) an improvement in indicators showing the efficiency of advertising investments, both occurring in the first half of the fiscal year. However, the factor in 2) also requires examination in terms of causing a loss of opportunity for new customer acquisitions as a delay in quantification could have caused the Company to miss the optimal timing for expanding investment in advertising.

For the Company's financial condition, total assets were up 39.2% on the end of the previous fiscal year to ¥5,902mn, mainly due to a significant increase in cash and deposits associated with growth in net sales and an increase in property, plant and equipment associated with the Company's Head Office relocation. The equity ratio rose to 73.7% (compared to 69.4% at the end of the previous fiscal year), because shareholders' equity significantly increased 47.8% YoY to ¥4,347mn due to the accumulation of retained earnings. ROE, an indicator of capital efficiency, also maintained an extremely high level at 54.2% (48.9% in the previous fiscal year), as the Company maintained its financial base in an excellent condition.

**FY2/20 financial highlights**

	FY2/19		FY2/20		Change		(¥mn)			
	Results	% of total	Results	% of total	Amount	% change	FY2/20		Difference	
							Initial forecast	% of total	Amount	Achievement rate
<b>Net sales</b>	8,312	-	10,093	-	1,780	21.4%	10,939	-	-846	92.3%
<b>Cost of sales</b>	1,852	22.3%	2,449	24.3%	596	32.2%	-	-	-	-
<b>SG&amp;A expenses</b>	4,590	55.2%	4,730	46.9%	139	3.0%	-	-	-	-
<b>Operating profit</b>	1,861	22.4%	2,915	28.9%	1,053	56.6%	2,702	24.7%	212	107.9%
<b>Ordinary profit</b>	1,861	22.4%	2,923	29.0%	1,062	57.1%	2,703	24.7%	220	108.1%
<b>Net profit</b>	1,293	15.6%	1,974	19.6%	681	52.7%	1,890	17.3%	84	104.4%

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

## ■ Topics and recognition of issues

### The “injecting cosmetics” series performed strongly, but issues for moving to the next stage have also shown up

#### 1. Main topics

##### (1) The “injecting cosmetics” series is a major hit

In FY2/20, HYALO DEEP PATCH (released September 2016) drove earnings growth as its sales expanded even faster than expected, drawing attention as an “injectable cosmetic” and becoming a major hit. Furthermore, the Company released another two products in the “injectable cosmetic” series. Of these, MIKEN PATCH, a cosmetic product specifically for the area between the eyebrows (released on July 9) achieved cumulative sales exceeding 20,000 units since its launch and sales in the first month of launch set a new record high for the Company’s newly launched product. Furthermore, the ODEKO DEEP PATCH, a cosmetic product specifically for the forehead (released on September 27) also appears to have made a strong start. In FY2/21, also, the Company has released its fourth product in the series on March 31, 2020, CHEEK PORE PATCH\*, a cosmetic product specifically for pores. The “injecting cosmetics” series applies the microneedle technology that is also used in the medical field as a new concept for cosmetic products, in which beauty ingredients are molded into a needle form to be directly injected into the skin. The Company has also obtained trademarks for several key expressions, such as “injecting cosmetics” to prevent the use of similar packaging presentation of the Company’s registered trademark products by other companies even if they develop similar generic products.

\* This product focuses on consumer concerns regarding the prominent “cheek pore zone” which has a high concentration of pores. By applying a sheet embedded with tiny needles made from moisturizing and toning compounds to prominent areas of the cheek, this cosmetic product specifically for cheek pores helps to achieve firm, smooth skin.

##### (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 in September 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 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).

In January 2020, the Company conducted a renewal sale of Luminapeel as a quasi-medicinal product. Luminapeel is a peeling gel specifically for the back of the hand, which uses a double approach of removing old skin and cosmetic whitening to rejuvenate the hands for those who have concerns about skin discoloration.

### (3) Strengthening the Management Foundation

In continuation from FY2/19, the Company is working to increase its personnel. As of February 29, 2020, the Company had 162 executives and employees (up by 48 people from the previous fiscal year-end). With this, the Company increased the size of the customer acquisition department by 24 people. 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 appears to have more or less completed establishing a structure for implementing it appropriately.

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, 2020, the Company opened the Tokyo Branch Office (Nihonbashi, Chuo Ward), and expanded the office space in February 2020. In particular, at the Tokyo Branch Office, the Company plans to hire 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. |

## 2. Recognition of issues

The reason for net sales undercutting the target in FY2/20, as mentioned above, is largely due to a lull in new customer acquisitions in the first half of the fiscal year. The Company has noted four causal factors as follows: 1) an inability to release appropriate advertising creative elements, 2) a cooling of consumer sentiment due to the consumption tax increase and the COVID-19 pandemic, 3) fewer new product releases than planned, and 4) missing the optimal timing for increasing advertising investment. Of these, 2) is an external factor, and 4) has been resolved by converting the numbers indicating advertising investment efficiency into coefficients. However, 1) and 3) are recognized as issues that remain to be addressed for the next stage. The Company intends to take the following initiatives as priority measures for FY2/21.

### (1) Strengthen the creative division

In mail-order sales, sales are significantly influenced by “product appeal” and “advertising creatives.” In particular, while it is important to have excellent creative elements, it is also necessary to replace creative elements regularly using different perspectives and openings to keep advertising fresh for the customer. The Company has prepared creative logic, manuals, support systems and so forth to help improve advertising. However, in falling behind on training team members following an increase in personnel, the Company was unable to maintain the freshness of its creative elements appropriately, resulting in a lull in new customer acquisitions. Accordingly, the Company is now looking to strengthen the training system and improve the skills of its creative team by allocating management personnel and increasing mid-career hiring of experienced personnel.

## (2) Strengthening the product development division

New product releases in FY2/20 were fewer than planned at just three products. As the mainstay products for the Company transition from health foods to basic skin care products, the basic skin care products will be impacted to some degree by waves in demand, compared to the steady demand for health foods, and must counter this impact by stimulating demand through periodic new product releases or renewals. The Company intends to establish a structure for advancing planning and development of multiple products in parallel in order to increase development speed. It will look to maintain quality while reviewing the planning process and taking steps to hire experienced personnel.

## ■ Outlook

### In FY2/21, the Company's earnings are expected to see temporary decreases in sales and profits, mainly due to rebuilding the organizational structure

The Company's forecasts for FY2/19 are for decreases in sales and profits due to rebuilding the organizational structure, with net sales to decrease 18.5% YoY to ¥8,227mn, operating profit to fall 31.2% to ¥2,006mn, ordinary profit to decrease 31.4% to ¥2,007mn, and net profit to fall 31.2% to ¥1,357mn.

As in FY2/20, growth in the "injecting cosmetics" series and continued use of other mainstay products can be expected; however, the Company is forecasting a temporary decrease in earnings, having positioned FY2/21 as a "year for rebuilding the organization structure," with a view to long-term growth. In other words, to help solve issues that have been thrown into relief during FY2/20, the Company intends to strengthen its creative divisions and strengthen its product development division, but the forecast is based on assumptions that do not incorporate the impact of eliminating the two issues of the lull in growth in new customer acquisitions and delays in the release of new products and sales of new products.

The Company has really shown its true value by accurately identifying issues to be addressed even when its earnings are growing steadily, and acting quickly to respond to them, as this is an important activity for realizing further growth. However, although there are some areas of uncertainty such as the impact of the COVID-19 pandemic, considering the Company's accumulative growth model, its earnings forecast seems to be a quite a conservative level. Therefore, it will be necessary to monitor the Company's performance closely each quarter, such as its progress on the various initiatives and the specific results.

#### FY2/21 forecasts

	FY2/20		FY2/21		Change	
	Results	% of total	Full-year forecast	% of total	Amount	% change
Net sales	10,093	-	8,227	-	-1,865	-18.5%
Operating profit	2,915	28.9%	2,006	24.4%	-908	-31.2%
Ordinary profit	2,923	29.0%	2,007	24.4%	-916	-31.4%
Net profit	1,974	19.6%	1,357	16.5%	-617	-31.2%

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

## ■ Growth strategy

### Work towards expanding into the large-scale mass markets

### Aim to become a company with net sales of ¥100.0bn in the future

The Company does not publish specific medium-term management targets, but looking back at its strategy to date, based on its policy of prioritizing profits above sales, basically it has pursued 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. In particular, the Company has operated a business with high profit margins by developing multiple products in relatively uncontested niche markets where each product is worth between ¥1.0-¥2.0bn, aiming for a total business scale of around ¥10.0bn. As a result, in FY2/20, net sales surpassed ¥10.0bn, thereby achieving its initial target. The Company is now placed to develop multiple products at a scale of ¥5.0-10.0bn in large mass markets going forward, and has laid out a strategy aiming to achieve net sales of ¥100.0bn and operating profit of ¥30.0bn in the future, while maintaining a high profit margin. Specifically, in addition to creating new markets, such as the “injecting cosmetics” series, the Company seems also to be envisaging categories with large markets, such as all-in-one gel and shampoo. In the background to this, 1) the Company has the skill to maintain high profit margins regardless of niche market or top share, 2) it has acquired the expertise to create businesses in the scale of ¥4.0bn to ¥5.0bn per product, and 3) it recognizes that the niche markets that it has targeted to date are encountering limits on room to grow. Accordingly, we recognize that the Company’s strategies reflect a response to its organizational capabilities and business foundation, and a desire to accelerate growth. On the other hand, in regard to its overseas expansion, the Company is eyeing further expansion, including in the Taiwan operations, which have already become profitable, and its policy is to focus particularly on promoting online sales, which are easy to expand horizontally. In particular, it appears to be promoting a sales strategy based on platforms such as Google, Yahoo!JAPAN, Facebook, Twitter, Criteo, and Amazon, among others.

For our part, we see the target level of ¥100.0bn for net sales as being very achievable on the assumption of annual growth of 30% over the long-term (8-10 year span), and we consider the Company to have that potential. Naturally, expansion into large-scale mass markets and overseas expansion are essential strategic themes for achieving this goal, and the recent change in direction appears to be a rational one. In particular, if the Company can accumulate not only market-making hit products such as HYALO DEEP PATCH but also around 15 to 20 products that can project a presence (originality) in part of the large-scale mass markets, we believe that the net sales of ¥100.0bn will naturally be achieved. In addition, if the Company achieves this, the strategy will enable it to readily leverage scale of economies and conduct large-scale M&As on its own initiative, which could further accelerate its scale expansion. Naturally, cosmetic products and mass markets entail different levels of difficulty compare to the health foods and niche markets that the Company has engaged in thus far, and the degree to which it can make progress in these directions without losing its distinctive character is a matter for demonstrating management skill. In that sense, resolving the challenges that the Company has now identified and laying a proper foundation for growth in FY2/22 and beyond can be considered an important litmus test for the Company, and the results of its activities over the coming year should be carefully observed.

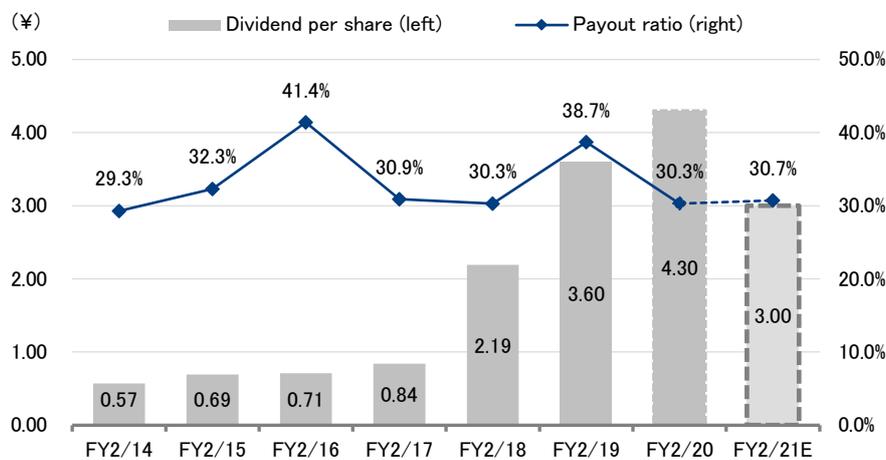
## Shareholder returns

**In FY2/21, the dividend is expected to decrease following the forecast for a decrease in profits**  
**However, there is significant room for further dividend increases in line with profit growth going forward**

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.

The annual dividend for FY2/20 was ¥4.3 per share (interim ¥2.1, year-end ¥2.2), an increase of ¥0.7 YoY (dividend payout ratio 30.3%). On the other hand, for FY2/21, the dividend forecasts are for a YoY decrease of ¥1.3 to ¥3.0 per share (interim ¥1.8, year-end ¥1.2) (dividend payout ratio 30.7%) as the Company is currently forecasting a decrease in profits. Naturally, it is perfectly possible that the dividend forecast could be revised depending on earnings trends, and future trends will therefore need to be monitored. The Company 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.

Trends in dividend per share and payout ratio



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

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. All shareholders who are recorded in the shareholders' register as holding 1 or more units of shares (100 shares) at the end of February each fiscal year 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.)



## Disclaimer

FISCO Ltd. ("FISCO") offer stock price and index information for use under the approval of the Tokyo Stock Exchange, the Osaka Stock Exchange and Nikkei Inc.

This report is provided solely for the purpose of offering information, and is not a solicitation of investment nor any other act or action.

FISCO prepared and published this report based on information which it considered reliable; however, FISCO does not warrant the accuracy, completeness, fitness nor reliability of the contents of this report or the said information.

The issuers' securities, currencies, commodities, securities and other financial instruments mentioned in this report may increase or decrease in value or lose their value due to influence from corporate activities, economic policies, world affairs and other factors. This report does not make any promises regarding any future outcomes. If you use this report or any information mentioned herein, regardless of the purpose therefor, such use shall be made based on your judgment and responsibility, and FISCO shall not be liable for any damage incurred by you as a result of such use, irrespective of the reason.

This report has been prepared at the request of the company subject hereto based on the provision of information by such company through telephone interviews and the like. However, the hypotheses, conclusions and all other contents contained herein are based on analysis by FISCO. The contents of this report are as of the time of the preparation hereof, and are subject to change without notice. FISCO is not obligated to update this report.

The intellectual property rights, including the copyrights to the main text hereof, the data and the like, belong to FISCO, and any revision, reprocessing, reproduction, transmission, distribution or the like of this report and any duplicate hereof without the permission of FISCO is strictly prohibited.

FISCO and its affiliated companies, as well as the directors, officers and employees thereof, may currently or in the future trade or hold the financial instruments or the securities of issuers that are mentioned in this report.

Please use the information in this report upon accepting the above points.

■ For inquiry, please contact: ■

FISCO Ltd.

5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062

Phone: 03-5774-2443 (Financial information Dept.)

Email: [support@fisco.co.jp](mailto:support@fisco.co.jp)