

Company Report

Non-China Internet



Sharpening focus on reuse is Mercari's ticket to the future

March 18, 2022

INVESTMENT SUMMARY

- Our tracking finds ~1/3 of Mercari's GMV is derived from new goods. Yahoo! Japan Auction (YJA) and Rakuma (Rakuten) also are similar. Till today, C2C is not a standalone e-commerce segment in Japan. Measuring under total GMV share, Mercari's market share is only 5%;
- However, Mercari's user base has reached 40-50% of that of Z Holdings and Rakuten, meaning its has provided differentiated value to the consumers. Given the rising environment-awareness in developed countries, online reuse might become a standalone e-commerce segment in the future;
- While we view Mercari's US venture more as a half success than a half failure, Mercari has missed out several important innovations in its home market and thus opened itself to attack in the near future. We would like to sit out until situation clears.

Research Team



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Mercari Inc. (TYO: 4385)

Walking a tight rope...Initiate w/ HOLD

- Mercari needs to break the mould. While its grip on Japan's online reuse market is solid, it has missed out key markets and important innovations, putting the company on the defensive;
- That said, we expect online reuse market to grow at a CAGR of 8.9% from 2021 to 2030, with online flea market to grow faster than auction and Mercari to gain market share;
- We initiate the stock with a HOLD and TP of JPY 3,486.

Reuse is still the bedrock of Mercari's investment case

Founded more than a decade after the big platforms (SoftBank/Z Holdings and Rakuten), Mercari amassed 20mn monthly active users (MAU) in Japan, a country of 126mn, and 5mn in US. We estimate Japan's online reuse market amounted to JPY1.58tn in 2021 and will grow to JPY3.39tn by 2030. We expect Mercari's market share to rise from 35% to 46% over this period.

But is reuse a standalone segment of e-commerce?

We believe it will be, but so far it's not. We find between 1/3 to 2/3 of GMV's on Japan's online reuse platforms are new goods, which means C2C and SME2B2C aren't readily separable. Despite Mercari's market leadership in online reuse, its overall market share in e-commerce in Japan is 2nd class.

Competition will rise in the near term

Reliance on new goods for growth means reliance on Chinese merchants, which is a double edge sword, as their maverick business practices often alienate native consumers. Further, ~50% of reuse GMV is auto, of which Yahoo! Japan Auction, part of Z Holdings, have a commanding share. Mercari has also missed market-shifting innovations, such as apparel reuse in US, consignment in apparel, and QR Code Payment in Japan.

Payment landscape change warrants more attention

Cash usage has been persistently high in Japan, until QR Code Payment introduced a replacement scenario. Leveraging market leadership in payment, Z Holdings is expanding across the e-commerce spectra and we believe its advantage will continue.

Summary financial data

Highlights	FY2019A	FY2020A	FY2021A	FY2022E	FY2023E
Revenues (JPY mn)	51,683	76,275	106,115	157,012	189,920
Operating profit (JPY mn)	(12,149)	(19,307)	5,186	(1,149)	3,781
Net income (JPY mn)	(13,762)	(22,957)	5,525	(2,732)	2,350
GAAP EPS (JPY)	(92)	(146)	36	(13)	15
EBITDA margin	(21.9%)	(23.8%)	6.1%	0.2%	2.9%
P/E (non-GAAP)	(35.1)	(22.0)	88.7	(256.0)	219.0
Free cash flow yield (%)	(3.0%)	(4.2%)	2.2%	(0.4%)	0.7%

Source: Bloomberg, Blue Lotus (as of 3/18/2022). Fiscal year end in June

BUY

HOLD

SELL

Target Price: JPY 3,486

Current Price: JPY 3,200

RIC: 4385 T

BBG: 4385:JP

Market cap (JPY mn)

512,194

Average daily volume (JPY mn)

8,227

Shares out/float (m)

160.1/101.9

Source: Bloomberg, Blue Lotus (as of 3/18/2022)

Key Changes

	New	Old	Diff
BLRI Recommendation	HOLD	-	
BLRI Target Price	JPY3,486	-	
FY2022E EPS (JPY)	(12.6)	-	
FY2023E EPS (JPY)	14.7	-	
FY2024E EPS (JPY)	20.3	-	

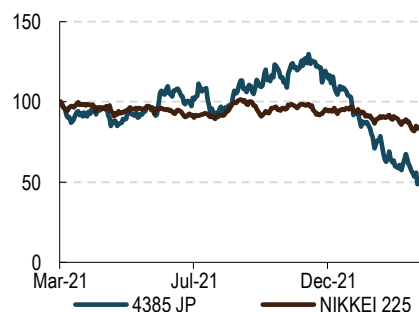
Source: Blue Lotus (as of 3/18/2022)

BLRI vs. The Street

No. of Bloomberg Recommendations	13
Target price vs. Bloomberg mean	(36%)
1-year-fwd EPS vs. Bloomberg mean	(80%)
Bloomberg recommendation	3.77

Source: Bloomberg Recommendation, Blue Lotus (1=SELL,5=BUY) (as of 3/18/2022)

Price performance and volume data



Source: Bloomberg, Blue Lotus (as of 3/18/2022)

Research team



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Blue Lotus Capital Advisors Limited

All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Bloomberg, Blue Lotus Capital Advisors Limited and subject companies. Consensus forward estimates are used in analysis. Past performance is not indicative of future results. Investors should consider this report as only a single factor in making their investment decision.

Mercari Inc.: Financial Summary

Fiscal year ends-June 30

Exhibit 1. Income statement

(JPY mn, or JPY)	2020A	2021A	2022E
GMV	699,199	909,319	1,061,312
Japan	625,700	784,400	910,948
US	73,499	124,919	150,364
Net sales	76,275	106,115	157,012
Japan	58,500	74,900	87,265
US	19,077	36,645	47,120
Cost of sales	(20,661)	(24,312)	(54,246)
Gross profit	55,614	81,803	102,765
SG&A	(74,921)	(76,617)	(103,914)
Non-operating income	210	7,183	67
Non-operating expense	(1,420)	(494)	(211)
Profit before tax	(20,517)	11,875	(1,293)
Tax	(2,317)	(6,981)	(809)
Net profit	(22,957)	5,525	(2,732)
EPS	(146)	36	(13)

Source: Mercari, Blue Lotus (3/18/2022)

Exhibit 2. Balance sheet

(JPY mn)	2020A	2021A	2022E
Cash and equivalent	135,747	171,463	192,177
Trade account receivable	1,119	2,413	2,816
Other receivable	15,612	47,001	42,452
Prepaid expenses	1,609	2,336	2,625
Deposits paid	9,718	6,251	7,296
Total current assets	169,275	227,924	245,570
PPE	2,905	2,623	2,666
Intangible assets	679	658	691
Guaranteed deposits	16,598	26,767	31,241
Investment and other assets	25,150	31,319	35,793
Total assets	198,009	262,524	284,720
ST borrowing	-	19,602	6,534
Current portion of LT borrowing	900	35,398	11,799
Accrued expense	861	1,147	1,262
Income tax payable	1,427	6,140	6,140
Deposits received	83,954	117,099	144,101
Total current liabilities	110,125	205,327	197,755
LT borrowing	51,547	16,148	5,383
Total liabilities	162,640	222,509	204,176
Shareholders' equity	30,966	39,066	44,855
Total liabilities and shareholders' equity	198,009	262,524	284,720

Source: Mercari, Blue Lotus (3/18/2022)

Company Description

Mercari Inc. is Japan's largest C2C platform with a market share of online reuse of 35% and of total merchandise e-commerce of 5%. Mercari was founded by Yamada Shintaro in 2013 after he sold his previous startup to Zynga. In FY2021, Japan contributed 71% of revenues and 86% of the GMV with the rest from Mercari USA.

Industry View

We expect Japan's reuse market, commercialization ratio and online penetration to grow from JPY10tn, 38% and 37% in 2021 to JPY9.8tn, 52% and 66% by 2030. We expect Mercari's GMV market share in online reuse in Japan to rise from 35% in 2021 to 51% in 2030.

Exhibit 3. Cash flow statement

(JPY mn)	2020A	2021A	2022E
Loss before income tax	(20,517)	11,875	(1,293)
Depreciation and amortization	1,463	845	968
Increase in allowance for doubtful accounts	309	1,011	404
Interest income	(116)	(30)	(125)
Interest expense	248	232	125
Change in working capital	9,352	(31,151)	5,891
Trade account receivables	577	(1,294)	403
Other receivable	137	(31,388)	4,549
Cash due to users and other payables	8,638	1,531	939
Deposits paid	(4,334)	3,466	(1,045)
Deposits received	37,695	32,908	27,002
Net cash provided by operating activities	12,533	3,366	74,791
Capex	(1,104)	(420)	(1,061)
Cashflow from investment activities	(2,654)	6,906	(774)
Cashflow from financing activities	466	19,773	(53,216)
Net increase/decrease in cash	10,358	30,451	20,714
Cash at beginning of the period	130,775	135,747	171,463
Cash at end of the period	135,747	171,463	192,177

Source: Mercari, Blue Lotus (3/18/2022)

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• Recent Reports

March 17, 2022: [PAGD (1833 HK, SELL, TP HK\$13) Target Price Change]:

Slowdown for transiting towards an uncertain future

March 17, 2022: [ZTO Express (ZTO US, HOLD, TP US\$30) Target Price Change]:

Domestic top player but needs new driver

March 17, 2022: [WuXi Biologics (2269 HK, BUY, TP HK\$78) Earnings Preview]:

Late-stage projects drive accelerated revenue growth

March 17, 2022: [Blue Lotus Sector Update]: **NEV credit price declines due to surging supply**

March 17, 2022: [Zhihu (ZH US, BUY, TP US\$3.3) Rating Change]: **Upgrade to BUY with positive outlook**

March 15, 2022: [Blue Lotus Sector Update]: **February NEV sales still show strong momentum**

March 15, 2022: [RemeGen (9995 HK, BUY, TP HK\$102) Target Price Change]: **Cut TP for COVID-19 hospital restriction in FY22**

March 15, 2022: [Futu Holdings (FUTU US, BUY, TP US\$40) Target Price Change]: **Stable revenue growth amid regulatory headwind**

March 14, 2022: [JD Logistics (2618 HK, BUY, TP HK\$30) Company Update]: **Deppon acquisition enhances LTL network**

Investment Cases at a Glance

Why is it not a BUY

- **Mercari's market share is too low overall and not high enough in reuse:** Mercari's GMV market share in Japan's e-commerce market was ~5% in 2020, behind Amazon Japan's 33%, Rakuten's 29%, Z Holdings' (Yahoo! Japan) 19% (incl. Zozotown) and in par with GMO Internet's 3%. Its GMV market share in online reuse market was 35% in 2021, vs. Yahoo! Japan's 24% and Rakuten's 6%, which to our view isn't dominant;
- **Mercari has several well-trenched and well-carved competitors:** Yahoo! Japan cornered the online used auto/parts market in Japan, which is the biggest reuse subsegment with ~50% of the GMV. Rakuma (Rakuten) has a focus on women and family. Zozotown (Z Holdings) is Japan's Vipshop (VIPS US, HOLD, US\$9.7). Further, luxury reuse is a special market in Japan with several offline listco's. These competitors are difficult to dislodge, in our view;
- **One third of Mercari's domestic GMV are new goods:** This means Mercari isn't new to B2B2C, which presents two problems: (1) differentiation against other e-commerce platforms aren't that big, (2) cannibalization with the new B2B2C initiative Mercari Shop (Souzoh) will likely result;
- **Best timing for turning around US operation has passed:** Mercari has been losing money in US since 2016, with operating loss margin at the business unit level gradually narrowed from ~(-200%) to ~(-50%) by our estimate. From C3Q21 (F1Q22), Mercari adopted US GAAP measures which included shipping revenue and cost into P&L. Our initial analysis showed Mercari US's shipping gross margin is negative, which means the more it ships, the more it losses. We believe Mercari entered US at an opportune time when eBay failed to adapt to the new environmental aware version of C2C. But Mercari failed to out-innovate US startups, which led to stronger competitors emerging to take eBay's place;
- **Mercari has lost several forward-looking battles at home, too:** QR Code Payment has risen rapidly as a substitution for cash in O2O. Z Holdings captured the lead with PayPay. Mercari's market share is minuscule. Mercari missed the rise of consignment model sales to Zozotown, as well as ceding its presence in food delivery to Rakuten and Z Holdings;
- **Valuation is reasonable but heavily reliant on consensus being right:** We are concerned on the overall competitive landscape becoming more intensive with both Z Holdings and Rakuten leveraging up to compete. The consensus might be too optimistic on cost, in our opinion.

Why is it not a SELL

- **Online commercialized reuse market is big and thriving:** We estimate Japan's reuse market to worth JPY10tn in 2021, of which 38% is commercialized and a further 42% is online. We project the commercialization

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March 14, 2022: [Blue Lotus Sector Update]: **TikTok will be increasingly attractive to influencers**

March 11, 2022: [JD Logistics (2618 HK, BUY, TP HK\$30) Target Price Change]: **Great potential in penetrating mid-sized brands**

March 11, 2022: [JD.com (JD US, BUY, TP US\$80) Target Price Change]: **Cut TP for low user engagement**

March 10, 2022: [KE Holdings (BEKE US, BUY, TP US\$21) Target Price Change]: **The rebound is real...Stick around**

March 9, 2022: [MedBot Group (2252 HK, SELL, TP HK\$19.9) Company Update]: **Speculation on procurement drove share weakness**

March 7, 2022: [ZTO Express (ZTO US, HOLD, TP US\$34) Company Update]: **Catching up market share in a slow market**

March 7, 2022: [Weibo (WB US, BUY, TP US\$34.3) Target Price Change]: **Diverse ad segments helped weather headwinds**

March 4, 2022: [Zai Lab (ZLAB US, BUY, TP US\$84) Target Price Change]: **Cut TP for potential COVID-19 negative impact**

March 4, 2022: [Grab Holdings (GRAB US, SELL, TP US\$3) Earnings Review]: **Bribing customers is not a business model**

March 4, 2022: [Bilibili (BILI US, SELL, TP US\$21.4) Target Price Change]: **Cost saving impacts revenue growth**

March 3, 2022: [Baidu (BIDU US, BUY, TP US\$237) Earnings Review]: **Autonomous driving generates revenue, maintain BUY**

ratio to reach 52% by 2030, of which online to reach 66%. Mercari's market share of online reuse will rise from 35% to 46% by 2030 and further to 51% by 2035;

- **Mercari has a respectable user base:** Mercari had 20mn MAU in Japan and 5mn in US as of C4Q21. While direct comparison is difficult, a Nielson data in 2019 pointed to Mercari's MAU at 44%, 46% and 199% of Amazon Japan, Rakuten Ichiba (Rakuten's new goods app) and Rakuma (Rakuten's used goods app), respectively;
- **New goods composition is the smallest among its peers:** Our tracker finds 2/3 of Yahoo! Japan Auction's (YJA) and 1/2 of Rakuma's listings to be new goods. Despite news good contributing a sizable part, Mercari remains the No.1 destination for reuse goods within Japanese e-commerce, which offers differentiation, in our view;
- **Clear moat exists:** We find Mercari's listing procedure, logistics and payment option in Japan to be one of the best, even though they are costly to replicate outside of Japan;
- **Mercari US has stood its feet and become native:** COVID-19 helped Mercari US in accelerating its C2Q20 GMV growth to 184% and MAU growth to 110% YoY, with significantly improved operating margins. Since then, Mercari US has largely stabilized its GMV, MAU and margin, even though turning profitable will likely still be difficult in a foreseeable future.

What are the key catalysts for the next 3-6 months

- **Revival of Z Holdings' e-commerce business (-):** We would continue to observe the extent to which PayPay can drive Z Holdings' e-commerce business, especially when it applies to online reuse, as well as merger synergy with LINE Japan in affecting the reuse market;
- **Post-COVID business momentum in US (-):** COVID has helped C2C platforms with a hobby/collectible focus and weakened those with an apparel and luxury focus. Mercari US's GMV growth might slowdown, or might require additional marketing to sustain its GMV growth;
- **The result of rollout of Souzoh (Mercari Shop) and the impact on GMV growth (-):** We believe the market will disappoint as Souzoh will cannibalize the new goods GMV of the C2C business. We also observe Mercari's business development effort on attracting Chinese merchants to be lacklustre;
- **Cost control in the next few quarters (-):** The latest quarter C4Q21 (F2Q22) had oversized SG&A which materially impacted profitability. We are concerned such trend will continue;
- **The implementation of personal credit (+):** We expect Mercari to roll out Merpay personal loan by June, 2022. We believe Mercari can gain further market share in payment, but the strategic merit of that is doubtful.

March 3, 2022: [Xpeng (XPEV US, BUY, TP US\$63) Earnings Review]: **Growing popularity of new models led to 4Q21 growth**

March 2, 2022: [SEA Limited (SE US, BUY, TP US\$180) Target Price Change]: **Cut TP for soft gaming performance**

March 1, 2022: [Zai Lab (ZLAB, BUY, TP US\$152) Earnings Preview]: **Good buying opportunity after price correction**

February 28, 2022: [Li Auto (LI US, BUY, TP US\$48) Earnings Review]: **A stable 4Q21 with improved vehicle margin**

Where can we be wrong?

- **The bold strategies of Z Holdings and Rakuten panned out (-):** Our current view is that Z Holdings' strategy of using QR Code Payment and social commerce to galvanize Japan's payment market, as well as Rakuten's entry to mobile communication to compete against Softbank (9984 JP, NR), will not materially impacted Mercari's position in online reuse. This is apparently not what Z Holdings and Rakuten have in mind;

What can change our view?

- **Mercari adopts an activist approach on Chinese merchants (/):** If Mercari adopts an active approach to Chinese merchants similar to what Amazon Japan has done, it might mean Mercari is seriously considering to transition to a general B2B2C platform, which will warrant us to reassess its likelihood of success.

Operating Metrics

Exhibit 4. Quarterly revenue table

(JPY mn)	F3Q21	F4Q21	F1Q22	F2Q22	F3Q22 (C1Q22)	F4Q22
Net sales	28,688	29,214	33,634	37,557	43,613	42,207
Cost of sales	(5,921)	(6,368)	(11,694)	(13,150)	(14,819)	(14,583)
Gross profit	22,767	22,846	21,940	24,407	28,794	27,625
Gross margin	79.36%	78.20%	65.23%	64.99%	66.02%	65.45%
SG&A	(22,608)	(19,190)	(21,090)	(27,031)	(29,039)	(26,754)
Operating profit (loss)	159	3,656	850	(2,624)	(245)	870.3
Operating margin	0.55%	12.51%	2.53%	(6.99%)	(0.56%)	2.06%
Total non-operating income	43	130	30	23	7.0	7.0
Total non-operating expenses	(46)	(200)	(46)	(105)	(30)	(30)
Net profit (loss) before income taxes	156	3,586	834	(2,706)	(268)	847
Net profit (loss)	(560)	1,443	(60)	(2,701)	(187)	847
Average No. of shares (mn)	157	158	159	160	160	161
Basic EPS (JPY)	(3)	10	0	(17)	(1)	5
fx JPY/USD avg	106	110	112	112	113	113

Source: Mercari, Blue Lotus (3/18/2022)

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China is a reality that Japan chooses to ignore

We found close to 1/3 of Mercari's GMV is derived from completely new goods. Such is also true for Yahoo! Japan Auction (YJA) and Rakuma, Rakuten's C2C subsidiary. If only used goods are counted, YJA and Rakuma's GMV are ~2/3 and 1/5 of Mercari. Given Mercari's category mix is geared towards apparel, 3C and sports (64%), which also has the highest concentration of new goods, Mercari's reliance on low-cost Chinese goods is significant. However, like its Japanese peers, Mercari has done little to cultivate the relationship with Chinese merchants, leaving them doing business on the Amazon platform.

Mercari's GMV concentration on new apparel, 3C and sports goods means its reliance on Chinese merchants is likely high.

1/3 of Mercari's GMV is derived from completely new goods

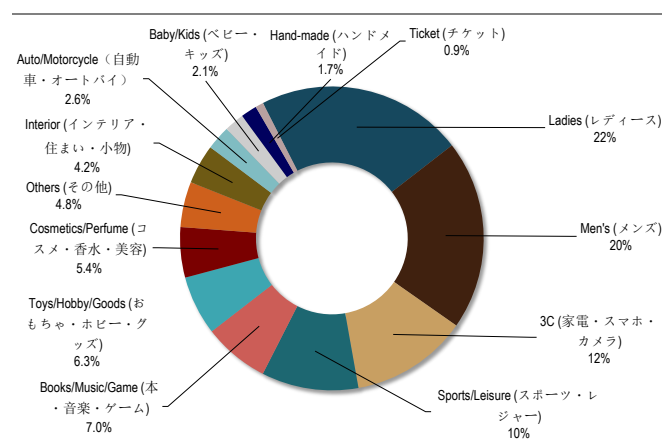
Our tracking found ~1/3 of Mercari's GMV is derived from completely new goods, with another ~10% from almost new goods (Exhibit 5). The same was also observed in Yahoo! Japan Auction (Exhibit 7).

Exhibit 5. Percentage of New/Never-used and Almost-new items, Mercari

	Listing %	Sold		On sale	
		New/Never used (新品/未使用)	Almost new (未使用に近い)	New/Never used	Almost new
Ladies'	22%	36%	12%	37%	11%
Men's	20%	28%	9.2%	27%	17%
Cosmetics	5.4%	62%	5.5%	65%	7.0%
3C	12%	55%	7.4%	41%	11%
Toys/Hobby	6.3%	53%	13%	58%	18%
Sports/Leisure	10%	37%	10%	43%	10%
Books/Music/Games	7.0%	14%	10%	16%	10%
Others *	17%	10%	5%	10%	5%
Total	100%	33%	9.9%	33%	11%

Source: Blue Lotus Research, Mercari (as of 3/18/2022) *Others are estimated

Exhibit 6. GMV breakdown in January 2022, Mercari



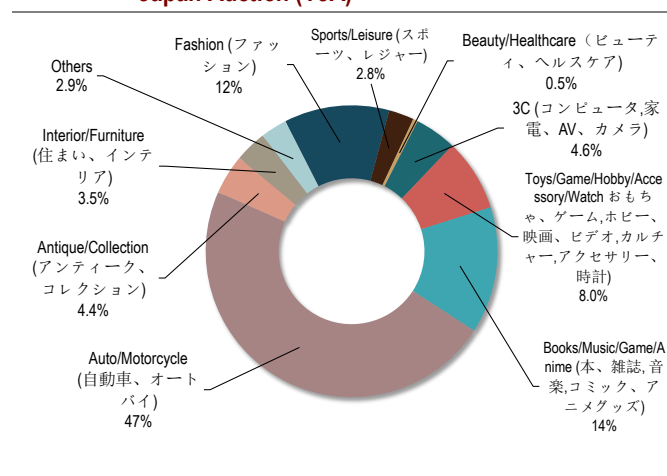
Source: Blue Lotus Research, Mercari (as of 3/18/2022)

Exhibit 7. Percentage of New/Never-used and Almost-new items, Yahoo! Japan Auction (YJA)

	Listing %	Auction		Fixed price (Flea market)	
		New/Never used	Almost new	New/Never used	Almost new
Fashion	12%	33%	4.7%	30%	4.7%
Beauty/ Healthcare	0.5%	62%	7.6%	83%	4.7%
3C	4.6%	41%	2.9%	72%	2.6%
Toys/Game/ Hobby /Accessory/Watch	8.0%	38%	7.5%	57%	8.9%
Sports/ Leisure	2.8%	47%	5.1%	67%	4.2%
Books/Music/Game/ Anime	14%	7.4%	2.8%	11%	1.9%
Auto/Motorcycle	47%	45%	4.6%	93%	0.3%
Antique/Collection	4.4%	20%	5.3%	32%	5.5%
Total		33%	5.0%	74%	2.1%

Source: Blue Lotus Research, Z Holdings (as of 3/18/2022)

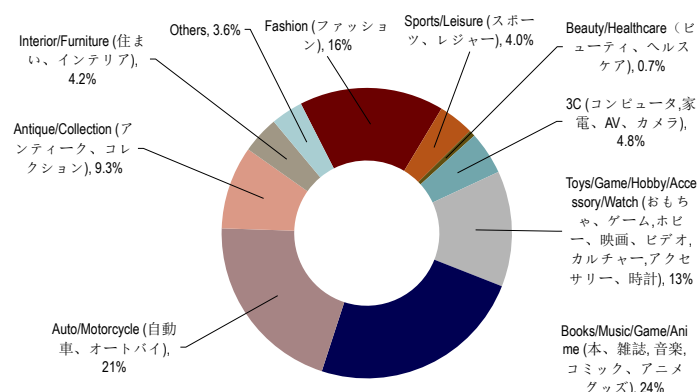
Exhibit 8. Listing composition in January 2022, Yahoo! Japan Auction (YJA)



Source: Blue Lotus Research, Z Holdings (as of 3/18/2022)

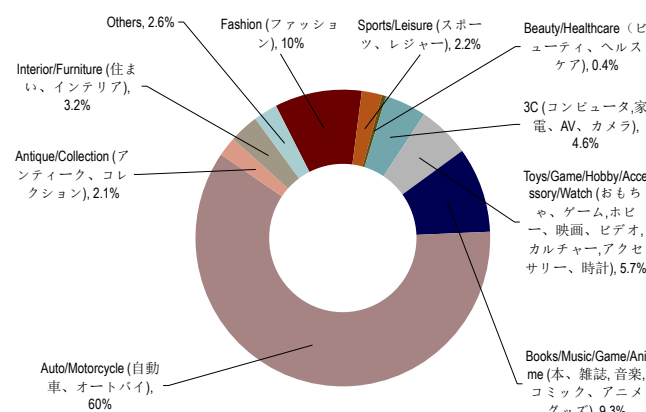
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Exhibit 9. Listing composition in January 2022, Yahoo! Japan Auction (YJA), Auction Pricing



Source: Blue Lotus Research, Z Holdings (as of 3/18/2022)

Exhibit 10. Listing composition in January 2022, Yahoo! Japan Auction (YJA), Fixed Pricing



Source: Blue Lotus Research, Z Holdings (as of 3/18/2022)

Further, given 47% of YJA's listing is auto-related while the majority of Mercari's GMV is low priced consumer goods (Exhibit 6 and 8), we can conclude that Yahoo! Japan Auction (YJA), Mercari and Rakuma divided Japan's C2C market into three subsegments.

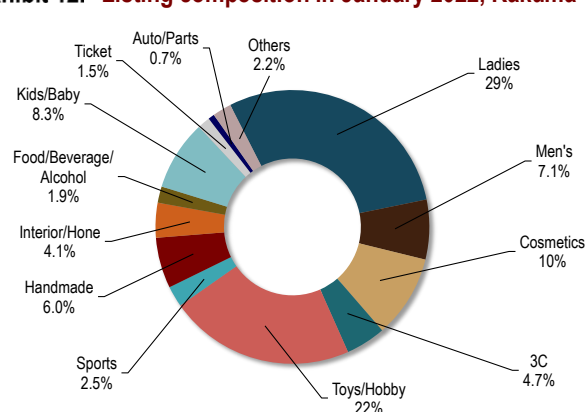
Certain e-commerce categories are dominated in used goods while others are in new goods.

Exhibit 11. Percent of New/Never-used items, Rakuma

	Listing %	Sold	On sale
		New/never used	New/never used
Ladies	29%	37%	40%
Men's	7.1%	47%	40%
Cosmetics	10%	71%	72%
3C	4.7%	92%	70%
Toys/Hobby	22%	44%	39%
Sports	2.5%	84%	88%
Handmade	6.0%	76%	76%
Interior/Hone	4.1%	31%	33%
Food/Beverage/Alcohol	1.9%	94%	93%
Others	13%	54%	53%
Total	100%	52%	49%

Source: Blue Lotus, Rakuma (as of 3/18/2022)

Exhibit 12. Listing composition in January 2022, Rakuma



Source: Blue Lotus, Rakuma (as of 3/18/2022)

Auto-related constitutes YJA's biggest GMV category (Exhibit 8) because it is non-standard and high value, both of which are suitable for the auction format, as observed also in the case of eBay. YJA has two pricing mechanisms: (1) fixed pricing (flea market) and (2) auction pricing. We found the category mix of the two dissimilar (Exhibit 9 and 10). Auction priced merchandises contain higher percentage of non-standard categories like Toys, Game, Hobby, Accessories, Books, Music, Animation, Antique, Collectibles and Fashion while fixed pricing merchandises contain higher percentage of standard categories like Auto-related. We found the auction priced auto-related merchandises to be mainly used cars while fixed priced ones to be mainly auto parts. YJA dominates the category of used cars and motorcycles and has since extended to the B2B2C categories of new merchandises like tires, spare parts, GPS, audio and car accessories. The completely percentage of

It is hard to breakout which category is dominantly new or used. In general, standard items use fixed price while non-standardized items use auction.

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YJA's fixed price section is as high as 74%. All together, >60% of YJA's listings are completely new.

Our tracking finds about half of Rakuma's listings are new items, between Mercari's 1/3 and YJA's 2/3 (Exhibit 11). Thus, we estimate Rakuma's market share in Japan's online reuse market to be 6.4% in 2020 (Exhibit 14). We believe this market share represents a decline from when Rakuten acquired FRIL and merged with Rakuma in C3Q16. At the time of acquisition, Rakuten announced Rakuma GMV at JPY140bn (2017). We estimate in 2020, it reached JPY172bn. Over the same period, Mercari's GMV grew 2.4x.

Rakuma's GMV composition tilts towards women and family, with oversized contribution from Ladies, Cosmetics, Handmade, Interior, Food Beverage and Kids, totalling 59% while the same categories on Mercari only amounted to 35% and YJA 12% (Exhibit 12).

Rakuma's category mix shares a lot of similarities to Mercari's and gears more towards women and family.

Exhibit 13. Percentage of professional sellers on Mercari

	>300 listings	<300 listings	% of >300	Max listings
Cosmetics, Perfumes	51	58	47%	29,725
3C	58	40	59%	31,161
Interior	49	56	47%	66,413
Men's	48	46	51%	18,425
Ladies	59	50	54%	7,372
Tickets	34	68	33%	7,810
Auto-related	36	55	40%	7,100
Handmade	59	39	60%	33,474
Books, Music, Games	41	57	42%	11,841
Toys/Hobby/Goods	44	69	39%	12,450
Baby/Kids	49	43	53%	13,318
Sport/Leisure	38	47	45%	6,968
Average	628	675	48%	20,113

Source: Mercari, Inc., Blue Lotus (as of 3/18/2022)

Professional sellers are occupying the front page

To validate the thesis, we scrape the first page of each category on Mercari to see how many items each seller has listed. We found more than half of the sellers have listed >300 items (Exhibit 13). Further the contribution of professional sellers has been consistent across categories and merchandise conditions. This means, in our opinion, Mercari needs to reassess its policy towards professional sellers and given them more targeted support.

Is C2C a standalone market? How about reuse?

According to METI (通産省), Japan's C2C e-commerce market is divided into (1) Auction and (2) Flea Market. In 2020, Japanese online auction market amounted to JPY989bn while online flea market amounted to JPY1.05tn. Mercari's market share in flea market was 72% and YJA's market share in auction was 81%. Online flea market has been growing at a much faster pace than online auction and Mercari has been gaining market share in flea market.

This was only half correct, in our view. METI failed to take into account that ~1/3 of Mercari's and ~60% of YJA's GMV are new goods. They are mostly B2B2C instead of C2C. METI's calculation led to a commercialization ratio of ~70% of Japan's reuse market, which we believe is improbable.

We believe METI's estimate of Mercari's market share and Japan's C2C market is wrong.

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After removing the contribution of new goods, our calculation yields only 37% of Japan's reuse market being commercialized and another 37% is online, which we believe is more realistic.

We put the cap of reuse commercialization at ~60%, because the values of used goods depreciate rapidly after repeated use, making older items not practical to commercialize, in our view. Japanese families' traditional value of good and durable items means a large chunk of used items are commercialized in the end. Even under today's more environment-aware social setting, older items are more likely to be thrown away or donated than being sold.

We also find METI's estimate of Japan's reuse market failed to take into account the value of auto auctions, which tend to have pricing far exceeding the flea market price.

Our adjusted market estimate is shown in Exhibit 14 and 15. We estimate Japan's total reuse market in 2020 was JPY9.97tn of which 37% was commercialized and 37% of that was online.

We believe commercialization ratio of Japan's reuse market shouldn't exceed 60% at the terminal year.

Exhibit 14. Japan reuse goods market size and share

JPY Bn	2016	2017	2018	2019	2020
Total reuse goods*	9,960	9,962	9,964	9,957	9,974
Commercialized reuse	3,869	3,792	3,717	3,650	3,642
Commercialize ratio	39%	38%	37%	37%	37%
Offline	3,000	2,800	2,615	2,444	2,285
Auto	2,000	1,900	1,805	1,715	1,629
Non-auto	1,000	900	810	729	656
Online	869	992	1,102	1,206	1,357
Auction	666	669	676	660	698
Flea market	203	322	426	546	659
Market share in online reuse					
Mercari	14%	20%	25%	30%	35%
Yahoo! Japan Auction	36%	32%	29%	26%	24%
Rakuma (Rakuten)	NA	NA	NA	NA	6.4%
Online penetration	22%	26%	30%	33%	37%

Source: Blue Lotus Research, METI (as of 3/18/2022) *Incl. ~25% attributable to auto.

Exhibit 15. Japan's reuse market size, 2020

	Percent become reuse in past year	Flea market price (K Yen)	Market size (bn Yen)
Furniture	21%	22	637
Apparel	21%	20	3,164
Baby/Kids	12%	2.3	178
Household	19%	7.6	993
Sports/leisure	12%	1.0	28
Books, Software, Media, Game, Toys	19%	3.6	1,997
3C	13%	5.8	443
Auto/motorcycle/parts	6.6%	23	186
Subtotal			7,626
Add: Auto offline			2,000
Auto online			314
Auto scrap			35
Total			9,974

Source: Blue Lotus Research, METI, MoE (as of 3/18/2022) 「平成 27 年度使用済製品等のリユース促進事業研究会報告書（平成 28 年 3 月）」

Positive and negative consequences of low reuse penetration

There are both positive and negative implications of our marketing sizing of the reuse market.

On the positive side, low penetration means more growth headroom for Mercari, which despite having 1/3 of its GMV being new goods, still leads its competitors in terms of used goods composition. We believe Mercari's used goods concentration is a differentiation that will continue to serve it in future competition.

On the negative side we believe the online reuse market is firmly divided along the merchandise and pricing mechanism lines. It will be difficult to break these lines to gain more market share.

- **Market segmentation is more pronounced along the merchandise line:** Almost half of YJA's listing is auto-related. YJA has cornered the used car and parts market, which to our estimate constitute about half of the entire reuse market. Only 2.6% of Mercari's listing were auto-related. Further, Japan's offline auction houses like Komihyo (2780 JP, NR), Daikokuya (6993 JP, NR) and SOU (9270 JP, NR) have cornered the luxury C2C market. In 2020, the combined GMV of Komihyo, Daikokuya and SOU were ~JPY150bn, or ~20% of Mercari's, by our estimate. All three have introduced online products;

Mercari's used goods ratio is 2x that of YJA, which will continue to serve as a differentiation.

But about half of commercialized reuse market is auto and YJA cornered the entire market.

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- **Market segmentation is less pronounced along the format line:** It seems not necessary to divide the C2C market into Auction and Flea Market as METI has done. As shown in Exhibit 9 and 10, YJA has both auction and fixed price even though it is called Yahoo! Japan Auction. Yahoo! Japan also has fixed priced new goods site such as Yahoo! Shopping and Z Holdings also has fixed priced new goods site such as Zozo Town. YJA actually has 2x the items under fixed price (flea market) than items under auction price.

Consumers don't seem to care whether it is auction of fixed price, used goods or new goods. It doesn't seem necessary to divide the C2C market into reuse and new since all reuse platforms sell a lot of new goods.

To this end, we believe three kinds of market shares make sense:

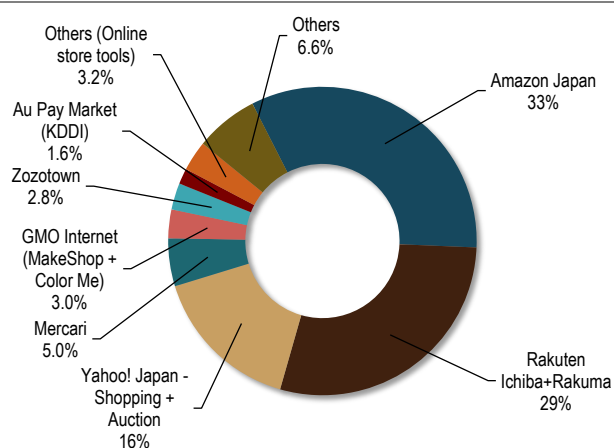
- **GMV market share in online reuse:** We estimate Mercari's market share in online reuse was 35% in 2020, comparing to 24% for YJA and 6.4% for Rakuma. Tracking the reuse market share makes sense because shopping reused items is the primary cause for visiting the site while new goods serve as an add-on to boost platform GMV;
- **GMV market share in e-commerce as a whole:** Mercari's market share in total e-commerce in Japan was only 5% as narrowly defined (Exhibit 16), ranking it below Amazon Japan, Rakuten and Yahoo! Japan by a wide margin. By narrowly defined, we remove the GMV's of online travel, online game/music/video, online catering and food delivery from METI's definition to make it compatible with normal definition of e-commerce. As shown, Mercari, GMO (9449 JP, NR) and Zozotown (3092 JP, NR) formed the 2nd tier platforms in Japan's e-commerce.
- **User base market share:** Mercari's respectable user base seems to suggest the reason for its low overall market share is its low shopping frequency, which is a common problem for e-commerce of the non-standard items. High frequency behaviour can be a driver for low frequency, but not vice versa.

Luxury reuse is a special market, thanks to wide user base of luxury items in Japan.

We do think it is useful to track the reuse portion of reuse platform GMV's because it is the primary reason users visit the site, even though they might end up buying new.

Our narrowly defined e-commerce is comparable with similar figures in China.

Exhibit 16. Japan e-commerce share, narrowly-defined, 2020



Source: METI, Blue Lotus Research (as of 3/18/2022). (1) Online store tools=Shopify-like site builders like EC-Cube and Futuresshop. (2) Rakuma is C2C subsidiary of Rakuten. (3) Narrowly-defined=Physical goods only (excl. travel, game, restaurant, food delivery, etc.)

Exhibit 17. China export to Japan and categories

(Rmb bn)	2017	2018	2019	2020	2021
China export to Japan	930	971	987	988	1,072
Among which general trade	49%	51%	52%	54%	57%
Within general trade					
Apparel	24%	22%	21%	19%	17%
3C & home electronics	1.3%	1.6%	1.6%	2.0%	1.9%
Furniture	4.8%	4.5%	4.6%	5.0%	5.5%
Toys	1.2%	1.2%	1.4%	2.0%	2.2%
Within general trade					
Apparel	108	110	111	101	106
3C	5.7	7.7	8.0	11	11
Toys	5.4	6.1	7.4	11	14
Mercari's GMV (used and new)					
Apparel	21	29	32	39	47
3C	3.5	5.4	7.3	10	13
Toys *	7.9	13	19	27	38

Source: METI, Blue Lotus Research (as of 3/18/2022). *Mercari's Toys category contains high ASP trading cards and likely contains books/media/game of which resale value is materially higher than import value.

Reuse and flea market both contributed to Mercari's rise

The question is how come Mercari has a sizable user base with such a low GMV market share. Can anything be done to improve Mercari's GMV market share?

We believe Mercari's success can be attributable to two factors: (1) it corrected YJA's mistakes, (2) it captured the tailwind of reuse in Japan. But these two factors cannot translate to sustained marketing share gaining drivers.

Auction is an alien concept in most Asian economies. It becomes the inception concept only because of eBay, which suited the early days of e-commerce in which transaction frequency was limited by logistics, payment and merchandise selection. YJA has its equivalent in China called EachNet, which was the predecessor of Alibaba's Taobao. EachNet once dominated China's early e-commerce.

This brings another topic, which is Japan Internet is both a beneficiary and victim of global Internet's empire building. A global empire still exists today in Japan, which is Softbank. Softbank used a series of alliances and investments to quickly corner the Japanese Internet market, leveraging Japan's weak enforcement of network neutrality to solidify its market position. Its business mix contains structures designed with convenience of the time in mind, leading itself vulnerable to new startups like Mercari. It then uses market power and financial leverage to stay in the game, impeding growth and suffocating innovation.

We believe Mercari is successful also because it captured the tailwind of environment awareness in reuse. Most reuse listco's were founded around Mercari's time frame, such as Poshmark (2011), Realreal (2011) and thredUP (2009) in US and SOU (2011) in Japan.

With Mercari being identified with reuse and C2C, we expect it to continue gain market share in online reuse through the capable management of its founder. However, we also don't expect it to dominate online reuse quickly because the driving forces behind Mercari's rise has largely depleted.

Most consumers don't have the time to sit out an auction.

Mercari is an innovator that spotted Yahoo! Japan's inefficiencies.

With its early driving force depleted, Mercari has been gaining share in Japan through stable and capable management comparing to its rivals.

Chinese merchants hold key to new goods but are hard to police

Another force that rose to correct eBay's mistake, on a global scale, is Amazon. Amazon's focus on standardized items with fulfilment capability fits well with high frequency shopping behaviors, which increasingly become the main stay of global e-commerce. In Japan, Amazon won by every day low price, efficiency logistics and wide selection of goods. Chinese merchants contribute greatly to Amazon's merchandise selection, which drives Amazon Japan to become Japan's No.1 in e-commerce. We estimate 30-40% of Amazon's 3rd party merchants are Chinese.

To compete against Amazon's direct sales and superior logistics, Japanese e-commerce platforms must win by merchandise selection. We believe the rising portion of general trade in China's export to Japan also pointed to Chinese new goods sold through the flea market format to be an important contributor. Unfortunately, associating with low quality Chinese goods is a value proposition that Japanese e-commerce platforms cannot partake. Reuse, being a community driven concept, is particularly vulnerable to this association, in our view. As such, based on our channel check, most Japanese e-commerce platforms choose to ignore the existence of Chinese merchants, which makes them even less competitive against Amazon Japan.

As Exhibit 17 shows, general trade within China's export to Japan has risen materially over the past five years, from 49% in 2017 to 57% in 2021. General trade (一般贸易) contains many finished products destined for the consumer market. Apparel occupies ~20% of China's general trade export

Chinese contributed merchandise selection, every day low price and superior logistics drive Amazon Japan to become No.1.

Reuse, being a community driven concept, is vulnerable to the association with low quality Chinese goods.

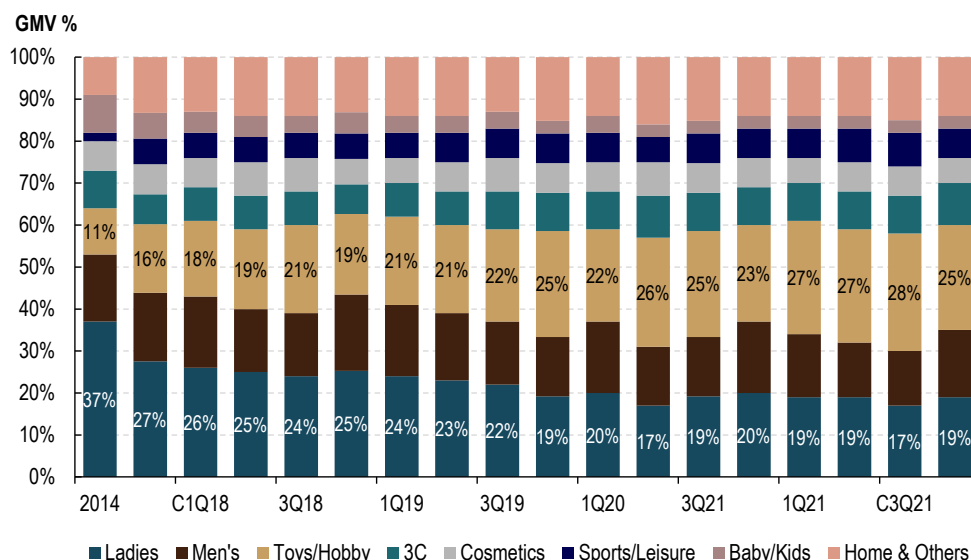
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to Japan but has been declining, replaced by categories like furniture, toys, plastic goods and electrical motors. We believe a large and rising chunk of China's general trade export to Japan showed up in e-commerce sites.

Based on our channel check, Chinese sellers account for 30-40% of B2B2C GMV in Japan, mostly selling on Amazon Japan and Rakuten. Chinese sellers have been increasingly selling in Mercari to take advantage of its user base. We estimate 20-25% of Mercari's GMV is sold by Chinese sellers. Mercari's GMV breakdown contains 62% of GMV in apparel, 3C, cosmetics and baby/kids, which has high concentration of new goods (Exhibit 18).

Advertising fee is the main difference between Amazon Japan and Mercari.

Exhibit 18. Mercari's GMV breakdown



Source: Mercari, Inc., Blue Lotus (as of 3/18/2022)

Exhibit 19 shows the estimated unit economics of Chinese sellers selling on Amazon Japan versus on Mercari. The key difference is Mercari doesn't charge platform advertising. Until 2020 it has been displaying products chronically. Such practice favors individual sellers but are unfriendly to merchants and professional sellers. Striking a balance is a tall order.

On the other hand, administration and salary cost for sellers are higher for Mercari because Mercari only allows sellers to list one inventory a time. Again this is a feature that discourages professional sellers.

Despite these restrictions, we believe the influx of new good merchants, mostly Chinese, have helped Mercari, in bringing more choices to the consumers. Yet like on Amazon, Chinese merchants also bring challenge to the user experience. In C4Q21, Amazon launched a worldwide crackdown on fraudulent promotional practices by Chinese merchants, leading to many to bankrupt. According to our channel check, despite so, most still expressed little interest to shift their operation to Mercari or Rakuten. Amazon remains their top choice.

On the other hand, complaints of counterfeit and other fraudulent behavior on have been commonplace on Mercari. Take counterfeit as an example, we found a brand-new Tommy Hilfiger Puffer Bumbag listed on Mercari for JPY6,000 while the same fanny pack on Tommy's official

Chinese merchants bring in the GMV, but also many customer complaints. Amazon's approach is actively support and active police, while Japanese e-commerce sites largely ignored.

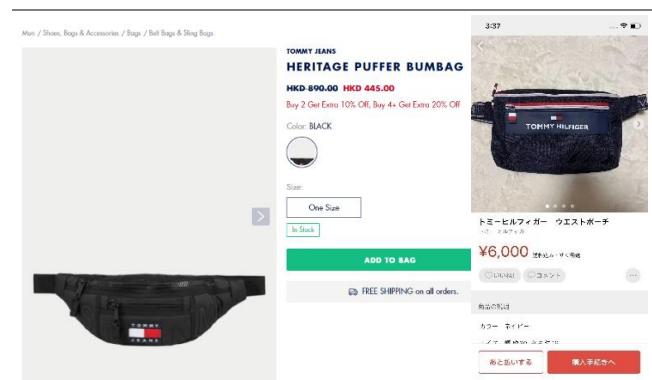
store to be JPY10,200 (Exhibit 20). As a reuse site, Mercari's counterfeit control has been minimum. But with 1/3 of its merchandises being new, it should not be.

Exhibit 19. Unit economics of Amazon Japan and Mercari

(RMB)	Amazon Japan	Mercari
Selling price (mark up 1.5x)	100	100
COGS	(40)	(40)
Import tax (10% of selling price)	(10)	(10)
Gross margin	50	50
Warehouse + operating fee	(2.0)	(2.0)
Delivery	(16)	(16)
Platform registration fee	(1.0)	-
Platform fees	(10)	(10)
Return	(2.0)	(2.0)
Advertising	(3.0)	-
Administration+ salary	(4.0)	(8.0)
Net profit	12	12
Net margin	12%	12%

Source: Blue Lotus (as of 3/18/2022)

Exhibit 20. Counterfeit on Mercari



Source: Mercari, Blue Lotus (as of 3/18/2022)

Our channel check with Chinese merchants in Japan suggested that Japanese e-commerce sites have largely ignored their existence. They neither encourage, nor discourage, Chinese merchants from doing business on their sites. In this regard Amazon's activist approach has worked better than Japanese e-commerce sites' passive approach. By activist approach, we mean the platform actively improve and perfect merchant experience in doing business but at the same time also actively crack down on fraudulent behavior. We believe the activist approach contributed to Amazon's success.

Chinese e-commerce export to Japan will grow

China's online imports take the form of consumer orders placed directly on Japanese sites and shipped across border. Japan's online imports, on the other hand, also take the form of consumer orders placed directly on Japanese sites, but through Chinese merchants. This leads to Japan's exports to China take the form of individual parcels while China's exports to Japan take the form of general trade between trading houses.

In 2021, China's export to Japan amounted to Rmb1.07tn with imports from Japan reaching Rmb1.33tn (Source: China Customs). China also exports to Japan through Hong Kong, which in 2021 amounted to HK\$118bn (Rmb 98bn). Japan also exports to China through Hong Kong, which in 2021 amounted to HK\$208bn (Rmb173bn). Adding together, China ran a deficit of Rmb333bn with Japan in 2021, representing a deficit ratio (deficit over total trade) of 12%. This ratio has steadily gone up over the years (Exhibit 21), thanks to faster growth of imports.

However, according to METI, the deficit ratio was 97% (Exhibit 22), i.e., Japan exports a lot to China while China exports a little to Japan. The trade balance is vastly different between online and offline.

In fact, there isn't much difference. We attribute this discrepancy to METI's narrow definition of cross-border e-commerce as those involving a direct order placed on a foreign web site. Indeed, if we add up METI's definition of import and export between Japan and China, it only amounts to 14% of the total trade between Japan and China while we know 58% of China's trade with Japan took

China's export to Japan takes different form from Japan's export to China.

We found the trade balance between online and offline aren't that different.

METI undercounted cross-border e-commerce GMV that is shipped to the destination country first and then sold.

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the form of general trade (*Source: China Customs*). The gap of 44% cannot be explained by offline alone.

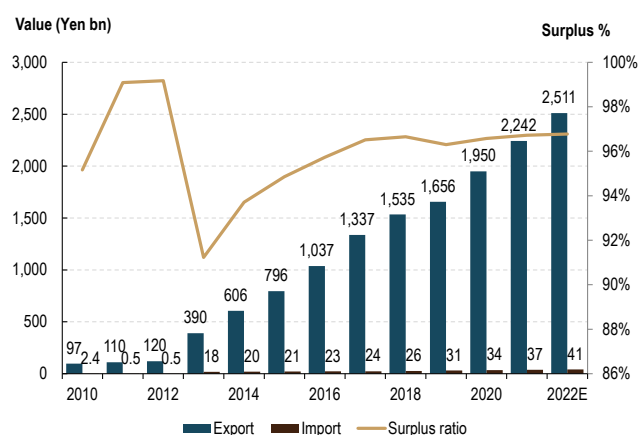
This difference, in our view, comes about due to Chinese consumers' habit of buying Japanese products directly from Japanese web sites or through duty-free channels, thereby resulting a cross border parcel captured by customs, while Japanese consumers like to buy Chinese products also from Japanese web site, supplied by Chinese merchants, which cross the customs in the form of general trade. This situation comes about because Chinese goods and Chinese web sites are deemed inferior and untrustworthy by the Japanese consumers while Chinese consumers also agree. The real deficit between Japan and China, both online and offline, isn't that different from the overall deficit of ~12%.

China also exports a lot to Japan through online channels.

Exhibit 21. China export/import to/from Japan and surplus/deficit, online and offline

(Rmb bn)	2015	2016	2017	2018	2019	2020	2021
China/Japan S/D	(46)	(110)	(190)	(220)	(197)	(221)	(258)
Export	842	853	930	971	987	988	1,072
Import	888	963	1,120	1,191	1,184	1,209	1,330
HK/Japan S/D	(97)	(89)	(99)	(92)	(71)	(58)	(64)
Domestic export	0.9	1.0	0.8	0.8	0.7	0.6	0.6
Domestic import	97	90	100	93	72	59	65
HK reexport	(27)	(31)	(23)	(33)	(43)	(55)	(75)
Reexport to Japan	101	96	106	107	100	91	98
Reexport to China	128	127	129	140	143	146	173
China/Japan adj. S/D	(72)	(141)	(213)	(253)	(239)	(276)	(333)
Export	944	949	1,036	1,078	1,087	1,079	1,171
Import	1,016	1,090	1,249	1,331	1,327	1,355	1,503
S/D as total trade	(3.7%)	(6.9%)	(9.3%)	(11%)	(10%)	(11%)	(12%)

Exhibit 22. China e-commerce export/import to/from Japan, narrowly defined by METI



Source: China Customs, HK CENSTATD, Blue Lotus Research (as of 3/18/2022). HK export Source: Blue Lotus Research, METI (as of 3/18/2022) can be divided by domestic export + reexport. HK import can be divided by domestic consumption+reexport to China. S/D=Surplus/Deficit

Can Mercari continue to gain market share in online reuse?

From 2016 to 2021, GMV of YJA grew at a CAGRA of 2.6% while that for Mercari grew 36% CAGR. Mercari likely gained market share over both YJA and Rakuma. Mercari's success has drawn the attention of Z Holdings and Rakuten. We estimate Mercari's online reuse market grew from 17% in its FY17 to 36% in its FY21. We expect Mercari to cross 40% market share in its FY26.

Mercari has roughly doubled its GMV market share in the last four years. But we expect it to gain only 4ppt share in the next five years.

As aforementioned, Mercari's success can be attributable to the following factors:

- Rise of online reuse market in Japan:** Mercari was founded in 2013, much later than its competitors Rakuten Ichiba (1997), Amazon Japan (2000) and YJA (1999). At the time of Mercari's founding, environmentally responsible consumption has become commonplace. Young Japanese are not ashamed at buying used goods. Luxury goods purchased during the bubble era started to surface in the reuse market;

- **Flexible category focus:** Women's apparel used to take up 37% of Mercari's GMV in 2014. Today it was only 25%. Discount women's apparel is an e-commerce category that has proven fertile worldwide, as evident by Etsy (ETSY US, NR), Poshmark (POSH US, NR), thredUp (TDUP US) and RealReal (REAL US, NR) in US, Alibaba (BABA US, HOLD, US\$102) and Vipshop in China. Mercari benefited from apparel in its early days but recently toys and trading cards have been the driving force behind the GMV growth.
- **Local entrepreneurship:** Founder Shintaro Yamada successfully spotted the opportunity left by global giants in meeting the local demand. Mercari made it very easy for individual buyers and sellers to engage in its site;
- **Rise of mobile Internet:** Mercari's mobile app was launched in July 2013, comparing to Rakuten's February 2011, Rakuma's June 2012 and Amazon Japan's June 2010. Mercari has the advantage of pursuing a mobile-only strategy while its rivals cannot.

Mercari benefited from apparel. But recently virtual goods like trading cards have been driving the growth.

Mercari's future market share gain will slow in our view.

Can Mercari continue to gain market share in online reuse? We believe it can, as long as it stays focused in the market. But as the early driving forces starting to deplete, we expect the pace for share gain to slow.

Tapping innovation is Mercari US's challenge

US has been Mercari's only and major overseas destination, opened just one year after its founding. Even though Mercari was helped by COVID-19 starting from C2Q20, the same help was observed in other hobby/collectible platforms. As the COVID effect starting to wear out, Mercari US still faces material losses with growing complicated competitive landscape. Further investment in US might impact Mercari's profit margin, in our opinion.

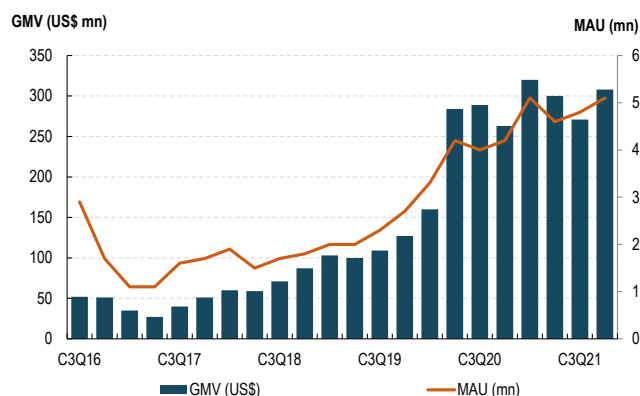
Positive COVID-19 impact boosted GMV and cut losses

Mercari US's GMV achieved a step change in C2Q20, when COVID-19 hit (Exhibit 23). The resulted spike in GMV growth was also observed in hobby/collectible platforms like ETSY and eBay (Exhibit 24) but not observed in apparel sites like Poshmark and thredUP, as well as luxury sites like Realreal. We speculate that both buyers and sellers stayed at home to pursue their hobbies at that point of time. After C2Q20, growth decelerated materially.

On the positive side, Mercari US seemed to have successfully maintained its GMV level and even continued to grow MAU (Exhibit 23). We estimate its operating loss margin has also shrunk from (150-300%) to ~(-30-70%). The narrowed loss at Mercari US helped Mercari to post five straight quarters of operating profit for the first time in its history.

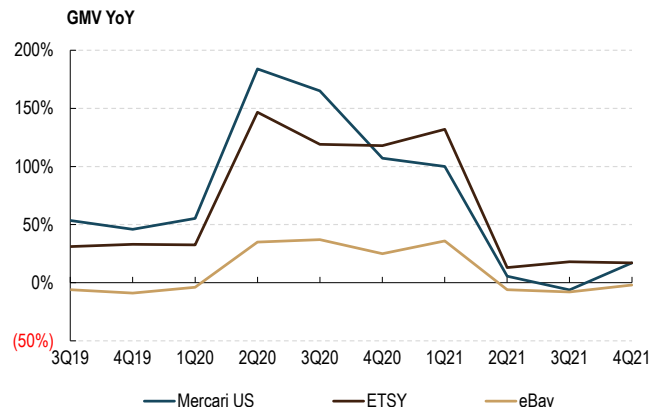
COVID pandemic helped Mercari to grow its GMV and cut its losses.

Exhibit 23. Mercari US GMV and MAU trend



Source: Mercari, Blue Lotus Research (as of 3/18/2022)

Exhibit 24. GMV growth trend, US hobby/collectible sites



Source: Mercari, ETSY, eBay, Blue Lotus Research (as of 3/18/2022).

But Mercari US's competitive position is not optimistic

The question is: can it sustain?

We doubt. Despite Mercari came to US at an opportune time, it has missed out several important innovations in the US market. Further, the IPO's of fashion reuse marketplaces Poshmark, thredUP and Realreal have spurred further venture investments into the reuse market. These upcoming players are:

- **Sportswear reuse platforms GOAT and StockX:** Both founded in 2015. Both have raised venture fundings valuing the companies at US\$3.8bn and US\$3.7bn, respectively as of April and June 2021. GOAT's reportedly exceeded US\$2bn in GMV TTM to July 2021. StockX announced its 2020 GMV exceeded US\$1.8bn. Mercari US's CY2021 GMV was US\$1.2bn;

Mercari US is likely not in the top 10 of US online reuse market in terms of GMV.

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- **Apparel reuse platform Vinted:** A Lithuania-based second-hand fashion marketplace, Vinted is now Europe's largest apparel reuse platform. It recently raised Series F funding valuing it at EUR3.5bn;
- **Apparel reuse platform Depop:** In June 2021, ETSY bought UK-based apparel reuse platform Depop for US\$1.6bn.

Besides the new start-ups, the mid-sized camp in online reuse has transformed in the past five years:

- **ETSY and Offerup have risen to a level to challenge eBay.** Both have reached quarterly GMV run rate of US\$2-3bn and MAU of tens of millions, by our estimates (Exhibit 25);
- **Facebook Marketplace and Amazon Warehouse both offer second hand goods:** Amazon offers returned goods for resale under the <Amazon Warehouse> program. Facebook Marketplace also contains many used goods for sale;
- **eBay and Craigslist are losing market shares but are still substantial:** The PC era leaders of the reuse market in US have lost their touches. Despite so, eBay's US GMV of US\$9.7bn a quarter still dwarfs its challengers.

The rise of US reuse market suggests that the awakening of reuse commerce is not confined to Japan. It is a global phenomenon.

By our estimates, Mercari's US GMV cannot break into the top 10 list in America's reuse market (Exhibit 25).

Exhibit 25. Competitive landscape of online reuse market in US, C4Q21

(mn, US\$mn)	Mercari US	Poshmark	thredUP	Realreal	GOAT	StockX	Vinted	Etsy	Offerup	Facebook Marketplace	eBay	Craigslist
Focus Area	General	Apparel and home	Apparel	Luxury	Sportswear	Sportswear	Apparel	Homemade or vintage	Auto, furniture, 3C	General	General	General
Business model	Flea market	Flea market	Consignment	Consignment	Flea market	Flea market	Advertising	Flea market	Flea market	Flea market	Auction	Flea market
MAU	5.1	NA	NA	0.772	NA	NA	NA	86	20	NA	NA	NA
GMV	308	443	NA	437	~800	~800	~500	2,352*	~3,000	NA	9,724	NA
Active buyers, TTM	NA	7.3	1.4mn	0.80	NA	NA	45	50	NA	NA	69*	NA
Year founded	2013	2011	2009	2011	2015	2015	2008	2005	2011	2016	1995	1995

Source: Company, Blue Lotus (as of 3/18/2022) *US only

Stay ahead in US requires constant maintenance

Retrospectively, we believe Mercari's overseas expansion is best applied on newly industrialized markets which lag behind Japan's environment awareness by 2-4 years. We also believe the reuse market can better grow in relatively income dispersed countries so that lower-income households can buy the second-hand goods from their next high-income cohorts.

As shown in Exhibit 26, household income distribution in Japan is evenly spread out, reflecting Japan as an egalitarian society. The US, on the other hand, has a more concentrated income profile while China has two income peaks. While all three can produce meaningful reuse markets, their working mechanism might be very different, in our view.

For example, apparel resale has caught up in rapid fashion in the US. thredUP estimated US apparel resale market reached US\$15bn, with another US\$21 sold through thrift stores and donations. Donating clothing has been existent in American communities for a long time, a process that moves

The US has middle class and the superrich. China has the middle class and the super poor. But Japan's household is relatively dispersed.

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goods from middle class to low income. Online reuse just migrates the GMV taken place in thrift stores and donations to online.

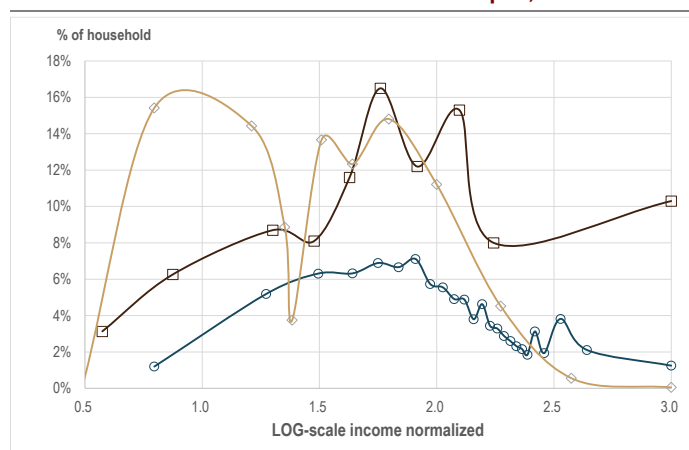
Apparel reuse in US traces its roots to social welfare s as well as commercial motivations. Buying secondhand clothing reduces carbon emission by 82%, according to thredUP. Environment-awareness and cost consciousness are driving female shoppers in these countries away from department stores and fast fashion to reuse (thredUP, Poshmark, etc.), rent (Rent the Runway, Nuuly, etc.) and subscription (Stitch Fix, Trunk Club, etc.). As a foreign company, Mercari found itself hard to tune in to the latest pulses of reuse driving forces, in our view.

Mercari estimated total value of reuse market was US\$580bn in US, of which US\$140bn was commercialized, in 2020. We estimate the total value of reuse market was JPY10tn (US\$92bn), of which JPY3.6tn (US\$34bn) was commercialized in 2020. The US reuse market was 6.3x of Japan in 2020, which is why Mercari has chosen US as its first market to enter one year after its founding.

Having a social agenda is important for a reuse category to kick off.

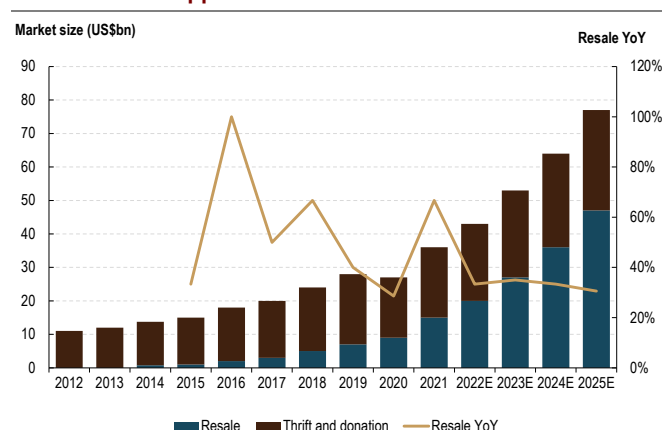
Mercari has chosen to tap the US market because total addressable market in US is ~6.3x of Japan.

Exhibit 26. Household income distribution Japan, US and China



Source: NBS, E-STAT, USCB, Blue Lotus Research (as of 3/18/2022)

Exhibit 27. US apparel resale market size



Source: thredUP, Blue Lotus Research (as of 3/18/2022).

However, under the market potential viewpoint, the conclusion may not be as straightforward. The markets of South Korea, Taiwan and Hong Kong have a total population 2/3 of Japan's. If we add the relatively developed markets of Southeast Asia, which are Singapore, Malaysia and Thailand, another 85% of Japan will result. Will they be better markets to tap than US? From a long-term perspective, we believe so.

Consignment model poses a threat in apparel to Mercari

One of the business innovations Mercari US has missed is apparel consignment. Within secondhand apparel thredUP and Realreal use the consignment model, with great success. Consignment model isn't new. Vipshop in China operates the consignment model under the business-to-business setting. So does Zozotown (Z Holdings) in Japan. But thredUP and Realreal take inventory directly from individual consumers, which means their operations require substantial community support. In a consignment model, the sellers send to the platform their cloths and the platform keeps them as inventory. If the cloth is successfully sold, the platform remits to the customer a portion of the selling price. If the cloth isn't successfully sold, the customer pays a fee to take the inventory back. Platform pays the buyer delivery cost.

In consignment model the platform performs logistics, photo taking and customer service in exchange for a revenue share with no inventory commitment.

The key advantage of the consignment model is that the platform owns the pricing without committing to the seller a fixed selling price. Therefore, the platform has the freedom to take price action to get the item sold while at the same time it also has the incentive to sell the item at the highest possible price to maximize its share. The platform and the seller share the inventory risk, with the platform being responsible for promoting the sales and deliver the goods. Such arrangement is ideal for merchandises whose value is hard to assess while the seller wants to move the item as soon as possible.

The consignment model has already proven working in Vipshop in China and Zozotown in Japan. It has also been working in offline luxury reuse stores like Komehyo, Daikokuya and SOU in Japan. However, reused apparel only accounts for <5% of Zozotown GMV and has been declining in contribution. We believe personal privacy is likely the reason behind slow adoption of apparel reuse in Japan.

Uncertain value and “can’t sit” are two defining characteristics of merchandises suitable for consignment.

The popularity of apparel reuse in US hasn’t found its resonance in Japan, despite familiarity with consignment as a business model.

Mercari is facing challenge in Japan, too

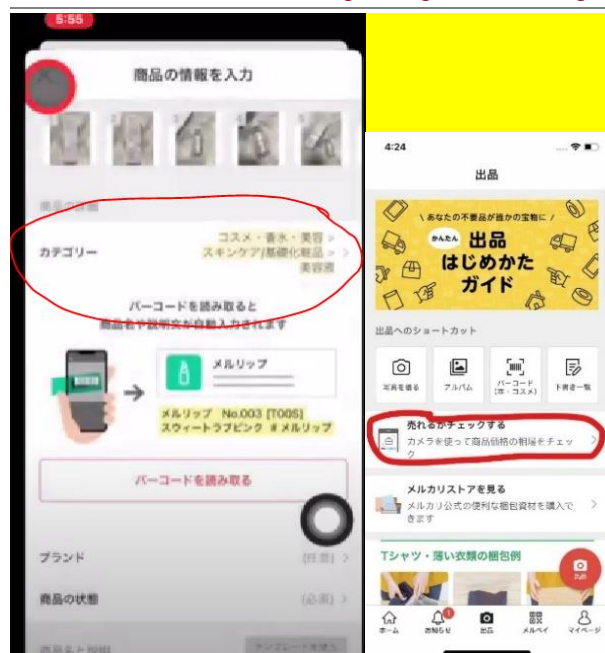
We found Mercari to have unique advantages in logistics, payment and user interface in Japan. Further, we believe reuse will increasingly become an identifiable brand tag to differentiate Mercari and defend its market share, despite the renewed attacks from Z Holdings and Rakuten.

Mercari's many differentiations are unique to Japan

- **Fast listing:** Mercari provides various tools to help individual sellers to list their merchandises, including a barcode scanning feature and a camera image recognition feature (Exhibit 28) to automatically populate a merchandise item and its suggested price. The later is unique among Japanese online reuse platforms, based on our observation. We, however, also believe this is feasible also because the overall SKU in Japan's consumption landscape is few;
- **Convenient and fast pickup and shipping:** Japan has a unique express delivery + convenience store infrastructure for the last mile. All e-commerce platforms collaborate with convenience stores, which is more critical for online reuse because convenience stores solve the pickup problem. Mercari went one step further. In 2020, Mercari launched Mercari Post in collaboration with Yamato Transport, Japan's largest door-to-door delivery service. Mercari Post is an unmanned mailbox for sellers to ship merchandises sold on Mercari after printing a shipping label at the Post. Currently Mercari has 1,062 Mercari Posts in Japan, with a goal to reach 5,000. Rival Yahoo! Japan tried to collaborate with SMARI, a subsidiary of Mitsubishi to install similar devices but now SMARI is carrying Mercari, too;

Mercari's user experience is tightly integrated with Japan's urban life.

Exhibit 28. Barcode and AI image recognition in listing



Source: Mercari, Blue Lotus Research (as of 3/18/2022)

Exhibit 29. Mercari Post and Mitsubishi Smari



Source: Mercari, Mitsubishi, Blue Lotus Research (as of 3/18/2022)

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- **Anonymous buyers and sellers:** Mercari, as well as other Japanese e-commerce platforms, allows anonymity between the buyers and sellers, which creates an entry barrier to new comers.

Exhibit 30 compares the product features of Mercari, Rakuma, Yahoo! Japan Auction and PayPay Flea Market (both Z Holdings). Launched only in C4Q19, Z Holding's latest entry, PayPay Flea Market, was the latest competitor in Japan's online reuse market. As we can see, PayPay Flea Market has a comprehensive set of features.

Leveraging its dominance in mobile payment, Z Holdings' PayPay Flea Market is a new competitor to Mercari.

Exhibit 30. User experience comparison, Japanese online reuse

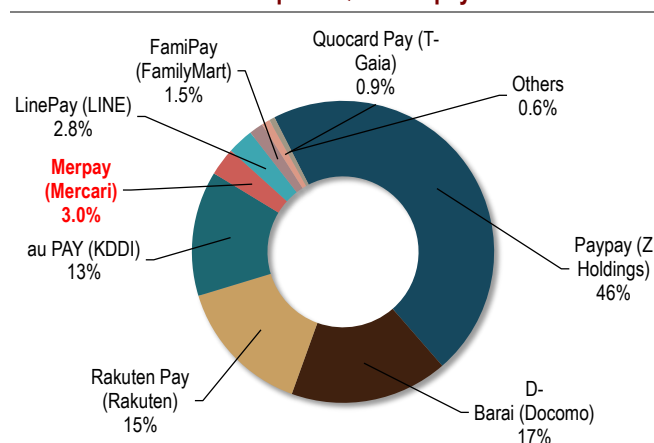
Category	Details	Mercari	Rakuma	Yahoo Japan Auction	PayPay Flea Market
Merchandise picture taking	Smartphone camera	✓	✓	✓	✓
	Smartphone gallery	✓	✓	✓	✓
	Barcode scan	✓	-	-	✓
	Video capture	-	-	-	✓
Merchandise details	AI selection	✓	-	-	-
	Automatic dimensioning	✓	-	-	-
	Brands recognition	✓	✓	-	-
	Product condition	✓	✓	✓	✓
	Description template	✓	-	-	-
In-house logistics		✓	✓	✓	-
Pricing	Reverse auction	-	-	-	✓
	AI suggested price	✓	-	-	-
	Auction	-	-	✓	-
	Negotiation	-	✓	-	-

Source: Mercari, Rakuma, Z Holdings, Blue Lotus (as of 3/18/2022)

O2O payment is made more important by cash's role

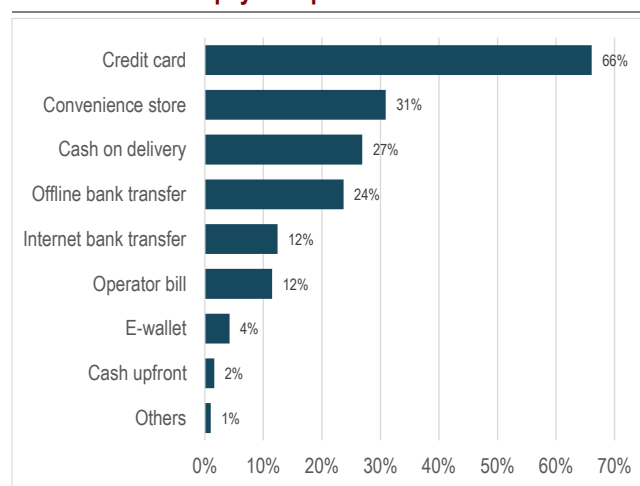
Similar to Alibaba's AliPay, Z Holdings' PayPay enjoys the strategic flexibility to enter many fields after it secured a dominant market share in Japan. In 2021, PayPay captured a 46% market share in Japan's QR Code payment industry (Exhibit 33).

Exhibit 31. The most frequent QR Code payment solution



Source: MMD, Blue Lotus (as of 3/18/2022)

Exhibit 32. Mobile payment preferences



Source: MIAC, Blue Lotus (as of 3/18/2022), N=1,633. Multiple choice allowed

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According to Ministry of Internal Affairs and Communications (総務省), credit card remained the most preferred payment method for e-commerce in Japan, with e-wallet used by only 4% of the people surveyed (Exhibit 32). Like in most developed countries where cashless payment has been well established before the arrival of e-commerce, Internet or mobile doesn't offer a chance to establish the market position of the payment solution of the e-commerce platforms.

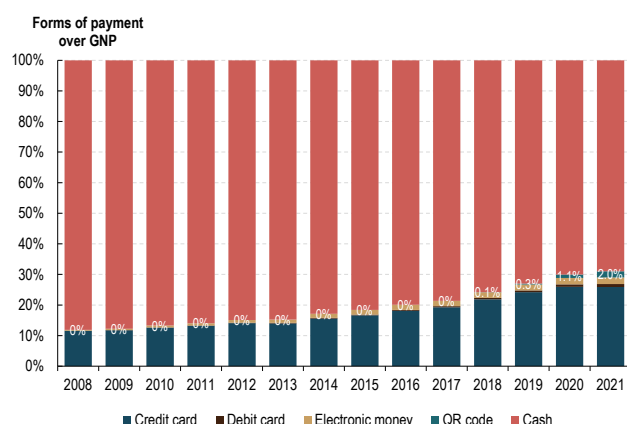
But QR Code Payment can. We believe the strategic importance of QR Code Payment is that it is a face-to-face payment that substitute the scenario of cash. By using QR Code Payment the operator is able to insert two payment steps (scan and pay) and link up merchants with customers. In other word, QR Code Payment in O2O is an Internet product while credit card payment in e-commerce is not.

According to Payments Japan Association, MAU of QR Code payment rose from 3.5mn in 2018 to 43mn by C2Q21, with transaction value growing from just JPY173bn in 2018 to JPY3.5tn in the first half of 2021 (Exhibit 35). We estimate QR Code payment as percentage of Japan's total consumption has risen from 0.3% in 2019 to 1.1% in 2020 and likely to 2.0% in 2021 (Exhibit 33). Its share in cashless payment has risen from 1.2% in 2019 to 4.7% in 2020 and to 8.3% in 2021. We believe COVID pandemic quickened the adoption of cashless payment forms like QR Code payment.

Payment is less relevant for e-commerce in developed countries because most already have credit cards. But O2O is.

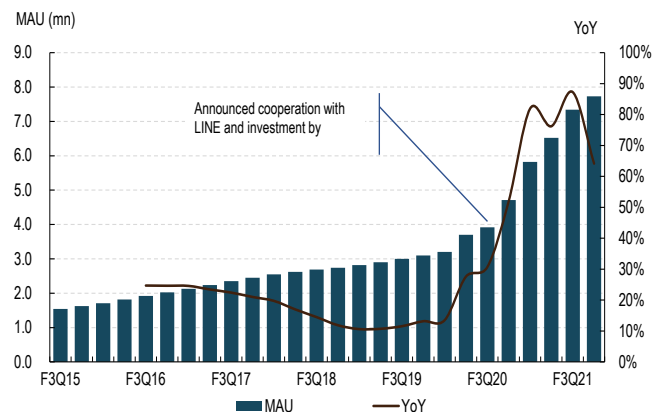
Because cash retains a persistent role in Japan, O2O payment actually has a bigger role. QR Code payment is winning the day.

Exhibit 33. Japan personal consumption payment methods



Source: MMD, Blue Lotus (as of 3/18/2022)

Exhibit 34. Demacan's MAU growth



Source: PJA, Blue Lotus (as of 3/18/2022)

Exhibit 35. Growth of QR Code payment in Japan

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	2018	2019	2020
MAU (mn)	27	29	30	36	43	43	3.5	19	36
Transaction value (JPY bn)	891	1,023	1,099	1,303	1,605	1,879	173	1,168	4,316
Store purchase	863	985	1,053	1,250	1,536	1,801	165	1,121	4,151
Money transfer	28	38	46	53	69	78	8.3	47	165
Transactions (mn)	548	601	744	865	985	1,207	54	829	2,758
Store purchase	540	591	732	851	967	1,186	52	816	2,714
Money transfer	7.6	10	12	14	18	21	2.6	13	44

Source: PJA, Blue Lotus (as of 3/18/2022)

Merpay's lack of presence will present some problems

Apparently Merpay's 3-5% market share in the rapidly growing QR Code payment market is a problem, especially given its rival Z Holdings, Yahoo! Japan's parent, owns the dominant player PayPay, who has actively pursued the reuse market through PayPay Flea Market. Further, Z Holdings, through its merger with LINE Japan, has owned Demaekan, Japan's leading food delivery operation. We can foresee Z Holdings using subsidies to drive adoption of PayPay, like Alibaba and Tencent have done through Meituan and Didi in 2014-16. Once PayPay establishes a bigger market presence, Z Holdings will use PayPay to expand further into all e-commerce markets. In January 2021, Mercari acquired QR Code Payment provider Origami. But without aggressive subsidies and marketing, the combined Merpay/Origami quickly lost ground.

PayPay's success gives Z Holdings some, but not a lot of, support to extend to the upstream e-commerce markets.

Softbank's and Rakuten's big plans may impact Mercari

Food delivery and ride hailing require significant consumer subsidy to form consumer habits. In China, this investment was made possible by the competitive needs of the payment platforms, in China's case it was AliPay and TenPay. Alibaba and Tencent stood behind Didi and Meituan in consolidating the markets. Earlier pioneers who could not adapt to the speed of change, such as Dianping and Kuaidi, disappeared.

We believe such is likely the story Z Holding is trying to unfold in Japan. Demaekan (2484 JP, NR) was Japan's leading food delivery courier founded in 1999. Without subsidy, growth was stable but in the low teens, gradually losing market share to Uber Eats (Exhibit 34). In C3Q20, Z Holdings and Naver jointly acquired 47% of Demaekan and replaced its CEO with a LINE employee. In C4Q20, Z Holdings merged with Naver's Japan business, LINE, which was created out of Hangame Japan, Livedoor and Naver Japan, with presences in Thailand, Taiwan and Indonesia. With Z Holding's investment, Demaekan became a player also in the food delivery scene of Southeast Asia.

Z Holdings and Naver merged to compete against global Internet giants with Softbank and Naver behind as major shareholders.

Following Z Holdings and Naver's investment, Demaekan's MAU and GMV growth accelerated. In F4Q21 (end November), Demaekan's GMV grew 59% YoY with MAU growing 64%. In C2Q21, KDDI invested in Japan's 3rd largest food delivery app, MENU. KDDI's QR Code Payment app, au Pay, had a market share of 13% in 2020.

Like KDDI, Japan's telecom carriers (telco's) have made inroads into Internet and vice versa. In C1Q20, Rakuten chose to enter mobile communication as Japan's 4th mobile after NTT Docomo, Softbank and KDDI, answering a call by Japanese government to lower the mobile tariff in Japan. Prior to that Rakuten was Japan's 3rd largest food delivery player and also the 3rd largest QR Code Payment vendor.

Z Holdings' plan to leverage PayPay requires it to invest and grow PayPay first, which means substantial subsidy ahead.

Strong ties between telecom carrier (telco) and Internet service providers (ISP) have historically existed in Japan. But we are afraid the war between Softbank/Z Holdings and Rakuten will intensify. We notice that Softbank's net debt has increased from JPY2.2tn in C2Q20 to JPY5.3tn in C4Q21. Rakuten's debt also increased 79% (~JPY1.5tn) from the quarter it launched Rakuten Mobile (C1Q20) to C4Q21.

If Z Holding and Rakuten successfully emerge from their investments to raise the adoption of mobile payment in Japan, we foresee them trying to translate their payment clout to a wide array of e-commerce segments, which will negatively impact Mercari.

We, however, doubt QR Code payment dominance can be easily translated to the reuse ecosystem.

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Mercari's response may be enough to defend its turf

Mercari's response, based on our observation, was to relaunch its B2B2C business, Souzoh (ソウゾウ) in January 2021. From our observation, the main change of this Souzoh relaunch is to make it easier for merchants to do business on Mercari. The major changes are:

- **Introducing the setting of inventory:** Mercari C2C only allows sellers to sell one inventory at a time. Souzoh introduced the setting of inventory;
- **Support CSV and Excel upload of product listings:** This allows professional sellers to manage their inventory and help Amazon and Rakuten sellers to list easily on Souzoh, in addition to encouraging existing Mercari user to try to become professional sellers.

Mercari's support of professional sellers is still very preliminary.

Based on our observation, Souzoh is a backend initiative, meaning storefronts under Souzoh is listed on Mercari's main platform, but from our observation, without visible tagging. In our view, the supporting measures so far lags far behind other general e-commerce platforms and thus constitute only a baby step towards B2B2C. We further doubt Mercari's commitment because so far we haven't seen major investment on logistics. We believe logistics will be a main challenge for Souzoh. We view Souzoh as more a defensive, gestural measure to protect GMV market share rather than an offensive measure to accelerate growth.

We believe Z Holdings' advancement in QR Code Payment and food delivery may not directly impact Mercari because:

- **QR Code Payment is an offline O2O method while Mercari is online:** Z Holdings can benefit from PayPay's brand recognition but PayPay must first translate its QR Code Payment dominance to e-commerce dominance, especially for payments made outside of Z Holdings' ecosystem;
- **Payment's postposition nature means its influence on front end e-commerce is limited:** We notice that even though AliPay has become China's 2nd largest mobile app, its ability to foster a front-position e-commerce ecosystem is far inferior to WeChat. The reason is social happens before e-commerce while payment happens after e-commerce.

Payment's ability to influence consumer's choice of e-commerce is limited because it happens after e-commerce.

Logistics and cannibalization will impede B2B2C ambition

As aforementioned, a sizable GMV on Mercari is already B2B2C. Relaunching Souzoh is going to cannibalize Mercari C2C. The question is how much.

If Souzoh focuses on brand merchants, cannibalization will be small. If it focuses on SME merchants, cannibalization will be significant.

However, catering to brand merchants also means substantial investment in logistics, which will become a new challenge for Mercari. C2C platform doesn't need to consider logistics. Buyers and sellers take care by themselves. Leveraging Japan's general postal system and the ubiquitous convenience store presence, Mercari's logistics investment has been so far cosmetic. But it will not be case if it seriously wants to pursue B2C or B2B2C.

B2C platforms like Amazon and JD.com make substantial investments in logistics to ensure speed of delivery and control of the inventory. Amazon opened its first fulfilment centre in Chiba Prefecture in Japan in 2000. Since then it has expanded to 18 fulfilment centres with a floor space

Does Mercari want to become Taobao or Tmall? It means different in terms of logistics requirements.

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of 8.1mn ft² (Exhibit 36). Since 2016 Amazon has further opened 9 Prime Now Hubs for its premium members.

Ten years after Amazon opened its first fulfilment centre, Rakuten realized the importance of logistic facilities to even B2B2C and opened its first distribution centre in 2011 in Chiba Prefecture. In 2012, Rakuten acquired French-based ADS and in 2013 US-based Webgistix and then renamed its logistic arm to Rakuten Super Logistics (RSL). In 2019, RSL acquired US-based FirstMile and IFS360. The capex investments, together with Rakuten's entry into mobile communications, crushed its balance sheet. In 2019, Rakuten formed a 50:50 JV with Japan Post called JP Rakuten Logistics to merge its Japan logistics assets to the JV. We took it as a signal that even a mammoth like Rakuten cannot sustain a strategy to invest in both mobile communication and logistics infrastructure. Today, Rakuten operates 6 fulfilment centres in Japan and 12 in US.

With the success of Fulfilment By Amazon (FBA), even B2B2C must build fulfilment centers.

Exhibit 36. Amazon's logistic facilities in Japan

	2013	14	15	16	17	18	19	20	2021
Fulfilment Centers	11	10	10	10	9	10	15	18	18
Active area (mn sq. ft)	3.6	6.2	6.2	6.1	6.1	6.1	6.8	8.1	8.1
Prime Now Hubs				8	4	7	9	9	9
Active are (mn sq ft)				0.02	0.02	0.08	0.31	0.31	0.31

Source Amazon, Blue Lotus (2022/3/8)

Exhibit 37. Rakuten's six fulfilment centres in Japan



Source: Rakuten, Blue Lotus (2022/3/8)

Crypto investment makes sense, but at early stage

In April, 2021, Mercari established Mercoin as a subsidiary to facilitate the payment of Mercari platform using crypto currency as well as the transaction and investment of virtual assets. In August 2021, Mercari acquired crypto-security provider Basset.

We believe Mercari realizes its value is to provide a marketplace for various kinds of assets. From 2016, the contribution of Toys/Hobby category to Mercari's GMV has been constantly on the rise. A major category of toys is the trading cards, game cards and other kinds of collectibles and souvenirs. Such items further break the culture boundary between US and Japan.

Crypto assets fit the same criteria, in our view, and is truly global in transaction, therefore represent a good category for Mercari. However, we view Mercari's crypto investment as part of its overall strategy towards payment and fintech, which after the failure of Merpay, still lags overall comparing to its rivals.

Crypto constitutes part of Mercari's payment/fintech strategy.

Valuation and peer analysis

Mercari's valuation is favorably disposed according to consensus but not so by our estimate. We expect Mercari to post an operating loss of JPY(1.15)bn in FY22 (ending June 2022) while consensus expect Mercari to post a profit of JPY5.16bn. In F1H22, Mercari had an operating loss of JPY(1.8)bn mainly due to surging SG&A cost in Mercari US. We believe Mercari US's improvement starting C2Q20 was a result of COVID lockdown leading to Americans staying at home and engaging in C2C activities. Similar trend was also observed in other C2C sites like eBay and ETSY. Operating losses have continuously widened from C2Q21 onward for Mercari. Since the management suggested it would step up investment to grow users and GMV in US, we believe the loss-making situation in Mercari US will worsen, which is the main reason behind our difference with the consensus.

We believe Mercari US's loss will widen, which is the main reason behind our difference from the consensus.

DCF valuation=JPY3,486 @TG=3% and WACC=14.5%

We typically put WACC for dominant Internet platforms at 10-12%. We believe Mercari belongs to the leading companies behind the first cachet of companies (Softbank, Rakuten and Z Holdings). Our assumption of terminal growth takes into account of Japan's aging demographics and thus the overall TAM (total addressable market) of Japan's reuse market

Japan's reuse market is likely not growing on TAM sense but will grow in levels of commercialization and online.

Exhibit 38. DCF valuation table

(JPY bn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
EBIT	(1.1)	3.8	4.8	10.2	19.8	29	41	54	77	103	124	153	181	209
EBIT x (1-tax)	(1.1)	2.4	3.4	7.2	13.9	20	28	38	54	72	87	107	126	146
Capex	(1.1)	(1.2)	(1.5)	(1.7)	(2.0)	(2.3)	(2.7)	(3.2)	(3.6)	(4.1)	(4.6)	(5.0)	(5.5)	(5.8)
Depreciation/ amortization	1.0	1.1	1.3	1.6	1.8	2.2	2.5	3.0	3.5	4.0	4.7	5.4	6.2	7.1
Change in working capital	5.9	(1.6)	0.1	0.1	0.9	1.4	(2.5)	(2.6)	(2.8)	(2.9)	(2.8)	(2.7)	(2.1)	(1.9)
Free cash flow	4.6	0.8	3.3	7.2	14.6	22	26	35	51	69	84	105	125	145
Discount Period	0.8	1.8	2.8	3.8	4.8	5.8	6.8	7.8	8.8	9.8	10.8	11.8	12.8	13.8
Discount Factors	90%	78%	69%	60%	52%	46%	40%	35%	30%	27%	23%	20%	18%	15%
Discount cash flow	4.2	0.6	2.3	4.3	7.6	9.8	10.2	12	16	18	20	21	22	22
Terminal growth rate	3.0%													
WACC	14.5%													
Terminal value (JPY bn)	1,303													
Equity value (JPY bn)	372													
Add: net cash	186													
Add: investment value														
Enterprise value (JPY bn)	558													
Total diluted shares (bn)	0.160													
Target price (JPY)	3,486													

Source: Blue Lotus (as of 3/18/2022)

Valuation by consensus is reasonable, but we disagree w/ cons.

In our view, Mercari's competitive landscape is worsening both domestically and internationally. The main reason is that Mercari has missed out several important innovations in its space, including (1) QR Code Payment, (2) Consignment Model, (3) Apparel reuse, and (4) Sportswear reuse. The most serious competitor that will post material challenge to Mercari is Z Holdings and

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to a lesser degree, ETSY. It appears that US startups are driving the category innovation of reuse while Z Holdings has a grand plan to galvanize Japan's e-commerce with QR Code Payment. Both trends are expected to sustain, in our view, while Mercari will be playing catch up.

Exhibit 39. Peer comparison table

Sector	Price	Mkt Cap	PE (consensus)			PEG	PS (consensus)			EV/EBITDA (consensus)	
	Ticker	(Local)	(US\$m)	2022E	2023E	2024E	2022E	2022E	2023E	2022E	2023E
Mercari (cons.)	4385 JP	2,757	3,730	38	24.6	12.0	0.5	2.3	1.9	36	19
Mercari (BLRI)				89	(256)	219	NM	3.3	2.7	1,476	101
Japan Internet											
SoftBank Group	9984 JP	4,280	62,334	7.4	6.9	8.6	(1.0)	1.1	1.1	12	12
Z Holdings	4689 JP	503	32,324	34	27	20	1.0	2.2	2.0	12	10
M3 Inc	2413 JP	4,009	22,998	48	40	34	2.6	11.8	10.3	25	28
Rakuten Group	4755 JP	909	12,143	(110.3)	16.4	8.4	NM	0.7	0.6	(41.1)	(12.1)
ZOZO	3092 JP	3,045	8,022	23.7	21.7	19.8	2.5	5.1	4.7	16.9	15.3
GMO internet	9449 JP	2,782	2,603	15.0	12.4	11.0	0.9	1.2	1.0	8.1	7.0
Kakaku.com	2371 JP	2,546	4,418	29.8	24.2	22.2	1.9	8.2	7.1	21.8	17.4
CyberAgent	4751 JP	1,385	5,919	17.0	15.2	18.4	(4.4)	0.9	0.9	6.1	5.5
Demae-Can	2484 JP	727	805	(2.5)	(17.8)	184.3	NM	0.9	0.7	(1.8)	(2.2)
Sector			140,424	7.8	15.7	12.1	0.8	2.8	2.5	4.3	7.0
Global Reuse											
eBay	EBAY US	52.09	30,604	12.2	11.5	10.5	1.5	2.8	2.6	8.6	8.1
Etsy	ETSY US	118.32	15,031	19.0	14.8	11.1	0.6	4.5	3.7	20.8	16.8
ThredUp	TDUP US	6.21	605	(14.2)	(35.5)	54.0	NM	1.5	1.2	(10.4)	(27.0)
RealReal	REAL US	5.83	543	(5.3)	(19.8)	7.7	NM	0.7	0.5	(6.7)	(18.6)
Poshmark	POSH US	10.99	846	(24.8)	(34.5)	(51.2)	NM	2.2	1.8	71.7	(42.9)
ATRenew	RERE US	2.42	533	12.2	3.6	2.4	0.1	0.3	0.2	(17.7)	57.0
Sector			48,163	13.2	10.7	10.0	1.2	3.3	2.9	12.8	9.7
Global E-commerce											
Amazon.com	AMZN US	2,837	1,443,622	29.3	21.8	18.0	1.1	2.3	2.0	18.1	14.2
Alibaba Group	BABA US	78	210,801	8.6	7.5	6.3	0.5	1.3	1.2	36.2	31.3
JD.com	JD US	43	66,943	14.3	10.8	7.4	0.4	0.3	0.3	86.8	56.4
Pinduoduo	PDD US	26	31,996	16.2	8.4	5.5	0.2	1.6	1.2	208.4	97.6
Sea	SE US	88	48,718	(28.5)	(197.9)	19.0	NM	2.6	2.1	(28.0)	(63.3)
MercadoLibre	MELI US	882	44,493	62.9	39.2	22.8	1.0	3.5	2.8	51.1	30.9
Sector			1,846,573	25.4	14.1	16.2	0.9	2.1	1.8	25.5	17.4

Source: Bloomberg, Blue Lotus (3/18/2022)

Annual Income Statement

Fiscal year ends-June 30

Exhibit 40. Annual income statement (Report Currency: JPY)

(JPY mn or JPY)	FY2016A	2017A	2018A	2019A	2020A	2021E	2022E	2023E
Net sales	12,256	22,071	35,765	51,683	76,275	106,115	157,012	189,920
Cost of sales	(786)	(2,720)	(6,806)	(12,864)	(20,661)	(24,312)	(54,246)	(62,512)
Gross profit	11,470	19,351	28,959	38,819	55,614	81,803	102,765	127,408
Gross margin	94%	88%	81%	75%	73%	77%	65%	67%
SG&A	(11,513)	(22,126)	(33,381)	(50,968)	(74,921)	(76,617)	(103,914)	(123,627)
Operating profit (loss)	(43)	(2,775)	(4,422)	(12,149)	(19,307)	5,186	(1,149)	3,781
Operating margin	(0.4%)	(12.6%)	(12.4%)	(23.5%)	(25.3%)	4.9%	(0.7%)	2.0%
Total non-operating income	4	27	35	91	210	7,183	67	28
Total non-operating expenses	(59)	(277)	(547)	(507)	(1,420)	(494)	(211)	(120)
Net profit (loss) before income taxes	(98)	(3,025)	(4,934)	(12,565)	(20,517)	11,875	(1,293)	3,689
Income taxes - current	(412)	(1,369)	(2,384)	(2,394)	(2,317)	(6,981)	(809)	(1,339)
Income taxes - deferred	161	188	278	1,197	(123)	631	(631)	0
Net profit (loss)	(349)	(4,206)	(7,040)	(13,762)	(22,957)	5,525	(2,732)	2,350
Net profit (loss) attributable to non-controlling interests	0	0	0	0	(186)	(195)	(73)	(80)
Net profit (loss) attributable to owners of parent	(349)	(4,206)	(7,040)	(13,762)	(22,771)	5,720	(2,028)	2,430
Average No. of shares (mn)	109	115	116	150	156	158	161	165
Basic EPS (JPY)	(3)	(37)	(61)	(92)	(146)	36	(13)	15

Source: Mercari, Blue Lotus (3/18/2022)

See the last page of the report for important disclosures

Annual Balance Sheet

Fiscal year ends- June 30

Exhibit 41. Annual Balance Sheet (Report Currency: JPY)

(JPY mn or JPY)	FY2017A	2018A	2019A	2020A	2021E	2022E	2023E
Cash and cash equivalents	50,863	109,157	125,578	135,747	171,463	192,177	220,337
Trade accounts receivable	107	359	1,341	1,119	2,413	2,816	3,282
Securities	0	0	5,196	5,260	-	-	-
Other receivable	1,133	2,774	14,176	15,612	47,001	42,452	47,003
Prepaid expenses	590	491	913	1,609	2,336	2,625	2,980
Deposits paid	0	786	5,383	9,718	6,251	7,296	8,503
Other current assets	347	304	319	1,614	876	1,022	1,192
Total current assets	53,038	113,723	151,812	169,275	227,924	245,570	280,011
Property, plant and equipment	313	1,037	1,883	2,905	2,623	2,666	2,765
Total intangible assets	325	120	1,080	679	658	691	725
Investment securities	106	416	533	5,881	215	215	215
Lease deposits	530	1,223	2,020	2,128	1,631	1,631	1,631
Deferred tax assets	0	627	1,825	108	2,362	2,362	2,362
Guarantee deposits	0	598	4,526	16,598	26,767	31,241	36,411
Total investments and other assets	810	2,867	8,904	25,150	31,319	35,793	40,963
Total non-current assets	1,449	4,024	11,867	28,734	34,600	39,150	44,453
Total assets	54,489	117,752	163,679	198,009	262,524	284,720	324,464
Short-term borrowings	3,500	1,000	0	0	19,602	6,534	2,178
Current portion of long-term borrowings	6,002	9,061	1,261	900	35,398	11,799	3,933
Cash due to users and other payables	24,064	5,170	7,281	16,206	17,775	18,714	21,243
Accrued expenses	690	1,422	1,081	861	1,147	1,262	1,388
Income taxes payable	1,263	2,260	1,687	1,427	6,140	6,140	6,140
Deposits received	807	23,730	45,818	83,954	117,099	144,101	175,368
Other current liabilities	851	979	1,352	4,764	5,529	6,214	7,053
Total current liabilities	37,177	44,301	61,009	110,125	205,327	197,755	220,667
Long-term borrowings	12,887	18,956	51,447	51,547	16,148	5,383	1,794
Total non-current liabilities	12,893	19,024	51,733	52,515	17,182	6,421	2,838
Total liabilities	50,070	63,325	112,742	162,640	222,509	204,176	223,505
Capital stock	6,286	34,803	40,110	41,440	42,630	46,893	51,582
Capital surplus	6,266	34,783	40,089	41,396	42,585	46,844	51,528
Retained earnings (Accumulated deficit)	(8,246)	(15,288)	(29,097)	(51,870)	(46,149)	(48,881)	(46,532)
Total shareholders' equity	4,306	54,298	51,102	30,966	39,066	44,855	56,579
Total accumulated other comprehensive income	110	123	(165)	3,819	(5)	0	0
Non-controlling interests	0	0	-	582	386	35,607	44,381
Total net assets	4,416	54,422	50,936	35,368	40,013	80,544	100,959
Total liabilities and net assets	54,489	117,752	163,679	198,009	262,524	284,720	324,464

Source: Mercari, Blue Lotus (3/18/2022)

See the last page of the report for important disclosures

Annual Cash Flow Statement

Fiscal year ends-June 30

Exhibit 42. Annual Cash Flow Statement (Report Currency: JPY)

(JPY mn or JPY)	FY2017A	2018A	2019A	2020A	2021E	2022E	2023E
Loss before income taxes	(3,026)	(4,935)	(12,567)	(20,517)	11,875	(1,293)	3,689
Depreciation and amortization	107	236	789	1,463	845	968	1,138
Amortization of goodwill	85	204	276	176	0	173	181
Gain on sales of investment securities	0	0	0	0	(6,942)	0	0
Loss on devaluation of investment securities	247	193	159	204	109	0	0
Bond issuance costs	0	0	0	0	111	0	0
Increase in allowance for doubtful accounts	2	145	946	309	1,011	404	467
Increase in provision for SBC	0	0	905	(727)	(24)	73	47
Interest income	(1)	(4)	(66)	(116)	(30)	(125)	(120)
Insurance income	0	(20)	0	0	0	0	0
Interest expense	30	92	78	248	232	125	120
Change in trade accounts receivable	(46)	(251)	(992)	577	(1,294)	403	466
Change in other receivable	(589)	(1,641)	(11,405)	137	(31,388)	4,549	(4,551)
Change in cash due to other payables	9,740	1,843	2,442	8,638	1,531	939	2,529
Increase in deposits paid	0	(753)	(4,608)	(4,334)	3,466	(1,045)	(1,207)
Increase in deposits received	0	1,791	22,077	37,695	32,908	27,002	31,267
Other—net	478	1,796	8	2,413	3,006	12,450	2,052
Interest income received	1	4	66	116	30	30	30
Interest expense paid	(30)	(92)	(78)	(248)	(232)	(232)	(232)
Income taxes paid	(646)	(1,705)	(2,491)	(2,735)	(2,429)	(809)	(809)
Net cash provided by (used in) operating activities	6,352	(3,439)	(7,292)	12,531	3,365	74,791	40,562
Purchase of investment securities	(53)	(503)	(189)	(109)	0	0	0
Purchase of property and equipment	(269)	(692)	(1,699)	(773)	(420)	(43)	(99)
Payments for lease deposits	(239)	(738)	(940)	(331)	0	(731)	0
Net cash provided by (used in) investing activities	(934)	(1,943)	(2,805)	(2,654)	6,906	(774)	(99)
Net increase (decrease) in short-term borrowings	2,453	(2,500)	(1,000)	0	19,602	(13,068)	(4,356)
Proceeds from long-term borrowings	21,500	16,000	50,000	1,000	0	0	0
Repayments of long-term borrowings	(2,629)	(6,871)	(25,308)	(1,261)	(900)	(23,599)	(7,866)
Proceeds from issuance of common stock	0	57,033	8,665	973	835	0	0
Net cash provided by (used in) financing activities	21,324	63,618	32,201	466	19,773	(53,216)	(12,222)
Net increase (decrease) in cash and cash equivalents	27,042	58,294	21,713	10,356	30,450	20,714	28,160
"FX translation adjustments on cash and cash equivalents"	300	58	(391)	13	406	(87)	(82)
Cash and cash equivalents at the beginning of period	23,823	50,865	109,159	130,775	135,747	171,463	192,177
Cash and cash equivalents at the end of period	50,865	109,159	130,775	135,747	171,463	192,177	220,337

Source: Mercari, Blue Lotus (3/18/2022)

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