

Kitanotatsujin Corporation

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

February 12, 2020

Reduced Advertising and Other Factors Weakened Current New Customer Acquisition

Update Report

 QUICK Corp.
Daisuke Harada

 Key benchmarks as of
February 7, 2020

Share price	¥647
High since last year	¥794 (October 16, 2019)
Low since last year	¥341 (January 15, 2019)
Shares outstanding	141,072,000 shares
Trading units	100 shares
Market capitalization	¥91,274 million
Projected dividend (Company)	¥4.20
Projected EPS (Analyst)	¥14.39
PBR (Results)	23.30

Issuance date of preceding reports

Basic	June 21, 2019
Update	December 3, 2019

Recurring shipping delays of a popular product caused a decrease in revenue for the three months of the third quarter, compared to the previous quarter

Net sales grew by 27% year-on-year to ¥7,547 million, while operating profit rose by 49% to ¥2,182 million in the non-consolidated financial results for the nine months ended November 30, 2019. Operating profit increased significantly due to a reduction in advertising expenses and the contribution from regular purchases by customers acquired in the previous fiscal year. Meanwhile, net sales for the three months of the third quarter were lackluster, with a 7% decrease compared to the previous quarter. This was due to recurring shipping delays of HYALO DEEP PATCH, which is currently enjoying strong sales, in the third quarter as in the first quarter, and subsequent shipping postponements of some products to the fourth quarter. In addition, weak new customer acquisitions due to reduced advertising in order to prioritize human resource development in the rapidly expanding customer acquisition department also had an impact on sales.

The Corporate Valuation Research Center revised its forecast for sales growth downward for the current fiscal year, as well as the next

Based on current circumstances, the QUICK Corporate Valuation Research Center ("the Research Center") revised its forecast of financial results. The net sales forecast for the fiscal year ending February 29, 2020 was revised downward by ¥500 million to ¥10,500 million (a 26% year-on-year rise), while revising the operating profit forecast upward by ¥200 million to ¥2,900 million (a 56% rise). Although the operating profit forecast was increased in light of the reduction in advertising, the net sales forecast was reduced due to weak new customer acquisitions. Furthermore, forecasts for the fiscal year ending February 28, 2021 were also revised: ¥13,000 million (a 24% rise) for net sales, down by ¥1,000 million; and ¥3,300 million (a 14% rise) for operating profit, down by ¥200 million. Although we anticipate an active rollout of advertising at this moment, with the current weak acquisition of new customers due to reduced advertising, we expect a sluggish increase in the number of customers who are regularly buying products, resulting in a slowdown of growth in the fiscal year ending February 28, 2021. Going forward, the key to re-energizing and maintaining the sales growth of the Company is the reformation of the customer acquisition department.

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	3rd quarter (March to November)	Results	5,958	60.7	1,462	66.5	1,462	66.4	1,009	66.8	7.26
FY2019	3rd quarter (March to November)	Results	7,547	26.7	2,182	49.2	2,186	49.5	1,487	47.3	10.70
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
		Analyst estimates (Announced in February 2020)	10,500	26.3	2,900	55.8	2,900	55.8	2,000	54.6	14.39
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
		Analyst estimates (Announced in February 2020)	13,000	23.8	3,300	13.8	3,300	13.8	2,300	15.0	16.55

Results

A 49% rise in operating profit for the nine months ended November 30, 2019, supported by reduced advertising expenses

■ Results for the nine months ended November 30, 2019 (March 1, 2019 to November 30, 2019)

Net sales grew by 27% year-on-year to ¥7,547 million, while operating profit rose by 49% to ¥2,182 million in the non-consolidated financial results for the nine months ended November 30, 2019. Continuing from the previous fiscal year, this was mainly due to further strengthening 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 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, despite a rise in personnel expenses due mainly to an enhancement of staff, primarily in the customer acquisition department.

Table 1. Non-consolidated financial results for the nine months

(Millions of yen)

	Nine months ended November 30, 2018	Nine months ended November 30, 2019		
		Results	YoY	
			(Changes)	(%)
Net sales	5,958	7,547	(1,588)	(26.7%)
Gross profit	4,650	5,739	(1,090)	(23.4%)
<i>Gross profit margin</i>	78.0%	76.1%	-	-
Selling, general and administrative expenses	3,187	3,557	(370)	(11.6%)
<i>Ratio of selling, general and administrative expenses</i>	53.5%	47.1%	-	-
Operating profit	1,462	2,182	(720)	(49.2%)
<i>Operating profit margin</i>	24.5%	28.9%	-	-
Ordinary profit	1,462	2,186	(724)	(49.5%)
Profit	1,009	1,487	(477)	(47.3%)

(Note 1) The nine months are from March 1 to November 30.

(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

Meanwhile, revenue for the three months of the third quarter declined compared to the previous quarter, due to recurring shipping delays.

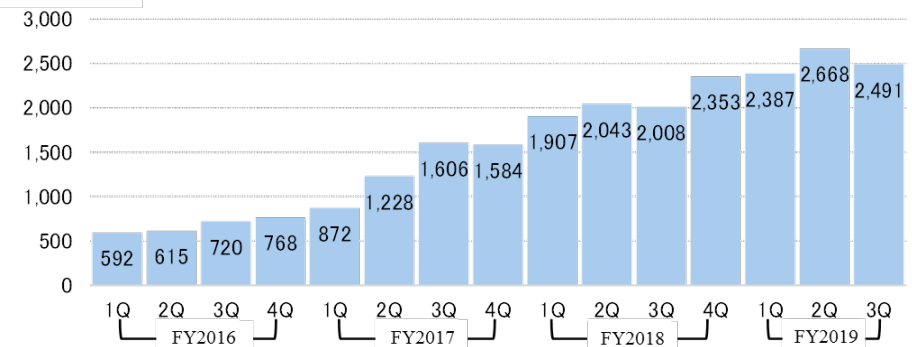
Meanwhile, net sales for the three months of the third quarter were lackluster, with a 7% decrease compared to the previous quarter. Shipping delays of HYALO DEEP PATCH, which is currently enjoying strong sales, and subsequent shipping postponements of some products, for which orders were received in the third quarter, to the fourth quarter contributed to the decline. Also in the first quarter, shipments of the product for new customers were postponed to the second quarter, due to the inability of production to keep pace with orders. Although shipping delays in the first quarter were reduced in the second quarter, the number of orders received continued to remain at roughly the maximum production capability level. Under such circumstances, the number of orders received for the product again exceeded production capabilities in the third quarter, leading to the recurring of shipping delays.

Results

Figure 1. Quarterly net sales

- Revenue for the three months of the third quarter declined compared to the previous quarter, due to recurring shipping delays of a popular product.

(Millions of yen)



(Note) Amounts less than one million yen are rounded down.

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

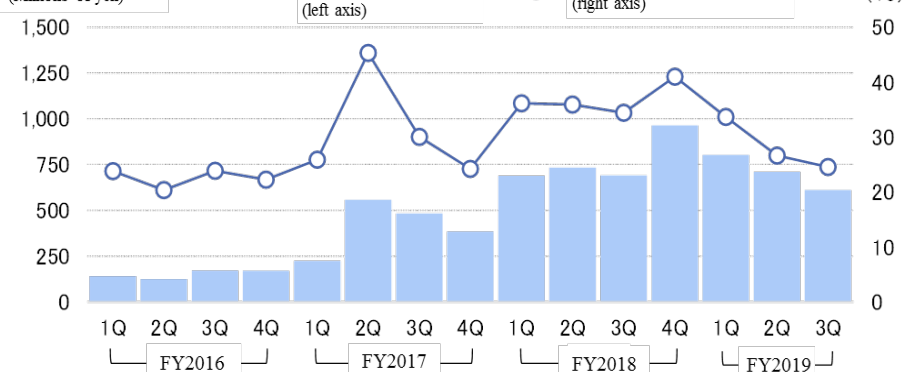
Reduced advertising to
prioritize human
resource development in
the rapidly expanding
customer acquisition
department

Advertising expenses have also been declining for the third consecutive quarter since the first quarter. The decline in the first and second quarters was due to reduced advertising for HYALO DEEP PATCH in light of shipping delays. In the third quarter, reductions in advertising for other products, in order to prioritize human resource development in the rapidly expanding customer acquisition department contributed to the decline, in addition to recurring shipping delays. The number of staff in the customer acquisition department, which was 37 as of the end of the fiscal year ended February 28, 2019, increased rapidly to 60 recently due to active recruitments. As a result, the acquisition of new customers slowed due to the continued reduction in advertising, leading to a decline in quarterly net sales.

Figure 2. Quarterly advertising expenses and the advertising expenses ratio

- Shipping delays and the prioritization of strengthening the customer acquisition system led to declines in advertising expenses compared to the previous quarter for three consecutive quarters.

(Millions of yen)



(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. Shipping delays were resolved.

- 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. Regarding the financial results in the nine months ended November 30, 2019, net sales were ¥541 million below the Company's forecast, due to shipping delays of HYALO DEEP PATCH and a reduction in advertising, while operating profit was ¥183 million above the forecast. The Company maintained its forecasts announced at the beginning of the fiscal year. Shipping delays were resolved in December 2019. Revenues from products that were not shipped, for which orders were received in the third quarter (¥167 million in net sales and ¥107 million in operating profit; the Company's estimates), are expected to be recorded in the fourth quarter. In addition, the Company plans to re-energize the acquisition of new customers, which has been slowing currently, through an active rollout of advertising.

Revised forecasts for the fiscal year ending February 29, 2020: down for net sales and up for operating profit

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

The QUICK Corporate Valuation Research Center revised its forecasts as of December 2019 for non-consolidated financial results for the fiscal year ending February 29, 2020. We revised the forecast for net sales down by ¥500 million, from ¥11,000 million (a 32% year-on-year rise) to ¥10,500 million (a 26% rise). This revision is based on the current weak acquisition of new customers due to reduced advertising. Meanwhile, the forecast for operating profit is up by ¥200 million, from ¥2,700 million (a 45% year-on-year rise) to ¥2,900 million (a 56% rise), as advertising expenses are not rising as much as expected (see Table 2).

The Research Center has expected an accelerated sales growth in the second half, on the back of active advertising for HYALO DEEP PATCH, for which shipping delays have been reduced as of the second quarter, and for a group of new products from the same "injecting cosmetics—DEEP PATCH series" as HYALO DEEP PATCH (see Figure 3 on page 7). However, net sales for the third quarter declined compared to the previous quarter, due to recurring shipping delays of HYALO DEEP PATCH, as well as reduced advertising resulting from the prioritization of strengthening the customer acquisition department. For the fourth quarter, a contribution to revenue is expected from those products for which shipping was postponed, and the Company plans to re-energize the acquisition of new customers through active advertising. However, we expect that it is difficult to recover the delay in progress that occurred during the past nine months. Meanwhile, we reflected a rise in the operating profit margin due to the reduced advertising in our forecast for operating profit.

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

Revised forecasts also for the fiscal year ending February 28, 2021: down for both net sales and operating profit

The Research Center also revised its forecasts for non-consolidated financial results for the fiscal year ending February 28, 2021: down for net sales by ¥1,000 million, from ¥14,000 million (a 27% year-on-year rise) to ¥13,000 million (a 24% rise); and down for operating profit by ¥200 million, from ¥3,500 million (a 30% rise) to ¥3,300 million (a 14% rise). We expect that the current slowdown in the acquisition of new customers due to reduced advertising will also have an impact on the financial results for the next fiscal year (see Table 2).

Results

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

(Millions of yen)

	Results	The Company's plan	The Research Center's forecast			
			Upper row: Previous forecasts (as of December 2019)			
			Lower row: Current forecasts (as of February 2020)			
	FY2018 full year	FY2019 full year	FY2019 full year		FY2020 full year	
				(YoY %)		(YoY %)
Net sales	8,312	10,939	11,000 → (32.3%) →		14,000 → (27.3%) →	
			10,500	(26.3%)	13,000	(23.8%)
Gross profit	6,451	-	8,300 → (28.6%) →		16,000 → (27.7%) →	
			8,000	(24.0%)	9,800	(22.5%)
Gross profit margin	77.6%	-	75.5% →		75.7% →	
			76.2%		75.4%	
Selling, general and administrative expenses	4,590	-	5,600 → (22.0%) →		7,100 → (26.8%) →	
			5,100	(11.1%)	6,500	(27.5%)
Ratio of selling, general and administrative expenses	55.2%	-	50.9% →		50.7% →	
			48.6%		50.0%	
Operating profit	1,861	2,702	2,700 → (45.0%) →		3,500 → (29.6%) →	
			2,900	(55.8%)	3,300	(13.8%)
Operating profit margin	22.4%	24.7%	24.5% →		25.0% →	
			27.6%		25.4%	
Ordinary profit	1,861	2,703	2,700 → (45.0%) →		3,500 → (29.6%) →	
			2,900	(55.8%)	3,300	(13.8%)
Profit	1,293	1,890	1,900 → (46.9%) →		2,400 → (26.3%) →	
			2,000	(54.6%)	2,300	(15.0%)

(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

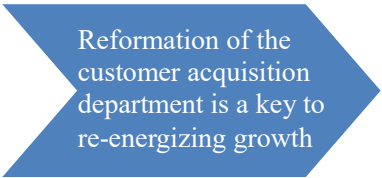
Reduced advertising will also affect growth in the fiscal year ending February 28, 2021

As for sales, the decreased net sales forecast for the fiscal year ending February 29, 2020 is reflected, and the forecast of the sales growth rate for the next fiscal year is reduced from 27% to 24%. As for advertising, which greatly affects sales growth, although we expect an active rollout of activities at this moment, the acquisition of new customers is currently weak due to reduced advertising. This may lead to a sluggish increase in the number of customers who are regularly buying products, resulting in a slowdown of sales growth in the fiscal year ending February 28, 2021.

Meanwhile, MIKEN DEEP PATCH, for which advertisement has been strengthened as a product of the "injecting cosmetics—DEEP PATCH series," is currently enjoying the steady sales growth, and production capabilities for HYALO DEEP PATCH have been gradually increased, apparently leading to an improved situation. Based on the above, in the fiscal year ending February 28, 2021, we expect growth to remain at a low level in the first half due to the current weak acquisition of new customers. However, in the second half, sales growth is expected to recover to a certain extent, mainly due to the effect of active advertising.

Results

The forecast for operating profit has reduced, reflecting a decline in the forecast for net sales. The forecast of the operating profit margin has not changed significantly from the previous forecast. Compared to the forecasts for the fiscal year ending February 29, 2020, the operating profit margin is expected to worsen, as a result of a decline in the gross profit margin due to growing sales of relatively unprofitable products, along with a rise in the ratio of selling, general and administrative expenses due to an active rollout of advertising.



Reformation of the customer acquisition department is a key to re-energizing growth

The Research Center expects a recovery in sales growth in the second half of the fiscal year ending February 28, 2021. Going forward, the key to definitely re-energizing the sales growth of the Company is the reformation of the customer acquisition department. The Company is undertaking a reform of the customer acquisition department through measures such as an enhancement of staff, in order to shift its growth strategy from the current reliance on sales expansion of certain products to expanding sales of more products. Meanwhile, shipping delays of HYALO DEEP PATCH in the first and third quarters, as well as a slowdown in growth resulting from reduced advertising exposed an adverse effect of growth that is dependent on sales expansion of certain products, indicating that the reformation and strategy shift are still a work in progress. However, initiatives such as enhancing staff in the customer acquisition department, human resource development, and reorganization are advancing, and the basis for placing advertisement for a number of products is steadily improving. Going forward, we will focus on whether active advertising for more products will lead to re-energizing of sales growth, as well as sustainable achievements.

Results

Table 3. Products available on the online shopping site, “J NORTH FARM” (as of November 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
FY2014	KITANO DAICHINO YUMESHIZUKU	A food with functional claims that increases sleep-enhancing hormones and improves sleep quality
	ZUKI SHIRAZUNO MI	A health food with a blend of feverfew, giant knotweed, and bitter 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 pyroligneous 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 pyroligneous 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	An anti-spot peeling gel for whitening the back of the hand (quasi-drug)
	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, which softens stiff skin and enhances skin rejuvenation
	ODEKO DEEP PATCH	An aging-care cosmetic specifically for the forehead, which enhances skin firmness and radiance
	ASESUCARE	A supplement product specifically for men who are troubled with dripping sweat that keeps running, made from ingredients that support autonomic nerve balance

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

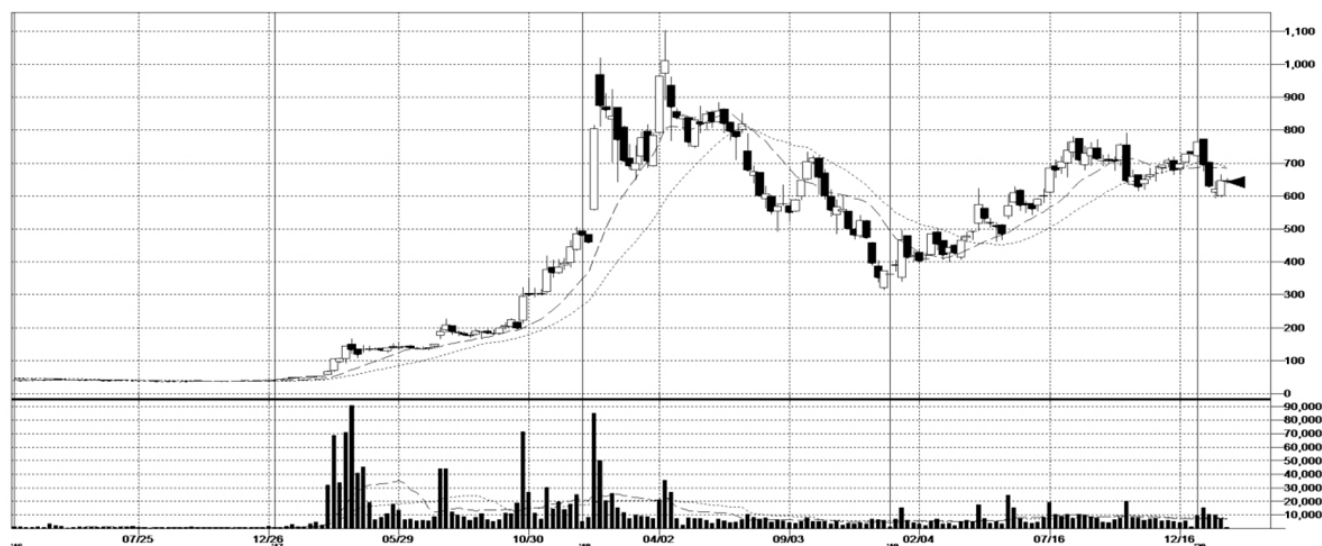
Figure 3. Three products of the “injectable cosmetics—DEEP PATCH series”

- MIKEN DEEP PATCH is also currently enjoying the steady sales growth.

HYALO DEEP PATCH MIKEN DEEP PATCH ODEKO DEEP PATCH



(Source) The Company's website



(Source) QUICK Corp.

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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	10,500
	Operating profit	Millions of yen	542	1,403	1,861	2,900
	Ordinary profit	Millions of yen	538	1,403	1,861	2,900
	Profit	Millions of yen	356	948	1,293	2,000
	EPS	Yen	2.70	7.21	9.30	14.39
	ROE	%	24.8	48.8	48.9	54.8
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	-
Main items of statements of cash flows	Total net assets	Millions of yen	1,545	2,345	2,942	-
	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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