

PROTO CORPORATION (4298 JP)

CHANGE IN CONSUMER BEHAVIOUR UNDER COVID-19 PRESENTS GROWTH OPPORTUNITIES

FY19 EARNINGS RESULT

Proto Corporation reported FY19 (ending March 2020) OP of ¥5,136mil (+12.5% YoY) on sales of ¥59,127mil (-5.0% YoY). The drop in sales was mostly from weakness in the Merchandise segment, which saw 1) sales from used car exports at a subsidiary KINGSAUTO fall, 2) weakness in sales of tyres and wheels at another subsidiary, AUTOWAY, and 3) closure of the Bike Bros business. As a result, FY19 sales fell short of the company guidance by 5.3%. On the other hand, OP overshot guidance by 4.5% thanks to steady growth of Goo-net / MOTOR GATE and DataLine Sales Guide (DLSG). Moreover, Goo-net Pit finally became profitable. In addition, Software solutions for garages developed by subsidiary Proto Rios made a one-off contribution to OP. OP grew by ¥571mil (+12.5% YoY) in FY19, of which ¥255mil came from the parent Proto Corporation – which includes Goo-net Pit, MOTOR GATE and DLSG – and ¥258mil of which was from special replacement demand for a subsidiary's software package product and the termination of Windows 7 support.

The impact from COVID-19 had already become apparent prior to the nationwide closures of schools and businesses on local governments' requests in late February. Dealers had voluntarily started to close stores and Proto could not undertake face-to-face marketing with potential new customers. However, the negative impact from COVID-19 became more apparent from April. For example, the contract completion rate at used car auctions fell in both April and May. USS (4732 JP), the largest auctioneer of used cars in Japan disclosed the monthly auction data with an April completion rate of 46.9% (vs. 59.2% in April 2019) and 53.3% in May (vs. 60.5% in Mar 2019). Weaker contract completion rates at auctions indicate that demand to source used car by dealers is low. In fact, the number of used car listings on Proto's Goo-net hit a record level of 535,000 cars as in March, up from 450,000 cars as of FY19 1H. This is because inventory at dealers remains high hence not much demand for auctions. Another reason for the weak auction demand is the lack of demand for used car export amid COVID-19.

The direct impact to Proto was such that advertisement demand remained weak among the small-scale dealerships from the middle of February – usually the high season for advertising. Fortunately, Proto's client base shifted to larger-scale dealerships with multiple branches which continued to advertise aggressively during the weak market. The target universe of used car advertisements defined by Proto's own research comprises 36,600 dealerships (+6.6% YoY). Goo-net's market share, based on the number of dealership companies, fell from 43% in FY18 to 38.3% in FY19. Also, the number of customers (based on number of companies) fell 5.1% YoY to 14,011 as of FY19 4Q. However, the declines were not because Goo-net itself is losing market share, but rather because its client base has shifted to larger companies who own multiple dealership stores. However, the number of dealership stores that advertise on Goo-net also saw an improvement YoY. [NB: Proto is planning to change the way to present the data going forward, from number of companies to number of stores that list advertisement on Goo-net].

EXECUTIVE SUMMARY

- Proto Corporation reported FY19 (to March 2020) OP of ¥5,136mil (+12.5% YoY) on sales of ¥59,127mil (-5.0% YoY).
- While sales fell short of company estimate by 5.3%, OP overshot by 4.5% thanks to solid growth in the Information & Service division, which includes DataLine Sales Guide (DLSG) for the new car dealers and software solutions for garages developed by a subsidiary Proto Rios.
- FY19 OP in the core Automobile Information segment hit ¥6,582mil (+14.5% YoY) on sales of ¥52,870mil (-5.9% YoY). The largest business division, Advertisement, earned sales of ¥21,485 (+1.0% YoY). Goo-net / MOTOR GATE, a used-car advertising platform and Goo-net Pit, a search engine for garages, enjoyed solid growth.
- FY19 Information & Service sales of ¥5,074mil (+10.2% YoY) were boosted by strong growth in DLSG and a one-off contribution from Proto Rios, a software solution provider.
- Number of listing on Goo-net reflected this and hit the record level of 535,000 listings amid rise in inventory at dealerships. Demand for advertisement from small dealers started being weak in February – March.
- Proto has not given FY20 guidance amid lack of visibility. Goo Inspection that certifies 620,000 used cars a year attracts unique users to Goo-net even during the closures under COVID. The firm plans to enhance its platforms by launching AI contents to attract unique users to their dealership clients, which eventually raise ARPU's earned through its platforms.

Proto Corporation (4298): Earnings Summary					
(¥mil) March year-end	FY18	FY19			
	Results	CE	Results	YoY (%)	vs. CE (%)
Sales	62,251	62,431	59,127	-5.0	-5.3
GP	23,832	24,689	24,406	2.4	-1.1
GPM (%)	38.3	39.5	41.3	+3.0pp	+0.8pp
EBITDA	5,920	6,255	6,455	9.0	3.2
EBITDA / sales (%)	9.5	10.0	10.9	+1.4pp	+0.9pp
OP	4,565	4,916	5,136	12.5	4.5
OPM (%)	7.3	7.9	8.7	+1.4pp	+0.8pp
RP	5,004	4,942	5,354	7.0	8.3
RPM (%)	8.0	7.9	9.1	+1.1pp	+1.2pp
Net profit belonging to the parent	3,159	4,512	4,991	58.0	10.6
NPM (%)	5.1	7.2	8.4	+3.3pp	+1.2pp
EPS (¥mil)	78.75	112.41	124.33	57.9	10.6

Source: Proto Corporation FY19 presentation materials

BUSINESS SEGMENTS

The core Automobile Information segment earned OP of ¥6,582mil (+14.5% YoY / 94.8% of total OP before adjusting for HQ costs) on sales of ¥52,870mil (-5.9% YoY / 89.4% of total revenue). FY19 segment OPM improved by 2.2pp to 12.5%, because two core products, Goo-net /MOTOR GATE and DLSG, saw steady growth, and Goo-net Pit finally became profitable. The segment is further divided into the following 3 divisions:

I. Advertisement:

Advertisement business saw FY19 sales of ¥21,485mil (+1.0% YoY). There are advertising fee sources.

i. Goo-net and MOTOR GATE:

Proto's core earning source is generated from 1) advertising revenue on its information platform Goo-net for the used car market and 2) a monthly subscription fee for its backbone system MOTOR GATE, which is mandatory for dealers if they wish to place advertisements on Goo-net. Dealers pay advertisement fees on a per-page basis on top of the mandatory monthly subscription fee. On average, a dealer pays a monthly fee of ¥100,000 and includes the per-page advertisement fee paid for Goo-net, a monthly subscription fee to MOTOR GATE and merchandise sales (which is included in the Merchandise Sales division) – such as tyres and wheels – dealers buy from Proto. The pure monthly MOTOR GATE ARPU/client company (not store) is ca. ¥80,000 per company. [NB: Circa 60% of the FY19 Advertisement business revenue (¥21,21,485mil (+1.0% YoY)) came from MOTOR GATE subscriptions].

The used car advertisement market is largely divided by Proto's Goo-net and Recruit Holdings' (6098 JP) Carsensor which has ca. 520,000 used car listings. Proto reckons that Goo-net differentiates itself from its rival thanks to Goo Inspection, an optional service that certifies the conditions of cars based on its unique criteria. Proto has its own capacity to carry out inspections in-house and the annual inspection capacity is currently available for 620,000 cars. Carsensor, on the other hand, outsources inspections to a subsidiary of the auctioneer, hence it has a much lower capacity to do inspections. Currently, the number of listed cars certified by Goo Inspection is 210,000 out of 535,000 cars listed vs Carsensor's ca. 60,000 out of 520,000 listings. Even under the State of Emergency amid the outbreak of COVID-19, the number of unique users on Goo-net increased despite the inability to visit dealerships, because buyers realised that they could check the condition of the cars on Goo-net without having to visit the dealerships.

ii. **Goo-net Pit:**

Proto gets advertisement revenue from Goo-net Pit, an online and mobile search engine platform for garages. The target universe is 91,788 garages nationwide, a slight drop from 92,044 a year ago. In FY19 4Q, 3.8% of the target universe, i.e. 3,480 garages (+5.1% YoY) paid to advertise on Goo-net Pit. Proto earns a monthly fee of ¥16,000 on average from the paying garages. In addition to the paying garages, there are ca. 7,527 non-paying garages (-4.3% YoY) listed on Goo-net Pit. The main reason for the fall in the number of non-paying garages was because some of them became paying customers.

Goo-net Pit also added a new function, the Goo-net Pit Smart Booking system, from July 19. However, it seems that it has not yet successfully engaged with Goo-net Pit users. Proto reckons monetising the booking system is the next step forward.

2. Information & Service:

The Information & Services business, which is included in the Automobile-related Information segment, earned revenue of ¥5,074mil (+10.2% YoY), thanks to steady growth in 1) DataLine Sales Guide sales, which provides digital sales and marketing solutions for new car dealers, and 2) special replacement demand for Racros 2, a software designed by a subsidiary Proto Rios as an operating system for garages and sheet metal workers. Many customers replaced their PCs when Windows 7 became redundant and took up Racros software.

The target universe of the DataLine Sales Guide (DLSG) solution was 14,670 new car dealers as of FY19 4Q, of which 5,697 dealers (+5.1% YoY) subscribed to DLSG. The DLSG solution was developed based on a vast amount of used car information built up over years in the Goo-net business and provides evaluation capabilities across any brand of cars. New car dealers are typically attached to OEM makers and do not usually have expertise in evaluating trade-in price of cars made by other manufacturers. On the DLSG platform, the firm has been expanding services such as creating proposal for trade-in, AI evaluation of existing cars that customers would like to trade in, CRM functions and AI chatbots from which customers can gain primary information needed while waiting for a dealer to attend to them. Usage of those extended functions was almost nil in FY18, however, it made progress in FY19. For example, 1,174 dealerships out of 5,697 currently subscribe for DLSG also uses a trade-in proposal function, which helped boost the ARPU of DLSG by 15% YoY.

3. Merchandise Sales:

The Merchandise Sales segment saw revenues decline 13.5%YoY to ¥25,827mil due to 1) a fall in export sales of used cars at a subsidiary KINGSAUTO, 2) the closure of the loss-making BIKEBROS business, and 3) a drop in sales of tyre and wheels at AUTOWAY. These three factors took ¥708mil off GP and ¥269mil off OP, however, this was offset by the stable growth in core businesses.

FY19 was also a year of business restructuring for Proto. The firm reviewed the entire business portfolio and identified subsidiaries with negative ROIC: The firm had already decided to close Proto Malaysia in Oct 19. Another overseas subsidiary, Proto Taiwan, was sold via share transfer in Jan 2020. BIKEBROS was merged to the parent from April 2019. I just realised you said 5 businesses but here you just describe 3...so maybe take out the word five or else add in the other two?

Through its restructuring efforts, Proto saved ca. ¥50mil in SG&A. Furthermore, FY19 OPM improved by 1.4% points, mainly because of steady growth of Goo-net / MOTOR GATE and DLSG, and Goo-net Pit finally became profitable.

Sales and OP by Segment: Proto Corporation (4298)									
(¥mil)		FY15	FY16	FY17	FY18	FY19CE			
		Results	Results	Results	Results	CE	Results	YoY (%)	vs. CE (%)
Automobile-related information	Sales	49,486	51,025	56,100	56,167	56,293	52,870	-5.9	-6.1
	Advertisement	21,006	21,231	21,618	21,278	21,639	21,485	1.0	-0.7
	Info & Service	5,087	4,893	5,053	5,053	5,074	5,557	10.2	9.5
	Merchandise Sales	23,392	24,899	29,429	29,429	29,579	25,827	-13.5	-12.7
	OP	5,277	3,939	4,933	5,758	6,524	6,582	14.3	0.9
	OPM (%)	10.7	7.7	8.8	10.3	11.6	12.5	+2.2pp	+0.9pp
Life-Related Information	Sales	3,467	4,236	4,370	4,335	4,331	4,168	-3.8	-3.9
	OP	307	478	370	249	138	169	-32.2	22.3
	OPM (%)	8.9	11.3	8.5	5.7	3.2	4.1	-1.6	+0.9pp
Real Estate	Sales	162	187	213	195	137	160	-17.7pp	16.7
	OP	109	147	170	193	34	135	-30.0	294.3
	OPM (%)	67.3	78.6	79.8	99.0	24.8	84.2	-14.8pp	+59.4pp
Others	Sales	1,182	1,268	1,426	1,553	1,668	1,928	24.2	15.6
	OP	-66	-136	-71	57	36	58	2.9	62.9
	OPM (%)	n/a	n/a	n/a	3.7	2.2	3.1	-0.6pp	+0.9pp
Total (adjusted)	Sales	54,297	56,717	62,111	62,251	62,431	59,127	-5.0	-5.3
	OP	4,071	2,795	3,674	4,565	4,916	5,136	12.5	4.5
	OPM (%)	7.5	4.9	5.9	7.3	7.9	8.7	+1.4pp	+0.8pp

Source: Nippon-IBR based on data available on Nikkei Value Search

Automobile-related Business Segment: Subsegments & Domains									
Service Name	Service Details	Subsegment	Domain	Customers	Users	FY18 Sales (¥mil)	FY19 Sales	YoY (%)	vs. CE (%)
Goo-net	Used car search engine	Advertisement	Used Car	Dealers	Used car buyers	21,278	21,485	1.0	-0.7
MOTOR GATE	Goo-net's background system	Advertisement	Used Car	Dealers	Dealers				
Goo-net Pit	Search engine for garages	Advertisement	Service & Repair	Garages	Car owners				
Goo-inspection (condition-check)	Disclose used cars' conditions online	Information & Service	Used Car	Dealers	Buyers	5,041	5,557	10.2	9.5
DataLine Sales Guide	Marketing tool for new car dealers	Information & Service	New Car	New car dealers	New car dealers				
Goo Check-up	Introducing customers for mandatory check-up and services	Information & Service	Service & Repair	Car owners	Car owners				
AUTOWAY	E-Commerce for imported tyres, wheel and used cars	Merchandise sales	EC	Consumers	Consumers	29,847	25,827	-13.5	-12.7

Source: Nippon-IBR based on Proto Corporation's company presentation

FY20 OUTLOOK

Proto did not announce FY20 guidance with its FY19 results due to lack of visibility for the market under the current environment. The firm aims to release guidance with FY20 IQ results.

In April alone, new car sales in Japan dropped ca. 30% YoY due to temporary closures and shortened operating hours at car dealers. Marketing activities were also suspended. In the used car market, dealer inventory started gradually increasing while there was a rise in the number of cars auctioned, though with a lower contract price and a drop in contract ratio. Goo-net currently is enjoying record levels of listings and advertisements posted through MOTOR GATE and they continue to rise. However, advertisement fee revenue remains flattish because Proto introduced temporary support measures for dealers by lifting the limit on the maximum number of advertisements they can post without an increase to the monthly MOTOR GATE fee. However, the number of unique users that have accessed the Goo-net search engine hit a record level in March, suggesting that demand for cars still existed during the closures. Proto reckons that interests in searching used cars has been somewhat triggered by local governments' request to refrain from using public transportation, which then led to 1) an increase in usage of short-distance drives in urban areas, 2) a rise in demand for low-cost used cars, and 3) greater demand for motorcycles.

Consumer behaviour under COVID-19 and the State of Emergency restrictions has revealed some growth potential for Proto. There has been emerging demand for remote, online communication from both Goo-net users and dealers, which was accelerated because of the physical restrictions due to COVID-19. According to Car User Report 2020, a survey by Proto Souken, a subsidiary in charge of car user research, states that almost 34% of used car buyers during CY19 bought cars without physically seeing the vehicle. Proto reckons that quality and contents of online information on used cars has improved over the past 10 years enough so as to support the decision-making process.

The firm's Goo Inspection service, which independently inspects and discloses each used cars' conditions, helps with the sales completion. Over the past 10 years, number of inspections by Goo Inspection has soared 4-fold. In addition to the existing features, Proto launched an online sales negotiation function on MOTOR GATE Calendar. Users can book an online chat with a dealer through its existing booking service when they make appointments for a store visit and test drive. The online negotiation can be arranged via LINE, Skype, Google Hangouts Meet, FaceTime, Zoom etc. By having online chats with a dealer, a customer can reduce the time they spend at the dealership when s/he visits for a test drive. Furthermore, it improves the efficiency at the dealership. The evidence that online chats can actually mobilise buyers even during the State of Emergency has attracted interests from dealers who were not Goo-net users.

Proto is developing other online contents to enrich the current platform and improve user / customer experience. For example, the firm has developed three AI contents in the areas such as:

- Improving dealers' inventory turnover (to assist dealers with multiple numbers of stores to optimise allocation of cars to each branch)
- Optimising dealers' inventory
- Minimise processes to register inventories.

One example is MOTOR GATE AI. This software predicts cars that can be sold tomorrow, based on used car sales data accumulated on Goo-net. Proto already added AI Chatbot and AI Valuation services to DLSG for new car dealers and the newly added online business negotiation booking service in May. AI Chatbot can be loaded on dealers' own websites and provide booking services and trade-in evaluations. Proto already proved that such additional functions on DLSG has led to more upselling to its existing customers. Given competition among new car dealers, even among dealers selling the same OEM brand, is fiercely competitive, Proto reckons that the key to success is to launch contents and services to improve efficiency at dealerships so that they can retain their existing customers who can potentially bring in more recurring revenue.

Proto aims to promptly disclose FY20 guidance as soon as there is visibility of the economic impact delivered by COVID. The firm plans to pay out an annual cash dividend of ¥25/share in FY20. A known negative factor for FY20 earnings is the likely drop in earnings at Proto Rios for special demand related to the Windows 7 replacement will not exist in FY20. However, Proto reckons the drop in Proto Rios earnings will likely be offset by recovery in sales of tyres and wheels at AUTOWAY as the charge for data fabrication on the security standards on the wheels it sells was dropped in Nov 2019.

MEDIUM-TERM PLAN

This year is the second year of the new medium-term management plan (FY19~FY21). The firm aims to achieve CAGR 6.4% in GP and 9.4% in OP, compared to the ¥23,789mil GP and ¥4,565mil OP achieved in FY18. The firm also plans to achieve an EPS of ¥100 and ROE of 12% or more in the final year of the plan (FY21, ending March 22). Although FY20 guidance is yet to be announced, so far, Proto has not changed its medium-term target.

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