



Medical System Network / 4350

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How to read a Shared Research report: This report begins with the trends and outlook section, which discusses the company's most recent earnings. First-time readers should start at the business section later in the report.

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Executive summary

Business overview

- Medical System Network operates the Nanohana Pharmacy chain. It also provides a wide range of pharmacy management support services (from pharmaceuticals procurement to pharmacist training) to dispensing pharmacies and medical institutions including directly operated pharmacies and non-group affiliates that register to become members of the company's network. The core of these services is the one-stop supply chain management service that comprises price negotiations with drug wholesalers, drug ordering, and settlement of bills. Medical System Network receives commissions from its network members based on the amount of drug orders they place. As of end-FY03/20, there were 5,245 network members (+1,455 from end-FY03/19) comprising 416 directly operated pharmacies and 4,829 affiliates. The company has reorganized its business segments in FY03/20, moving the Pharmaceuticals Network and Dispensing Pharmacy businesses, as well as the manufacture and market pharmaceuticals business previously included in the Other business, under the Community Pharmacy Network segment. The Leasing and Facility-related business and the Food Service business are unchanged. In the Other business, since the manufacture and market pharmaceuticals business is transferred out, the main business comprises home-visit nursing care.
- Nanohana Pharmacies, the company's directly operated pharmacies, are generally located near large medical institutions or in medical malls or complexes that integrate multiple clinics and hospitals. According to the Regional Bureaus of Health and Welfare, there were approximately 58,000 dispensing pharmacies in Japan in April 2019, but the market is highly fragmented; the top 10 pharmacies with nationwide chains, including Medical System Network with 0.7% share of pharmacies, have a combined market share of less than 10%. Because mid-tier regional chains with roots in local communities and small, family-owned pharmacies account for 90% of the domestic market, the primary growth strategy of major pharmacy chains is opening new pharmacies and expanding through M&A.
- In FY03/20, Community Pharmacy Network accounted for 94.7% of sales, Leasing and Facility-related 2.5%, Food Service 2.6%, and Other 0.2%. The Community Pharmacy Network segment is a new segment following a segment change in FY03/20, combining the former Pharmaceuticals Network and Dispensing Pharmacy segments with manufacture and market pharmaceuticals business (previously part of Other segment). The Community Pharmacy Network segment comprises the Pharmaceuticals Network, Dispensing Pharmacy, and manufacture and market pharmaceuticals businesses. The company discloses operating status of each business under the Community Pharmacy Network segment, but does not provide a sales and profit breakdown by business.

Trends and outlook

- In FY03/20, consolidated sales were JPY105.2bn (+7.1% YoY), operating profit was JPY1.6bn (+13.0% YoY), and recurring profit was JPY1.6bn (+3.9% YoY). The company reported a net loss attributable to owners of the parent of JPY895mn (versus a JPY462mn profit in FY03/19). Sales, operating profit, and recurring profit all were broadly in line with the revised full-year forecast issued on March 25, 2020. In the Community Pharmacy Network segment, there was solid growth in network member counts at the Pharmaceuticals Network business, mainly among small and mid-tier pharmacies. However the Dispensing Pharmacy business saw decreases in the number of prescriptions filled and downward pressure on generic drug prices as a consequence of NHI drug price revisions. The company also assessed potential for recovering investments in dispensing pharmacies whose profitability had worsened amid deterioration in the business climate, subsequently booking JPY1.5bn in impairment losses (JPY1.49bn of which was booked in Q4) in connection with fixed assets of the group's Dispensing Pharmacy business, and goodwill associated with shares in subsidiaries acquired via M&A. This led to Medical System Network reporting a net loss.
- The company issued its full-year FY3/21 forecast in range form, citing uncertainty over the extent of effects from the spread of COVID-19. It is projecting full-year consolidated sales of JPY103.5–105.5bn (-1.7% to +0.2% YoY), operating profit of JPY1.2–2.2bn (-28.8% to +33.1% YoY), and recurring profit of JPY1.1–2.1bn (-29.5% to +34.6% YoY), with no forecast for net income (losses) attributable to owners of the parent. It targets an earnings recovery driven by growth in the number of network members at the Pharmaceuticals Network business, contributions to the Dispensing Pharmacy business from stores acquired

via M&A, diminished investment in dispensing pharmacy IT systems, and increased occupancy at serviced elderly housing facilities run by the Leasing and Facility-related segment. Medical System Network has chosen to issue forecasts in range form as the spread of COVID-19 already has caused a downturn in the number of prescriptions filled (one of the main factors that affect profitability of the Dispensing Pharmacy division), and it remains difficult to predict when the disease outbreak will be contained as of the beginning of FY03/21.

- Medical System Network announced its fifth medium-term plan spanning a four-year period ending FY03/22 (previous plans covered three-year periods). Numerical targets for the final year of the plan are as follows: 5,000 network members, JPY120.0bn in consolidated sales, JPY5.0bn in consolidated operating profit (consolidated EBITDA of JPY7.5bn), and equity ratio of over 30%.

Strengths and weaknesses

Strengths: a management support network service available to small and mid-tier pharmacies; certified pharmacist training support system that appeals to pharmacies struggling with the pharmacist shortage; and regional dispensing pharmacy strategy in line with administrative guidance. Weaknesses: potential conflict of interest between M&A-driven pharmacy chain expansion and support services for small pharmacies; low profit margins for dispensing pharmacies without drugstore function; and relatively small assets being a disadvantage in acquisitions. (See the Strengths and weaknesses section for details.)

Key financial data

Income statement (JPYmn)	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.	FY03/20 Cons.	FY03/21 Cons. Est.
Sales	25,411	54,827	66,182	75,548	87,715	88,865	93,977	98,232	105,241	103,500-105,500
YoY	-	-	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%	-
Gross profit	8,960	19,412	22,737	28,476	32,801	34,164	36,607	37,271	40,214	
YoY	-	-	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%	
GPM	35.3%	35.4%	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%	
Operating profit	1,357	2,047	2,091	2,641	3,783	2,113	3,163	1,428	1,615	1,150-2,150
YoY	-	-	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%	-
OPM	5.3%	3.7%	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%	-
Recurring profit	1,315	1,912	2,020	2,540	3,860	2,109	3,250	1,501	1,560	1,100-2,100
YoY	-	-	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%	-
RPM	5.2%	3.5%	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%	-
Net income	518	756	668	885	1,720	571	1,022	462	-895	-
YoY	-	-	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%	-293.7%	-
Net margin	2.0%	1.4%	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%	-	-
Per share data (JPY)										
Shares issued (year-end; '000)	6,492	25,970	25,970	25,970	29,890	29,890	30,523	30,643	30,643	-
EPS	5.0	29.1	27.7	37.1	60.1	19.3	34.5	15.3	-29.5	-
EPS (fully diluted)	-	-	-	-	-	-	34.3	15.0	-	-
Dividend per share	3.8	8.0	8.0	8.0	9.5	10.0	10.0	10.0	10.0	-
Book value per share	50.5	222.9	214.7	243.3	334.9	345.3	351.4	354.8	310.4	-
Balance sheet (JPYmn)										
Cash and cash equivalents	2,072	2,092	3,106	2,499	2,081	2,252	10,201	11,703	11,722	
Total current assets	8,902	8,271	10,941	11,023	10,783	11,098	18,736	21,055	20,578	
Tangible fixed assets	9,976	11,472	15,976	17,249	20,253	21,246	24,129	25,721	25,126	
Investments and other assets	2,685	2,783	3,798	3,759	4,329	4,559	4,847	5,922	6,143	
Intangible fixed assets	5,040	8,263	12,399	13,554	13,481	13,833	15,045	16,235	14,615	
Total assets	26,603	30,789	43,114	45,587	48,847	50,737	62,759	68,935	66,464	
Accounts payable	5,158	5,616	7,798	8,598	9,525	9,144	9,416	10,198	10,021	
Short-term debt	3,856	5,119	12,922	9,214	6,910	3,863	7,463	9,158	8,905	
Total current liabilities	12,693	14,375	24,880	21,626	21,061	16,920	21,769	23,844	23,296	
Long-term debt	7,029	8,758	10,948	15,391	14,859	20,186	26,329	29,739	28,653	
Total fixed liabilities	8,230	10,178	12,882	17,826	17,520	23,172	30,404	34,329	33,749	
Total liabilities	20,923	24,553	37,762	39,452	38,581	40,092	52,174	58,173	57,045	
Net assets	5,680	6,236	5,352	6,136	10,265	10,644	10,584	10,761	9,418	
Total interest-bearing debt	10,885	13,877	23,870	24,605	21,769	24,049	33,792	38,897	37,558	
Cash flow statement (JPYmn)										
Cash flows from operating activities	1,566	3,790	3,706	3,838	6,409	3,084	6,699	2,840	4,232	
Cash flows from investing activities	-1,248	-5,425	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383	
Cash flows from financing activities	425	1,654	4,864	-483	-1,792	998	8,050	4,338	-1,687	
Financial ratios										
ROA (RP-based)	5.1%	6.7%	5.5%	5.7%	8.2%	4.2%	5.7%	2.3%	2.3%	
ROE	10.2%	13.7%	12.2%	16.2%	21.9%	5.7%	9.8%	4.3%	-8.9%	
Equity ratio	19.7%	18.8%	11.9%	12.7%	20.3%	20.1%	16.9%	15.6%	14.2%	

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Segment sales and profit (JPYmn)	FY03/15 Act.	FY03/16 Act.	FY03/17 Act.	FY03/18 Act.	FY03/19 Act.
Sales	75,548	87,715	88,865	93,977	98,232
YoY	14.2%	16.1%	1.3%	5.8%	4.5%
Pharmaceuticals Network	2,814	3,235	3,237	3,639	3,951
YoY	-1.0%	15.0%	0.1%	12.4%	8.6%
% of total	3.6%	3.6%	3.5%	3.8%	4.0%
Dispensing Pharmacy	71,743	82,002	81,650	87,172	90,706
YoY	13.9%	14.3%	-0.4%	6.8%	4.1%
% of total	91.8%	90.5%	89.0%	89.8%	91.7%
Leasing and Facility-related	1,517	2,430	2,046	2,031	3,320
YoY	15.1%	60.2%	-15.8%	-0.7%	63.5%
% of total	1.9%	2.7%	2.2%	2.1%	3.4%
Food Service	1,932	2,830	4,667	4,103	3,161
YoY	218.3%	46.5%	64.9%	-12.1%	-23.0%
% of total	2.5%	3.1%	5.1%	4.2%	3.2%
Other	182	143	163	92	261
YoY	-55.3%	-21.4%	14.0%	-43.6%	183.7%
% of total	0.2%	0.2%	0.2%	0.1%	0.3%
Segment sales adjustments	-2,641	-2,926	-2,900	-3,063	-674
Operating profit	2,641	3,783	2,113	3,163	1,428
YoY	26.3%	43.2%	-44.1%	49.7%	-54.9%
Pharmaceuticals Network	1,549	1,776	1,718	1,949	2,331
YoY	5.0%	14.7%	-3.3%	13.4%	19.6%
OPM	55.0%	54.9%	53.1%	53.6%	59.0%
Dispensing Pharmacy	2,377	3,412	2,314	3,060	1,068
YoY	29.2%	43.5%	-32.2%	32.2%	-65.1%
OPM	3.3%	4.2%	2.8%	3.5%	1.2%
Leasing and Facility-related	25	129	-143	-182	-84
YoY	-	416.0%	-	-	-
OPM	1.6%	5.3%	-7.0%	-9.0%	-2.5%
Food Service	-13	-89	-129	45	34
YoY	-	-	-	-	-24.4%
OPM	-0.7%	-3.1%	-2.8%	1.1%	1.1%
Other	-76	-109	-163	-97	-101
YoY	-	-	-	-	-
OPM	-41.8%	-76.2%	-100.0%	-105.4%	-38.7%
Segment profit adjustments	-1,221	-1,335	-1,482	-1,610	-1,733

Segment sales and profit (JPYmn)	FY03/19 Act.	FY03/20 Act.	FY03/21 Est.
Sales	98,232	105,241	103,500-105,500
YoY	4.5%	7.1%	-
Community Pharmacy Network	92,284	99,617	
YoY	-	7.9%	
% of total	93.3%	94.7%	
Three other businesses	6,622	6,388	
YoY	-	-3.5%	
% of total	6.7%	6.1%	
Segment sales adjustments	-674	-764	-
Operating profit	1,428	1,615	1,150-2,150
YoY	-54.9%	13.1%	-
Community Pharmacy Network	3,313	3,743	
YoY	-	13.0%	
OPM	3.6%	3.8%	
Three other businesses	-150	-69	
YoY	-	-	
OPM	-	-	
Segment profit adjustments	-1,733	-2,057	

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Note: The company changed its segments from FY03/20. The new segmentation integrates the former Pharmaceuticals Network and Dispensing Pharmacy businesses with the manufacture and market pharmaceuticals business (included in the Other business) under the Community Pharmacy Network business. The Leasing and Facility-related and Food Service segments are unchanged, but they are included under "Other businesses" in the above table with the home-visit nursing care business (previously included in the Other segment).

Recent updates

Highlights

On **June 29, 2020**, Shared Research updated the report following interviews with Medical System Network Co., Ltd.

On **June 19, 2020**, the company announced the launch of sales of generic drugs (five ingredients and eight products) by consolidated subsidiary Feldsenf Pharma Co., Ltd.

The company announced that consolidated subsidiary Feldsenf Pharma began selling five generic drug APIs and eight products from June 19, 2020, the date NHI drug prices applied.

On **the same day**, the company announced management changes at its consolidated subsidiaries.

The company announced changes to representative directors at its consolidated subsidiaries Paltecno Co., Ltd. and Feldsenf Pharma Co., Ltd.

1. Paltecno Co., Ltd. (effective June 11, 2020)

Name:	New position	Current position
Tatsushi Muraoka	Chairman	President
Fumitaka Nakamura*	President	-

* Also serves as General Manager of Project Promotion Office at Medical System Network

2. Feldsenf Pharma Co., Ltd. (effective June 18, 2020)

Name:	New position	Current position
Inao Tajiri*	Chairman	President
Kiwamu Nakada	President	Director

* Also serves as President of Medical System Network

On **May 8, 2020**, the company announced earnings results for full-year FY03/20; see the results section for details.

On the same day, the company issued a Notice of Differences between Results Forecasts and Actual Results and announced the booking of extraordinary (impairment) losses.

On **March 25 2020**, the company announced revisions to its full-year forecast for FY03/20 consolidated results.

Revised company forecast for FY03/20 consolidated results

Sales:	JPY105.0bn (previously JPY103.0bn)
Operating profit:	JPY1.5bn (JPY2.5bn)
Recurring profit:	JPY1.5bn (JPY2.4bn)
Net loss*:	JPY250mn (versus profit of JPY650mn)
Loss per share:	JPY8.23 (versus EPS of JPY21.39)

* Net loss attributable to owners of the parent

Reasons for forecast revision

The company's revised forecast sees full-year consolidated sales finishing JPY2.0bn ahead of its initial estimate but is projecting shortfalls in earnings at all levels. Compared with its initial projections, the company has cut its full-year operating profit estimate by JPY970mn, recurring profit estimate by JPY900mn, and net income estimate by JPY900mn. The upward revision to the company's projection for sales reflects solid growth in network member counts at its Pharmaceuticals Network business and, at its Dispensing Pharmacy business, increases in the number of high-value prescriptions filled and an accompanying increase in the average value of prescriptions filled. The higher sales notwithstanding, earnings are expected to fall short of initial projections as a result of a smaller-than-expected number of prescriptions. The measures being taken to prevent the spread of the novel coronavirus have led to a smaller number of people than usual going in for medical checkups. The lower-than-usual attack rate of seasonal influenza also affected results. According to the company, since the start of Q4 (January-March 2020) the number of prescriptions filled has been running 10.3% below plan, translating into roughly JPY600mn less in gross profit. Further aggravating the shortfall in earnings are the larger-than-expected cuts in NHI drug reimbursement prices for generic drugs initiated in October 2019.

For previous releases and developments, please refer to the News and topics section.

Trends and outlook

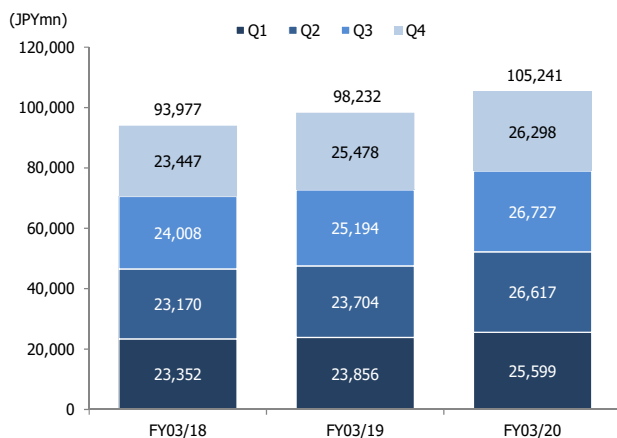
Quarterly trends and results

Cumulative (JPYmn)	FY03/19				FY03/20				FY03/20	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	% of FY	FY Est.
Sales	23,856	47,560	72,754	98,232	25,599	52,216	78,943	105,241	100.2%	105,000
YoY	2.2%	2.2%	3.2%	4.5%	7.3%	9.8%	8.5%	7.1%		6.9%
Gross profit	9,079	17,887	27,527	37,271	9,839	19,819	30,225	40,214		
YoY	0.1%	-1.2%	0.0%	1.8%	8.4%	10.8%	9.8%	7.9%		
GPM	38.1%	37.6%	37.8%	37.9%	38.4%	38.0%	38.3%	38.2%		
SG&A expenses	8,867	17,410	26,487	35,842	9,504	19,022	28,997	38,599		
YoY	4.6%	3.4%	5.0%	7.2%	7.2%	9.3%	9.5%	7.7%		
SG&A ratio	37.2%	36.6%	36.4%	36.5%	37.1%	36.4%	36.7%	36.7%		
Operating profit	212	476	1,040	1,428	334	796	1,228	1,615	105.6%	1,530
YoY	-64.2%	-62.5%	-54.5%	-54.9%	57.5%	67.2%	18.1%	13.1%		7.1%
OPM	0.9%	1.0%	1.4%	1.5%	1.3%	1.5%	1.6%	1.5%		1.5%
Recurring profit	192	438	1,010	1,501	323	784	1,208	1,560	104.0%	1,500
YoY	-67.5%	-65.6%	-56.7%	-53.8%	68.2%	79.0%	19.6%	3.9%		-0.1%
RPM	0.8%	0.9%	1.4%	1.5%	1.3%	1.5%	1.5%	1.5%		1.4%
Net income	101	119	372	462	97	218	326	-895	-	-250
YoY	-65.1%	-67.2%	-60.6%	-54.8%	-4.0%	83.2%	-12.4%	-		-
Net margin	0.4%	0.3%	0.5%	0.5%	0.4%	0.4%	0.4%	-		-
Quarterly (JPYmn)	FY03/19				FY03/20					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Sales	23,856	23,704	25,194	25,478	25,599	26,617	26,727	26,298		
YoY	2.2%	2.3%	4.9%	8.7%	7.3%	12.3%	6.1%	3.2%		
Gross profit	9,079	8,808	9,640	9,744	9,839	9,980	10,406	9,989		
YoY	0.1%	-2.6%	2.5%	7.2%	8.4%	13.3%	7.9%	2.5%		
GPM	38.1%	37.2%	38.3%	38.2%	38.4%	37.5%	38.9%	38.0%		
SG&A expenses	8,867	8,543	9,077	9,355	9,504	9,518	9,975	9,602		
YoY	4.6%	2.2%	8.2%	13.8%	7.2%	11.4%	9.9%	2.6%		
SG&A ratio	37.2%	36.0%	36.0%	36.7%	37.1%	35.8%	37.3%	36.5%		
Operating profit	212	264	564	388	334	462	432	387		
YoY	-64.2%	-61.1%	-44.5%	-55.7%	57.5%	75.0%	-23.4%	-0.3%		
OPM	0.9%	1.1%	2.2%	1.5%	1.3%	1.7%	1.6%	1.5%		
Recurring profit	192	246	572	491	323	461	424	352		
YoY	-67.5%	-63.9%	-46.1%	-46.4%	68.2%	87.4%	-25.9%	-28.3%		
RPM	0.8%	1.0%	2.3%	1.9%	1.3%	1.7%	1.6%	1.3%		
Net income	101	18	253	90	97	121	108	-1,221		
YoY	-65.1%	-75.7%	-56.5%	15.4%	-4.0%	572.2%	-57.3%	-		
Net margin	0.4%	0.1%	1.0%	0.4%	0.4%	0.5%	0.4%	-		

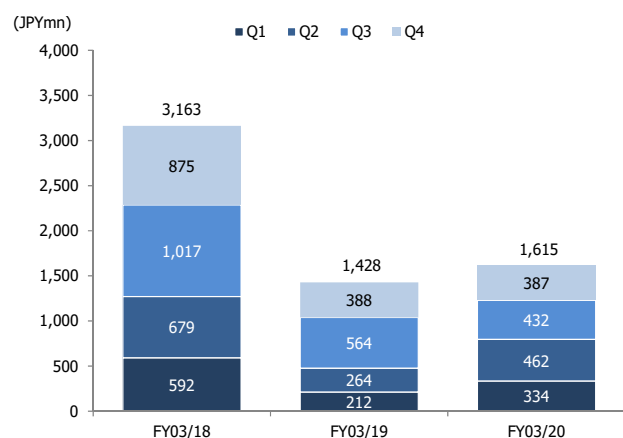
Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Quarterly sales



Quarterly operating profit



Source: Shared Research based on company data

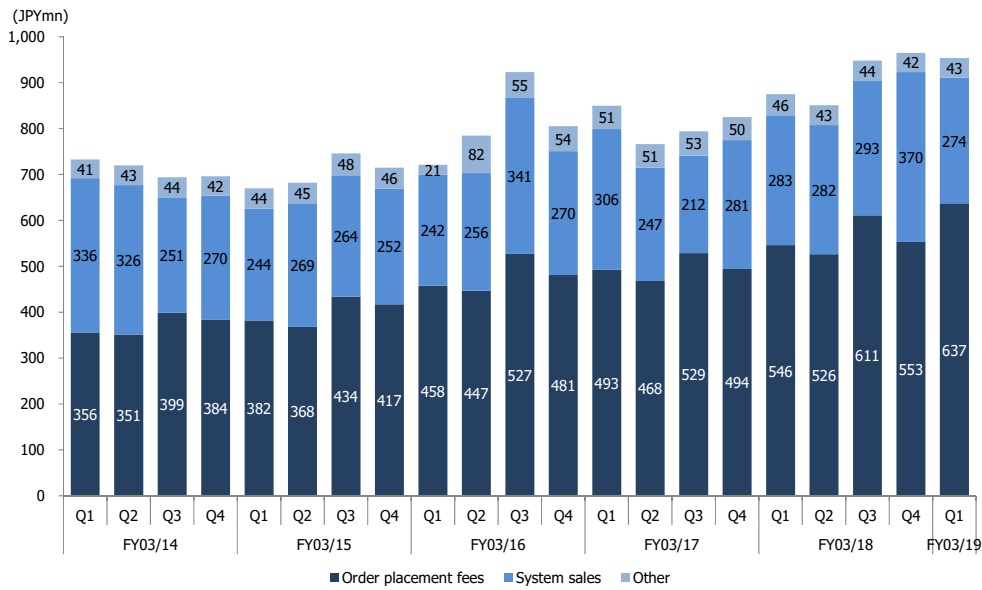
Quarterly results

By segment (cumulative)					FY03/19					FY03/19					FY03/20					FY03/20			
(JPYmm)	Q1	Q2	Q3	Q4		Q1 retro	Q2 retro	Q3 retro	Q4 retro		Q1	Q2	Q3	Q4		% of FY	FY Est.						
Sales	23,856	47,560	72,754	98,232	Sales	23,856	47,560	72,754	52,216		25,599	52,216	78,943	105,241		100.2%	105,000						
YoY	2.2%	2.2%	3.2%	4.5%	YoY	2.2%	2.2%	3.2%	9.8%		7.3%	9.8%	8.5%	7.1%			6.9%						
Pharmaceuticals Network	955	1,818	2,897	3,951	Community Pharmacy Network	22,564	44,717	68,408	49,290		24,224	49,290	74,636	99,617									
YoY	9.1%	5.2%	8.3%	8.6%	YoY	-	-	-	10.2%		7.4%	10.2%	9.1%	7.9%									
% of total	3.9%	3.7%	4.0%	4.0%	% of total	94.1%	94.7%	94.4%	93.6%		94.1%	93.6%	93.8%	94.0%									
Dispensing Pharmacy	22,222	44,035	67,291	90,706																			
YoY	3.2%	2.7%	3.2%	4.1%																			
% of total	90.3%	89.8%	91.8%	91.7%																			
Leasing and Facility-related	600	1,508	2,382	3,320	Leasing and Facility-related	600	1,508	2,382	1,829		760	1,829	2,659	3,425									
YoY	15.2%	38.9%	52.6%	63.5%	YoY	15.2%	38.9%	52.6%	21.3%		26.7%	21.3%	11.6%	3.2%									
% of total	2.4%	3.1%	3.3%	3.4%	% of total	2.5%	3.1%	3.3%	3.5%		3.0%	3.5%	3.3%	3.2%									
Food Service	788	1,586	2,382	3,161	Food Service	788	1,586	2,382	1,434		730	1,434	2,128	2,797									
YoY	-31.8%	-31.0%	-27.4%	-23.0%	YoY	-31.8%	-31.0%	-27.4%	-9.6%		-7.4%	-9.6%	-10.7%	-11.5%									
% of total	3.2%	3.2%	3.3%	3.2%	% of total	3.3%	3.2%	3.3%	2.7%		2.8%	2.7%	2.7%	2.6%									
Other	33	91	166	261	Other	33	91	166	79		38	79	122	165									
YoY	0.0%	71.7%	133.8%	183.7%	YoY	0.0%	71.7%	133.8%	-13.2%		15.2%	-13.2%	-26.5%	-36.8%									
% of total	0.1%	0.2%	0.2%	0.3%	% of total	0.1%	0.2%	0.2%	0.2%		0.1%	0.2%	0.2%	0.2%									
Segment sales adjustments	-743	-1,479	-523	-674	Segment sales adjustments	-130	320	320	-417		-154	-417	-603	-764									
Operating profit	212	476	1,040	1,428	Operating profit	212	476	1,040	796		334	796	1,228	1,615		105.6%	1,530						
YoY	-64.2%	-62.5%	-54.5%	-54.9%	YoY	-64.2%	-62.5%	-54.5%	67.2%		57.5%	67.2%	18.1%	13.1%			7.1%						
Pharmaceuticals Network	554	1,060	1,697	2,331	Community Pharmacy Network	642	1,227	2,332	1,736		825	1,736	2,764	3,743									
YoY	17.6%	13.5%	17.5%	19.6%	YoY	-	-	-	41.5%		28.5%	41.5%	18.5%	13.0%									
OPM	58.0%	58.3%	58.6%	59.0%	OPM	2.8%	2.7%	3.4%	3.5%		3.4%	3.5%	3.7%	3.8%									
Dispensing Pharmacy	130	202	712	1,068																			
YoY	-78.0%	-83.4%	-67.8%	-65.1%																			
OPM	0.6%	0.5%	1.1%	1.2%																			
Leasing and Facility-related	-32	10	-51	-84	Leasing and Facility-related	-32	10	-51	68		-8	68	947	45									
YoY	-	-	-	-	YoY	-	-	-	580.0%		-	580.0%	-	-									
OPM	-	0.7%	-	-	OPM	-	0.7%	-	-		-	-	-	-									
Food Service	1	18	28	34	Food Service	1	18	28	-34		-12	-34	-38	-43									
YoY	-80.0%	-47.1%	-42.9%	-24.4%	YoY	-80.0%	-47.1%	-42.9%	-		-	-	-	-									
OPM	0.1%	1.1%	1.2%	1.1%	OPM	0.1%	1.1%	1.2%	-		-	-	-	-									
Other	-36	-57	-82	-101	Other	-29	-57	-82	-39		-21	-39	-56	-71									
YoY	-	-	-	-	YoY	-	-	-	-		-	-	-	-									
OPM	-	-	-	-	OPM	-	-	-	-		-	-	-	-									
Segment profit adjustments	-405	-721	-1,186	-1,733	Segment profit adjustments	-369	-721	-721	-934		-447	-934	-1,508	-2,057									
By segment (quarterly)					FY03/19													FY03/20					
(JPYmm)	Q1	Q2	Q3	Q4		Q1 retro	Q2 retro	Q3 retro	Q4 retro		Q1	Q2	Q3	Q4									
Sales	23,856	23,704	25,194	25,478	Sales	23,856	23,704	25,194	26,617		25,599	26,617	26,727	26,298									
YoY	2.2%	2.3%	4.9%	8.7%	YoY	2.2%	2.3%	4.9%	12.3%		7.3%	12.3%	6.1%	3.2%									
Pharmaceuticals Network	955	863	1,079	1,054	Community Pharmacy Network	22,564	22,153	23,691	25,066		24,224	25,066	25,346	24,981									
YoY	9.1%	1.2%	13.9%	9.3%	YoY	-	-	-	13.1%		7.4%	13.1%	7.0%	4.6%									
% of total	4.4%	3.5%	4.5%	4.1%	% of total	94.1%	95.3%	94.0%	93.3%		96.6%	93.3%	94.2%	94.4%									
Leasing and Facility-related	600	908	874	938	Leasing and Facility-related	600	908	874	1,069		760	1,069	830	766									
YoY	15.2%	60.7%	84.0%	99.6%	YoY	-	-	-	17.7%		26.7%	17.7%	-5.0%	-18.3%									
% of total	2.8%	3.7%	3.6%	3.7%	% of total	2.5%	3.9%	3.5%	4.0%		3.0%	4.0%	3.1%	2.9%									
Food Service	788	798	796	779	Food Service	788	798	796	704		730	704	694	669									
YoY	-31.8%	-30.1%	-18.9%	-5.5%	YoY	-	-	-	-11.8%		-7.4%	-11.8%	-12.8%	-14.1%									
% of total	3.7%	3.3%	3.3%	3.0%	% of total	3.3%	3.4%	3.2%	2.6%		2.9%	2.6%	2.6%	2.5%									
Other	33	58	75	95	Other	33	58	75	41		38	41	43	43									
YoY	0.0%	190.0%	316.7%	352.4%	YoY	-	-	-	-29.3%		15.2%	-29.3%	-42.7%	-54.7%									
% of total	0.2%	0.2%	0.3%	0.4%	% of total	0.1%	0.2%	0.3%	0.2%		0.2%	0.2%	0.2%	0.2%									
Segment sales adjustments	2,320	-736	956	-151	Segment sales adjustments	-130	450	-	-263		520	-263	-186	-161									
Operating profit	212	264	564	388	Operating profit	212	264	564	462		334	462	432	387									
YoY	-64.2%	-61.1%	-44.5%	-55.7%	YoY	-64.2%	-61.1%	-44.5%	75.0%		57.5%	75.0%	-23.4%	-0.3%									
Pharmaceuticals Network	554	506	637	634	Community Pharmacy Network	642	585	1,105	911		825	911	1,028	979									
YoY	17.6%	9.3%	24.9%	25.5%	YoY	-	-	-	80.0%		28.5%	80.0%	61.4%	-									
OPM	58.0%	58.6%	59.0%	60.2%	OPM	2.8%	2.6%	4.7%	3.6%		3.4%	3.6%	4.1%	-									
Dispensing Pharmacy	130	72	510	356																			
YoY	-78.0%	-88.6%	-48.5%	-58.1%																			
OPM	0.6%	0.3%	2.2%	1.5%																			
Leasing and Facility-related	-32	42	-61	-33	Leasing and Facility-related	-32	42	-61	76		-8	76	-1	-22									
YoY	-	-	-	-	YoY	-	-	-	-		-	-	-	-									
OPM	-	4.6%	-	-	OPM	-	-	-	7.1%		-	7.1%	-	-									
Food Service	1	17	10	6	Food Service	1	17	10	-22		-12	-22	-4	-5									
YoY	-80.0%	-41.4%	-33.3%	-250.0%	YoY	-	-	-	-		-	-	-	-									
OPM	0.1%	2.1%	1.3%	0.8%	OPM	0.1%	2.1%	1.3%	-		-	-	-	-									
Other	-36	-21	-25	-19	Other	-29	-28	-25	-18		-21	-18	-17	-15									
YoY	-	-	-	-	YoY	-	-	-	-		-	-	-	-									
OPM	-	-	-	-	OPM	-	-	-	-		-	-	-	-									
Segment profit adjustments	-405	-316	-465	-547	Segment profit adjustments	-369	-352	-	-487		-447	-487	-574	-549									

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

(Reference) Former Pharmaceuticals Network segment sales

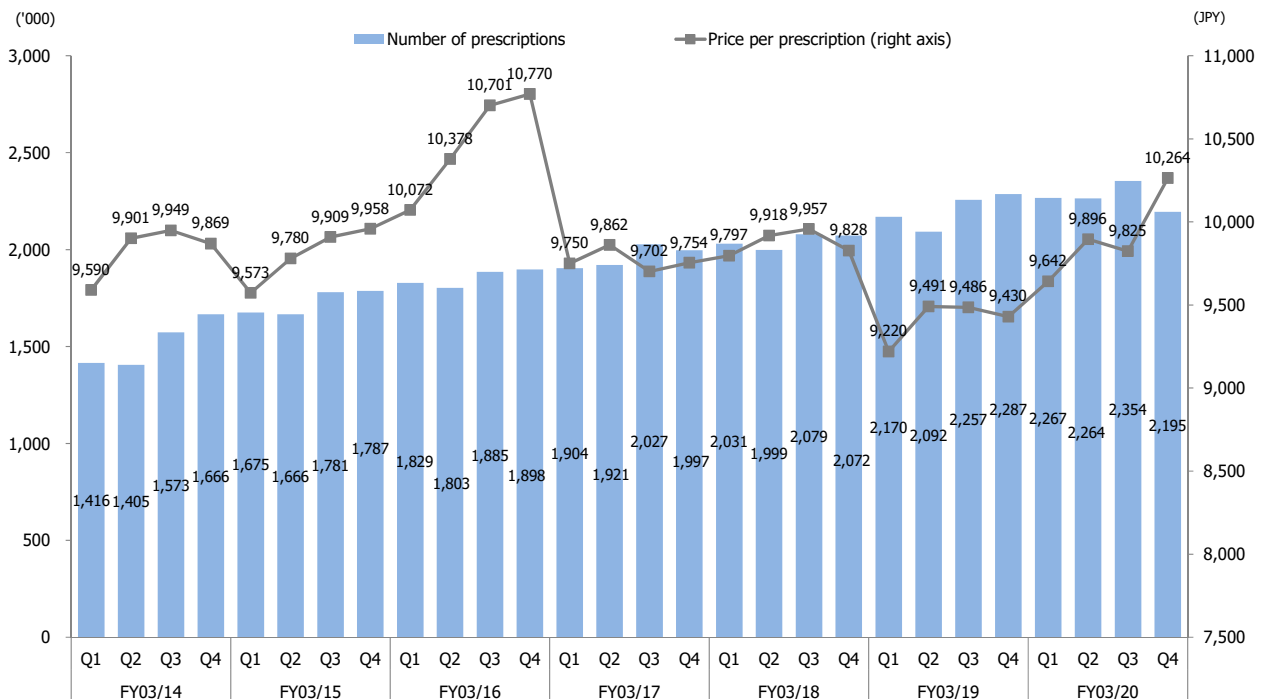


Source: Shared Research based on company data

Notes: Undisclosed from Q2 FY03/19

The former Pharmaceuticals Network segment was integrated into the new Community Pharmacy Network segment from FY03/20

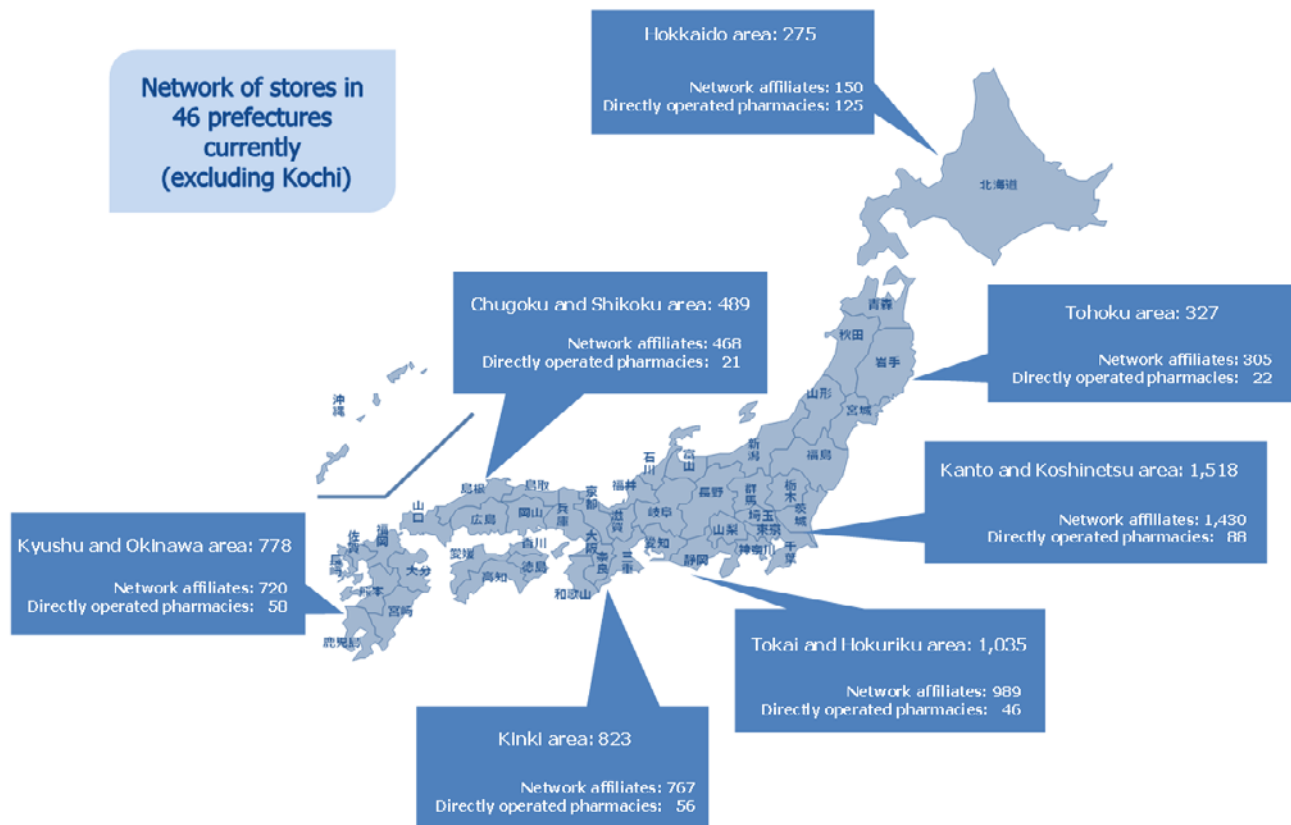
Quarterly trends in prescription volume and price per prescription (drug price + technical fees; Dispensing Pharmacy business; all stores)



Source: Shared Research based on company data

Note: NHI drug price and dispensing fee revisions were put into effect on April 1, 2014, April 1, 2016, and April 1, 2018.

Distribution of network members (as of March 31, 2020)



Source: Shared Research based on company data

Number of dispensing pharmacies by region

Region	Directly operated pharmacies	Affiliates	Total network members
Hokkaido	125	150	275
Tohoku	22	305	327
Kanto and Koshinetsu	88	1,430	1,518
Tokai and Hokuriku	46	989	1035
Kinki	56	767	823
Chugoku and Shikoku	21	468	489
Kyushu and Okinawa	58	720	778
Total	416	4,829	5,245

Source: Shared Research based on company data (March 31, 2020)

Full-year FY03/20 earnings results (out May 8, 2020)

Overview

FY03/20 (April 2019 to March 2020) earnings results

- ▷ Sales: JPY105.2bn (+7.1% YoY)
- ▷ Operating profit: JPY1.6bn (+13.0% YoY)
- ▷ Recurring profit: JPY1.6bn (+3.9% YoY)
- ▷ Net loss*: JPY895mn (profit of JPY462mn)

*Net income/loss attributable to owners of the parent

- ▷ Business environment: NHI drug price and dispensing fee revisions were conducted in April 2018. Dispensing pharmacies had to streamline their management structures following the implementation of the MHLW's "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs," whose purpose was to ensure stable supply of ethical drugs.
- ▷ Company response and business conditions: Performance was strong at the core Community Pharmacy Network segment, fueled by steady expansion in the Pharmaceuticals Network business and contributions to the Dispensing Pharmacy business from pharmacies acquired in FY03/19 via M&A. There was also a rise in the average value of prescriptions filled in tandem with growth in long-term prescriptions and an increase in high-value prescriptions filled, which contributed to sales. However, since January 2020, the number of prescriptions filled stagnated owing to fewer medical examinations as a result of the spread of COVID-19 and a low rate of influenza transmission compared to previous years. As a result, the number of prescriptions filled was fewer than expected at the Dispensing Pharmacy business, which weighed on profits.
- ▷ The company posted a net loss, because it booked a JPY1.5bn impairment loss consisting mainly of a JPY1.3bn charge on fixed assets of stores whose profitability had deteriorated in the Dispensing Pharmacy business and goodwill of acquired subsidiaries, and a JPY112mn charge related to the Food Service business. Shared Research thinks that the increased impairment loss is due in part to preparing ahead for a worsening business environment due to the spread of COVID-19.

Segment performance

Community Pharmacy Network

This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other.

Full-year FY03/20 (April 2019 to March 2020) segment earnings results

- ▷ Segment sales: JPY99.6bn (+7.9% YoY; includes internal sales or transfers between segments; same hereafter)
- ▷ Segment profit: JPY3.7bn (+13.0% YoY)
- ▷ Pharmaceuticals Network division: The number of new network members showed a strong increase driven by the need for improved distribution efficiency. As at end-March 2020, the number of network members was 5,245 (up 1,455 from end-FY03/19). This consisted of 416 directly operated pharmacies and 4,829 affiliates. Membership has been increasing steadily amid worsening business conditions for dispensing pharmacies, such as annual NHI drug price revisions and price negotiations with wholesalers.
- ▷ Dispensing Pharmacy division: In addition to the contribution from stores acquired via M&A, sales at existing pharmacies remained steady. However, the number of prescriptions filled slowed in Q4 due to the effects of the COVID-19 outbreak, such as a drop in customer traffic (associated with an increase in long-term prescriptions) and a reduction in the number of influenza patients as a result of rigorous antivirus measures to prevent the spread of COVID-19. Accordingly, Q4 saw a rise in the price per prescriptions due to the increase in long-term prescriptions, but the number of prescriptions filled turned down. This was

reflected in solid sales, but difficulty in adding value such as technical fees charged per prescription, which led to lower profits. Overall, the company's sales surpassed the initial forecast, but OPM was 0.9pp lower than expected. As at end-March 2020, there were 416 dispensing pharmacies, one care plan center, and eight cosmetic/drug stores.

- ▷ Manufacture and market pharmaceuticals division: This business aims to provide a stable supply of good-quality, low-priced generic drugs. The company sold 23 ingredients and 51 products as of end-March 2020.

Leasing and Facility-related

Full-year FY03/20 (April 2019 to March 2020) segment earnings results

- ▷ Segment sales: JPY3.4bn (+3.2% YoY)
- ▷ Segment profit: JPY45mn (loss of JPY84mn in FY03/19)
- ▷ The reason for sales and profit growth: Steady inflow of leasing revenue and rise in occupancy at the company's serviced elderly housing facilities contributed to earnings growth. The number of occupied units as of end-March 2020 was 67 out of 82 units total at Wisteria Senri-Chuo, and 71 out of 116 units total at Wisteria Minami Ichijo. The number of occupied units is trending up, and the company continues to carry out aggressive sales activities targeting an occupancy rate of over 90%.

Food Service

Full-year FY03/20 (April 2019 to March 2020) segment earnings results

- ▷ Segment sales: JPY2.8bn (-11.5% YoY)
- ▷ Segment loss: JPY43mn (profit of 34mn in FY03/19)
- ▷ Business reforms: Despite withdrawal from certain unprofitable facilities and pricing adjustments made to contracts, segment profit fell from higher labor costs as the company employed temporary resources in response to staff shortage. The company booked a JPY112mn impairment loss in FY03/20.

Other

The main business is home-visit nursing care.

Full-year FY03/20 (April 2019 to March 2020) segment earnings results

- ▷ Segment sales: JPY165mn (+17.1% YoY)
- ▷ Segment loss: JPY71mn (loss of JPY101mn in FY03/19)

For details on previous quarterly and annual results, please refer to the Historical performance and financial statements section.

Full-year FY03/21 company forecasts

Recent performance and FY03/21 company forecasts

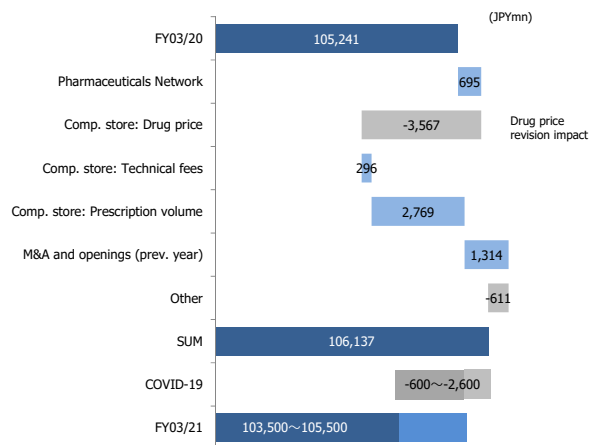
(JPYmn)	FY03/18			FY03/19			FY03/20			FY03/21 FY Est.
	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	
Sales	46,522	47,455	93,977	47,560	50,672	98,232	52,216	53,025	105,241	103,500-105,500
YoY	7.2%	4.4%	5.8%	2.2%	6.8%	4.5%	9.8%	4.6%	7.1%	-
Cost of sales	28,413	28,957	57,370	29,673	31,288	60,961	32,397	32,630	65,027	
Gross profit	18,109	18,498	36,607	17,887	19,384	37,271	19,819	20,395	40,214	
GPM	38.9%	39.0%	39.0%	37.6%	38.3%	37.9%	38.0%	38.5%	38.2%	
SG&A expenses	16,837	16,607	33,444	17,410	18,432	35,842	19,022	19,577	38,599	
SG&A ratio	36.2%	35.0%	35.6%	36.6%	36.4%	36.5%	36.4%	36.9%	36.7%	
Operating profit	1,271	1,892	3,163	476	952	1,428	796	819	1,615	1,150-2,150
YoY	131.5%	21.0%	49.7%	-62.5%	-49.7%	-54.9%	67.2%	-14.0%	13.1%	-
OPM	2.7%	4.0%	3.4%	1.0%	1.9%	1.5%	1.5%	1.5%	1.5%	-
Recurring profit	1,272	1,978	3,250	438	1,063	1,501	784	776	1,560	1,100-2,100
YoY	134.7%	26.2%	54.1%	-65.6%	-46.3%	-53.8%	79.0%	-27.0%	3.9%	-
RPM	2.7%	4.2%	3.5%	0.9%	2.1%	1.5%	1.5%	1.5%	1.5%	-
Net income	363	659	1,022	119	343	462	218	-1,113	-895	-
YoY	450.0%	30.5%	79.0%	-67.2%	-48.0%	-54.8%	83.2%	-424.5%	-293.7%	-
Net margin	0.8%	1.4%	1.1%	0.3%	0.7%	0.5%	0.4%	-2.1%	-0.9%	-

Source: Shared Research based on company data

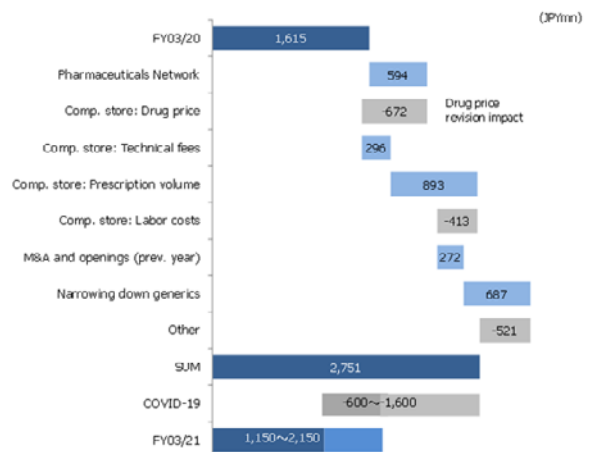
Note: Figures may differ from company materials due to differences in rounding methods.

- ▷ The company issued its full-year FY03/21 forecast in range form, citing uncertainty over the extent of effects from COVID-19. It is projecting full-year consolidated sales of JPY103.5–105.0bn (-1.7% to +0.2% YoY), operating profit of JPY1.2–2.2bn (-28.8% to +33.1% YoY), and recurring profit of JPY1.1–2.1bn (-29.5% to +34.6% YoY), with no forecast for net income (losses) attributable to owners of the parent.
- ▷ It targets an earnings recovery driven by growth in the number of network members at the Pharmaceuticals Network business, contributions to the Dispensing Pharmacy business from stores acquired via M&A, diminished investment in dispensing pharmacy IT systems, and increased occupancy at serviced elderly housing facilities run by the Leasing and Facility-related segment. The company has chosen to issue forecasts in range form as the spread of COVID-19 has caused a downturn in the number of prescriptions filled (one of the main factors that affect profitability of the Dispensing Pharmacy division), and it remains difficult to predict when the disease outbreak will be contained as of the beginning of FY03/21.
- ▷ Assuming no impact of COVID-19, the company estimates sales growth of JPY695mn in the Pharmaceuticals Network business, JPY812mn in the Dispensing Pharmacy business from existing stores and stores acquired via M&A and newly opened in FY03/20 (plan to compensate for the impact of the NHI drug price revisions by increasing the number of prescriptions filled by existing pharmacies and M&A). Expected negative impacts on sales (including the Other segment) total JPY611mn for an estimate of JPY106.1bn (+0.9% YoY) in FY03/21. After factoring in the JPY600mn–2.6bn impact of COVID-19, the company's FY03/21 sales forecast is expressed in a range of JPY103.5bn–105.5bn.
- ▷ The company's operating profit estimate is JPY2.8bn (+70.3% YoY), with brisk performance of the Pharmaceuticals Network business, recovery in the number of prescriptions filled in the Dispensing Pharmacy business, and a selective focus on generic drugs offsetting the negative effects of the NHI drug price revisions and increased labor costs. Factoring in the JPY600mn–1.6bn impact of COVID-19, the FY03/21 operating profit forecast is expressed in a range of JPY1.2bn–2.2bn.

Earnings forecasts Sales



Operating profit



Source: Shared Research based on company data

Company recognizes the harsh environment

The company expects the pharmaceuticals industry to expand in the longer term as healthcare spending continues to rise alongside Japan's aging population. At the same time, however, owing to implementation of such measures as NHI drug price and dispensing fee revisions aimed at reducing healthcare spending, as well as to the initiation of MHLW's "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs," dispensing pharmacies and the drug distribution industry as a whole are under pressure to streamline their management. Shared Research believes that the current environment could work in the favor of the Community Pharmacy Network segment, in particular the Pharmaceuticals Network business. There remains a need for dispensing pharmacies to streamline their operations and pursue efficiency gains, and for regional pharmacies that do not belong to large chains, it would be more convenient to join a network such as the company's. Wholesalers also benefit from lower delivery costs, stable terms of payment, and reduced workload for price negotiations. Medical System Network has laid out a policy of continuing management streamlining support for small and mid-tier pharmacies that underpin regional healthcare by expanding its pharmaceuticals network.

The company is instructing directly operated dispensing pharmacies (mainly Nanohana Pharmacies) to increase the number of prescriptions they handle in order to contribute to earnings. That said, Shared Research believes that store-level efforts by the company (e.g., expanding its pharmaceuticals network) are not enough to ensure that prescription numbers grow; it is necessary also to change prescription holders' perception of the family pharmacy concept.

In the medium term, the company plans to make a greater contribution to regional healthcare and strengthen family pharmacy functions to make qualitative improvements to their services. It will also work to spread the use of generic drugs, an initiative promoted by the Japanese government, by expanding the lineup of generic drugs it manufactures and markets, especially via consolidated subsidiary Feldsenf Pharma, and by continually working on improving the distribution of generic drugs.

Medium-term plan (out May 8, 2018)

Core strategies of the fifth medium-term plan

Comparison with fourth medium-term plan

Medical System Network announced its fifth medium-term plan (FY03/19–22) at the time of its earnings announcement for FY03/18. The company had previously reviewed its medium-term plans every three years. The fourth medium-term plan that ended in FY03/18, was preceded by a plan covering FY03/13–15. Starting from the fifth medium-term plan, however, the company changed the term to four years, which would be in line with the cycle of medical treatment fee revisions.

Core strategies: Details and company targets

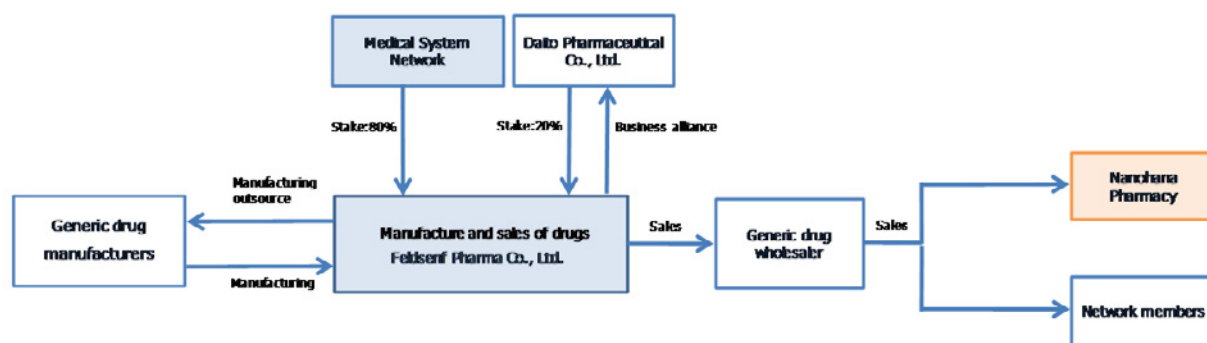
The core strategies of the fifth medium-term plan are as follows. The first four are in response to the NHI drug price and dispensing fee revisions implemented in April 2018. The third strategy is linked to the company's full-scale entry into the generic drug business (manufacture and sales), and the company expects earnings contribution from its consolidated subsidiary Feldsenf Pharma, which will have a central role in managing the business. Regarding the fifth strategy, given that the construction of a new serviced elderly housing facility was near completion as of end FY03/18, the company intends to focus on boosting occupancy rates for these units. Also, having made continued investments into these new facilities up until now, the company sees the period covered by the fifth medium-term plan as a time to focus on stepping up its financial base.

- ▷ Drive collective efforts of all network members to expand the pharmaceuticals network and provide management support to small and mid-tier pharmacies that help sustain community-based medical care; also improve drug distribution efficiency through collective efforts.
- ▷ Position group pharmacies as medical institutions and raise their caliber; promote their family pharmacy functions, allowing them to take initiative in resolving issues surrounding community medical care.
- ▷ Assist government-driven efforts to increase generic drug utilization and help develop efficient drug distribution systems by expanding manufacture and sales of quality generic drugs.
- ▷ Strengthen collaboration among group businesses and take a unified approach in providing community care functions (medical care, long-term care, and disease prevention) that are considered essential to the community-based integrated care system.
- ▷ Improve cash flows, take further steps to achieve efficient management structure, and fortify financial base.

We understand that in the mid- to long-term, Feldsenf Pharma, a generic drugs subsidiary (manufacture and sales) established by the company, will take on a significant role in Medical System Network's generic drug business cited in the third strategy. In the final year of the fifth medium-term plan, the company plans on sourcing around 50% of its consolidated operating profit from the Supply Chain Management (SCM) business, which is the combination of the generic drugs business centering on Feldsenf Pharma, and the Pharmaceuticals Network business.

Medical System Network has not changed its basic policy outlined above, even after the change in business environment due to the spread of COVID-19 in FY03/20. It provides specific policies for each business in the core Community Pharmacy Network segment. In the Pharmaceuticals Network business, the company will continue to maintain and increase member pharmacies. In the Dispensing Pharmacy business, the company aims to strengthen the family pharmacy function of its directly managed Nanohana Pharmacies. In the manufacture and market pharmaceuticals business, the company seeks to increase the product lineup of generic drugs sold as well as the number of member pharmacies that sell its products. With the spread of COVID-19 affecting its earnings from the start of year in FY03/21, the company plans to review numerical target of its fifth medium-term plan to reflect the change in business environment.

Feldsenf Pharma's generic drugs supply chain



Source: Shared Research based on company data

According to information released by the company in February 2018, Feldsenf Pharma's product lineup only comprised six generic drug APIs and 13 products, but the subsidiary looks to expand and improve the lineup, which would also include existing generic drugs. At end-FY03/20, Feldsenf Pharma's product lineup had grown to 23 generic drug APIs and 51 products, with a target of 100 products at end-FY03/22. Feldsenf Pharma is unmatched by industry peers in that it can lower transport costs, control production based on demand from network members (affiliates and directly managed pharmacies), and has a strategy to reduce delivery charges. We believe Feldsenf Pharma, by fulfilling its given role, will not only help raise the generic drugs ratio at Medical System Network pharmacies but also contribute to the company's consolidated results. The company targets an increase in the number of pharmacies selling its products to 1,000 at end-FY03/21.

Numerical targets (as of when plan was announced)

The company outlined numerical targets for FY03/22 (the final year of the fifth medium-term plan) as follows: JPY120.0bn in sales, JPY5.0bn in operating profit (consolidated EBITDA of JPY7.5bn), equity ratio of over 30%, and 5,000 network members. The target of 5,000 network members amounts to nearly 10% of domestic dispensing pharmacies; thus, Shared Research believes achieving this number will further strengthen the company's influence in the industry.

The number of pharmacies looking to become network members continues a steady increase. With more pharmacies having sought to become network members since the April 2018 NHI drug price revision, the company cleared the 5,000-member target in FY03/20, two years earlier than initially planned.

In terms of earnings forecasts, the company revised its FY03/20 forecasts to reflect the impact of COVID-19 and associated significant change in the operating environment. The company issued its full-year FY03/21 forecast in range form and is considering a revision of numerical targets for FY03/22, the final year of its fifth medium-term plan, to reflect the impact of COVID-19.

(Reference) Numerical targets for the fifth medium-term plan (at time of announcement)

(JPYmn)	FY03/17 Act.	FY03/18 Act.	FY03/19 Act.		FY03/20 Est.	FY03/22 Target
Sales	88,865	93,977	98,232	Sales	103,000	120,000
Pharmaceuticals Network	3,237	3,639	3,951	Pharmaceuticals Network	97,461	-
Dispensing Pharmacy	81,650	87,172	90,706	Three other businesses	6,113	-
Operating profit	2,113	3,163	1,428	Operating profit	2,500	5,000
Pharmaceuticals Network	1,718	1,949	2,331	Pharmaceuticals Network	4,783	-
Dispensing Pharmacy	2,314	3,060	1,068	Three other businesses	-240	-
EBITDA	4,717	5,711	4,200	EBITDA	-	7,500
Recurring profit	2,109	3,250	1,501	Recurring profit	2,400	-
RPM	2.4%	3.5%	1.5%	RPM	2.3%	-
Net income	571	1,022	462	Net income	650	-
Equity ratio	20.1%	16.9%	15.6%	Equity ratio	-	30% or higher
Pharmaceuticals Network members	1,770	2,509	3,790	Pharmaceuticals Network members	5,000	5,000
No. of regional pharmacies	377	399	420	No. of regional pharmacies	-	-

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Note: Segment figures include internal transactions.

Business

Business model

Medical System Network provides dispensing pharmacy support services to its own pharmacies and to affiliates. Based on the FY03/19 results reported under the former segment classifications, approximately 90% of the company's sales came from the operation of dispensing pharmacies (Dispensing Pharmacy business*). The dispensing pharmacy support service (Pharmaceutical Network business*), while highly profitable, accounts for a smaller portion of overall sales than operation of dispensing pharmacies. As such, the company can be considered a pharmacy chain that also extends its services to non-group pharmacies.

*The Dispensing Pharmacy business and the Pharmaceutical Network business were formerly independent reportable segments. The two businesses were consolidated into the new Community Pharmacy Network segment in FY03/20.

The dispensing pharmacy support service developed by Medical System Network is provided not only to directly-operated pharmacies but also to non-group dispensing pharmacies (affiliates). The Dispensing Pharmacy business generated about 30% of operating profit (unadjusted for internal transactions) in FY03/19 while the Pharmaceuticals Network business accounted for about 70%, suggesting high OPM for the latter considering the segment's small share of sales.

Dispensing pharmacies in Japan are regulated by the nation's universal healthcare insurance system governed by the Ministry of Health, Labour and Welfare (MHLW). The system requires the separation of prescription and dispensary practices, where patients receive prescriptions from physicians at medical institutions and have them filled at dispensing pharmacies by a pharmacist. Under the universal healthcare insurance system, the cost of medication is split between patients and their insurance plans. When a pharmacy dispenses drugs, it collects the patient co-payment (30% of total cost for most company employees) in cash and obtains dispensing fee receivables for the insurance plan portion (70%), for which a reimbursement claim is later submitted. The prices for drugs and medical services are set by the regulatory authorities.

Overview of business segments

Medical System Network comprised five business segments until FY03/19. The mainstay segments were Pharmaceuticals Network and Dispensing Pharmacy. These two segments were consolidated into the Community Pharmacy Network segment along with the manufacture and market pharmaceuticals business (previously included in the Other business and operated by Feldsenf Pharma). The new Community Pharmacy Network segment comprises the Pharmaceuticals Network, Dispensing Pharmacy, and manufacture and market pharmaceuticals businesses. The company does not disclose a sales and profit breakdown by business. The company maintains its medical and long-term-care related businesses in the Leasing and Facility-related, Food Service, and Other segments, at the core of which is the home-visit nursing care business. Each business segment continues to be operated by core subsidiaries.

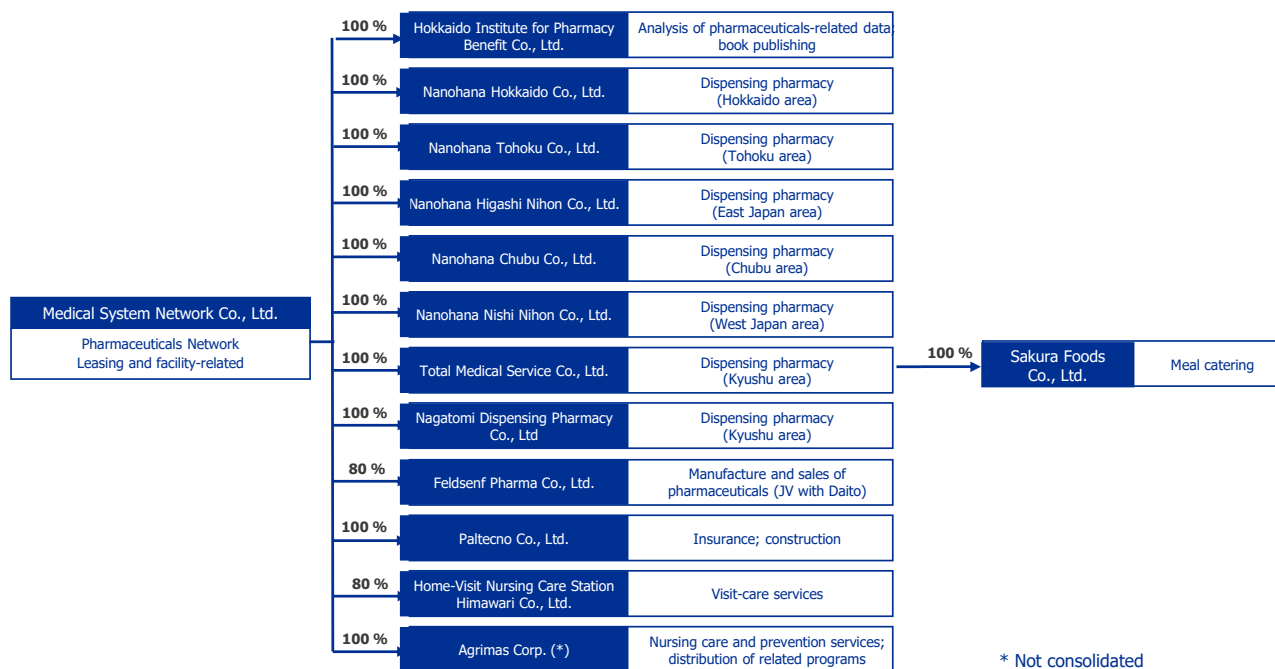
Affiliated companies (as of March 2, 2020)

Segment	Company	Location	Ratio of voting rights
Dispensing Pharmacy	Nanohana Hokkaido Co., Ltd.	Sapporo, Hokkaido	100.0%
	Nanohana Tohoku Co., Ltd.	Hachinohe, Aomori	100.0%
	Nanohana East Japan Co., Ltd.	Minato-ku, Tokyo	100.0%
	Nanohana Central Co., Ltd.	Nagoya, Aichi	100.0%
	Nanohana West Japan Co., Ltd.	Toyonaka, Osaka	100.0%
	Total Medical Service Co., Ltd.	Kasuya, Fukuoka	100.0%
	Nagatomi Pharmacy Co., Ltd.	Oita, Oita	100.0%
	Hokkaido Institute for Pharmacy Benefit Co., Ltd.	Sapporo, Hokkaido	100.0%
Leasing and Facility	Paltecno Co., Ltd.	Sapporo, Hokkaido	100.0%
Food Service	Sakura Foods Co., Ltd.	Kasuya, Fukuoka	100.0%
Other	Agrimas Corp. *	Ota-ku, Tokyo	77.7%
	Home-Visit Nursing Care Station Himawari Co., Ltd.	Nerima-ku, Tokyo	100.0%
	Feldsenf Pharma Co., Ltd.	Sapporo, Hokkaido	80.0%

Source: Shared Research based on company data
Notes: *Not consolidated

**Company names for Apotec Co., Ltd. and Kyoei Pharmacy Co., Ltd. were changed to Nanohana Tohoku Co., Ltd. and Nanohana West Japan Co., Ltd. as of April 1, 2019.

Affiliated companies (as of March 2, 2020)



Source: Shared Research based on company data

Community Pharmacy Network

The Community Pharmacy Network business is a new segment created in FY03/20 from consolidating the Pharmaceuticals Network, Dispensing Pharmacy, and a part of the Other (manufacture and market pharmaceuticals business) segments.

The company cited following two reasons for the reorganization:

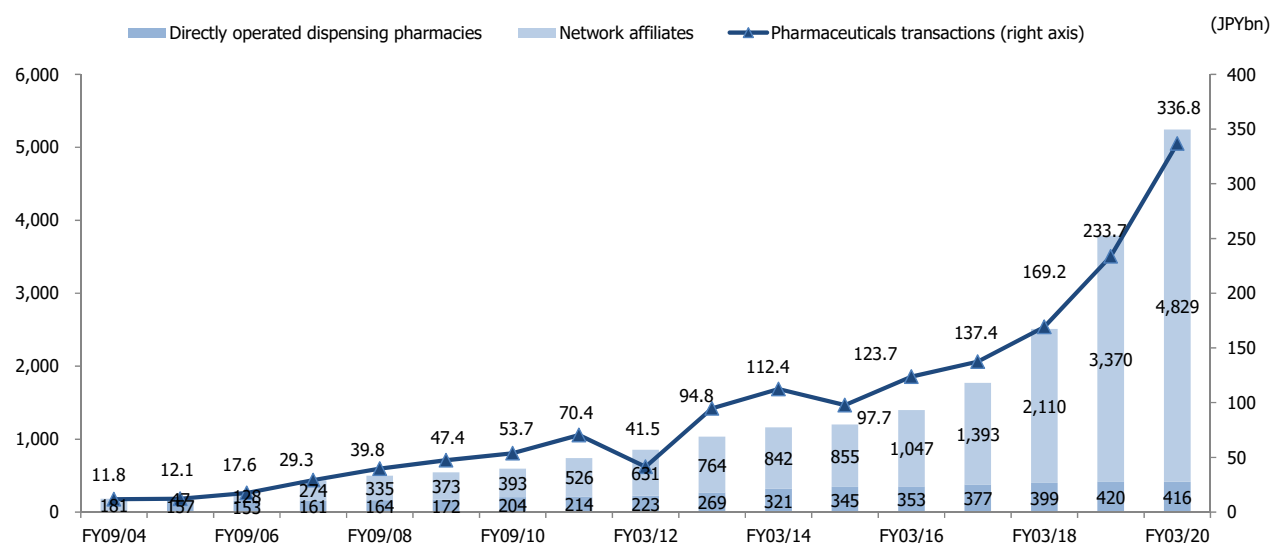
- ▷ To accommodate expansion of the company's business scope to the entire supply chain accompanied by the rise in pharmaceuticals network affiliates and full-scale development of the manufacture and market pharmaceuticals business
- ▷ To transition to a structure that can provide value to the entire supply chain while taking into account possible conflicts of interest between business segments due to the aforementioned changes

Details of the company business are given in accordance with the former segment classifications of Pharmaceuticals Network, Dispensing Pharmacy, and Other (manufacture and market pharmaceuticals).

Pharmaceuticals Network business (former Pharmaceuticals Network segment)

The core Pharmaceuticals Network business offers comprehensive support for operating pharmacies, ranging from the sourcing of drugs to pharmacist training and financing. It can be broken down into four major functions: Pharmaceuticals supply chain management, slow moving inventory clearance, pharmacist training, and financing.

Network members and pharmaceuticals transactions



Note: Figures for FY09/04 are totals of directly operated dispensing pharmacies and affiliates only.
Source: Shared Research based on company data

Four functions

(1) Pharmaceuticals supply chain management

Medical System Network negotiates terms of business with drug wholesalers on behalf of its network members. Typically, dispensing pharmacies have to negotiate prices separately with each wholesaler. However, the company represents its network members collectively in negotiations with wholesalers around the country. The wholesalers benefit from the company's services in a number of ways. They can receive payment from all network members two months after closing instead of the standard three months, which reduces interest expenses. The company's collection service helps them minimize the cost of recovering outstanding payments for pharmaceutical products. The online ordering system improves and optimizes inventory control for pharmacies, reducing order frequency and emergency deliveries, thus lowering wholesaler costs. These cost-saving advantages give the company the power to negotiate better prices with wholesalers. Price negotiation is crucial to dispensing pharmacies that interact with multiple drug wholesalers since the difference between the actual drug sourcing cost and official price of prescription drugs represents their profit stream, but it is also a source of heavy operational burden.

In negotiating terms with wholesalers, Medical System Network adopts the law of one price. Instead of using order volume as bargaining power (making lower price a condition for large orders), it negotiates with all wholesalers based on a common price per each pharmaceutical product. Further, the company does not get involved in the transactions and relationships between the pharmacies and their regular suppliers* (wholesalers). Members can choose which wholesaler to buy from on the basis of service and other conditions, not price. This system lowers the hurdle for dispensing pharmacies thinking of joining the network, but wants to keep existing trading accounts with their regular suppliers, and appeals to wholesalers as well, because they can maintain relationships with existing customers. It is thus a win-win for both retailers and wholesalers. The company also benefits, because it can attract new network members by allowing them to maintain their existing accounts.

Medical System Network is also focusing on handling generics, whose use is being strongly promoted by MHLW. The company gathers and analyzes detailed information such as interview forms** mainly about drugs added to the NHI list that it receives from pharmaceutical companies. The company then negotiates with wholesalers about stable supply of the product, price, and other conditions, and provides information on the product to network members if it concludes that it can be dispensed safely by the pharmacists. The company also provides a substantial support system to its affiliates to increase their handling of generics, including an inventory management system with the same features as the generic drug recommendation system used by its directly operated pharmacies.

*Regular supplier/trading account: A relationship between retailer and wholesaler whereby the retailer has a trading account with the wholesaler. For a retailer, a regular supplier is a wholesaler with which it has a history of doing business.

**Interview form: Pharmaceutical Interview Form (IF), whose purpose is to supplement information that is not fully covered in package inserts of prescription drugs. These forms are supplied by pharmaceutical companies and provide all-round product information. Japan Society of Hospital Pharmacists (JSHP) sets IF drafting guidelines and instructs pharmaceutical companies to distribute the forms. Historically produced by pharmacists interviewing companies, the current format was established in 1988.

(2) Slow moving inventory clearance service (dead stock exchange)

This system allows for the exchange of dead stock pharmaceuticals among network members. A pharmaceutical product can no longer be dispensed once it expires, so the disposal of dead stock becomes a cost burden on dispensing pharmacies. The primary objective of the system is to reduce inventory disposal losses substantially by registering members' dead stock in the system and matching the stock with other members that can use it. Charges for matched dead stock can be settled together with order placement commissions to Medical System Network, so member pharmacies do not need to make payments to each other.

The MHLW has identified wasted pharmaceuticals as a cost burden that needs to be addressed in healthcare reforms. Note that Medical System Network has acquired a patent for this system.

(3) Pharmacist training support

An attractive training system can improve staff loyalty and draw talented recruits to dispensing pharmacies. The company holds nationwide training courses for pharmacists including those working at network pharmacies in collaboration with training organization Iyaku Sogo Kenkyukai (ISK). These workshops are run by dispensing pharmacies and online courses are also available. The workshops cover topics such as simulated patient training, POS* training, case studies, and customer relations training. Certification by Japan Pharmacists Education Center (JPEC; a public interest incorporated foundation) requires attendance at, and gaining credits for workshops run by JPEC and registered organizations that provide group and practical training sessions such as Japan Society of Hospital Pharmacists (JSHP) and Japan Pharmaceutical Association (and their regional chapters). ISK is one of the few private-sector organizations registered as a provider of various certification programs for pharmacists. Medical System Network and ISK help pharmacies run training sessions and apply for accreditation, which enables them to become members of the ISK organization and run JPEC accredited training courses. ISK issues attendance stickers to pharmacists who attend these courses. This is an incentive for network pharmacies, because it helps them recruit pharmacists.

*POS: Problem Oriented System. A predetermined logical and scientific resolution approach used in team medical care, wherein patient information and healthcare professionals' records are shared to clearly ascertain patient medical problems from each professional's point of view.

(4) Financing support

In Japan, the cost of prescription drugs is borne by patients and the public health insurance programs (such as social insurance for company employees and the National Health Insurance [NHI] for non-employees). Dispensing pharmacies receive the patient co-payment over the counter when dispensing drugs and the portion covered by insurance becomes dispensing fee receivables until it gets monetized two months later when pharmacies receive payment from the insurance programs. Under the company's financing support service (optional), these receivables are purchased and securitized, and group pharmacies are provided cash funding more than a month earlier than the payment from insurance programs. This service offers dispensing pharmacies stable low-cost financing, as unlike financing from a bank, no collateral is required. There are also no restrictions on how the funds can be utilized. Social insurance and NHI claims can be securitized separately. Dispensing fee receivables are converted into small-lot securities through financial institutions and sold to investors for capital recovery.

Dispensing Pharmacy business (former Dispensing Pharmacy segment)

Scale

The Dispensing Pharmacy business (operation of dispensing pharmacies) is a core business that accounts for about 90% of the company's sales and about half of its operating profit. The group's dispensing pharmacies had been operating under the umbrella of a holding company Pharmaholdings Co., Ltd., which was the company's subsidiary until October 2017, when it was absorbed by the company. As of May 2019, the group's dispensing pharmacies are operated through seven consolidated subsidiaries. Another subsidiary, Hokkaido Institute for Pharmacy Benefit Co., Ltd., publishes specialized books for pharmacists and other healthcare professionals and analyzes pharmaceuticals-related data.

The Dispensing Pharmacy business operates the group's directly operated pharmacies. The company provides support services through its pharmaceuticals network to both its directly-operated pharmacies and non-group pharmacies (affiliates). Directly operated pharmacies and affiliates make up the company's pharmaceuticals network, but the affiliates are not included in the scope of the Dispensing Pharmacy business.

The numbers of both affiliates and directly operated pharmacies continue to rise. The total value of drug orders (which dictates the company's commission revenue) tends to rise in line with the increase in network members, although there have been periods when the value declined due to drug price revisions.

Affiliates and directly operated pharmacies are found in most areas nationwide, although the home base of Hokkaido has the highest concentration of the latter followed by the Kanto and Koshinetsu area. The highest concentration of affiliates is in the Kanto and Koshinetsu area followed by the Tokai and Hokuriku area (for recent regional patterns see the figures Distribution of network members and Number of pharmacies by region in the Trends and Outlook section). As of March 2020, the number of directly operated pharmacies and affiliates stood at over 5,245, and surpassing the fifth medium-term plan goal of 5,000 during FY03/20, two years ahead of schedule.

Directly operated pharmacies

Functions provided by the company's directly operated dispensing pharmacies do not dramatically differ from those of other dispensing pharmacies, although one distinguishing characteristic is that they tend to be located in residential areas where homes and medical institutions coexist (categorized by the company as the medical mall format including medical plazas). As such, they are well suited to take on the "family pharmacy" function advocated by MHLW. The company aims to strengthen the family pharmacy functions of its pharmacies by offering consultation services concerning nutrition, health, and self-care. .

The company regularly provides guidance to directly operated pharmacies. It sets a bar for their financial performance, and when the pharmacies fail to meet those targets, the company investigates the cause and seeks possible solutions. It also advises pharmacy managers, on matters including potential closures. With such guidance, the company continues to promote revitalization of pharmacies, and in FY03/19 it closed 15 outlets while opening eight new stores and acquiring three through M&A.

Market position of directly operated Nanohana Pharmacy

The number of Nanohana brand pharmacies totaled 416 at end-March 2020. The following table compares sales and pharmacy numbers for other major pharmacy chains as of their fiscal year-ends. Unlisted companies and companies mainly operating dispensaries within drugstores are excluded. While Medical System Network ranks within the top 10, it has far fewer outlets than the top-ranking pharmacy chains.

Number of dispensing pharmacies

	FY end	Sales (JPYmn)	No. of pharmacies
1 Ain Holdings	April	275,596	1,186
2 Qol	March	165,411	813
3 Toho Holdings	March	96,124	778
4 Sogo Medical Holdings	March	-	719
5 Nihon Chouzai	March	231,001	650
6 Suzuken	March	96,439	613
7 Kraft*	-	185,700	580
8 Medical System Network	March	90,706	416
9 Aisei Pharmacy	March	61,518	373
10 Pharmarise Holdings	May	43,202	312

Source: Shared Research based on data from each company's websites and materials

Note: Sales figures are aggregate of dispensing pharmacy segment, Aisei Pharmacy Co., Ltd. and Kraft Inc. are unlisted, and companies that are primarily drugstore chains were excluded.

Note: Based on earnings announcement data disclosed as of June 2019.

Note: Number of pharmacies for Kraft (Sakura Pharmacy) only includes directly operated pharmacies.

Initiatives in line with the distribution improvement guidelines

The company has taken steps in line with the MHLW objective of reducing medical expenses through streamlining distribution to establish a more efficient supply chain that bolsters online ordering, reduces product returns, and lowers delivery frequency. Particularly noteworthy is its local network initiatives.

A local network aims to foster collaboration among local affiliates of the company's pharmaceuticals network within a community with the following four objectives:

- ▷ Information sharing by affiliates of available pharmaceuticals and inventories
- ▷ Enhanced distribution for the entire region
- ▷ Cooperation on at-home medical care, facility sharing, holding study sessions and exchange meetings
- ▷ Product sharing, interaction and collaboration among employees, and knowledge sharing

Efforts to streamline Nanohana Pharmacy operations

Several measures have been taken to streamline operations of the directly operated pharmacy chain, Nanohana Pharmacy.

- ▷ Reduce time required to input medication history and register drugs to be reviewed: Tablet computers are provided to each pharmacist thus making work more flexible and enabling utilization of free time between dispensing work. Average time required for this task was reduced from 60 minutes to 30 minutes a day.
- ▷ Reduce time spent on ordering drugs: Full adoption of in-house developed automated drug ordering system reduced the time spent on ordering drugs from a daily average of 30 minutes to less than 10 minutes.
- ▷ Reduce patient waiting time: Improvement of waiting time measurement system helped identify causes of long waiting time. A successful case showed that waiting time was cut by about five minutes three months after the identified problem was solved.
- ▷ Optimization of staffing: Setting standard working hours for pharmacists and staff (appropriate number of staff) for each pharmacy and installing management tools enabled the company to gauge appropriate staffing for any given week or any given day of the week.

Leasing and Facility-related

Planning and development of medical buildings and medical plazas

In addition to private practice clinics, the company engages in the planning and development of facilities that house multiple medical clinics (medical buildings and medical plazas). The real estate business is mainly operated by subsidiary Nihon Leben, which was a subsidiary, but was absorbed in October 2017.

This business supports development of clinics that goes beyond just real estate brokerage. The focus is on providing a broad range of support to physicians looking to start a practice, beginning with the stage of formulating a basic business plan for the clinic, and spanning the creation of a management philosophy and strategy, investigating the medical area, selecting real estate property, overseeing design and construction, financing, and processing the business start-up application.

The company develops medical malls* where multiple medical institutions are located in one area, which benefit both patients and physicians. Grouping various medical institutions in the same premises provides patients with opportunities to receive one-stop treatment from multiple specialists. It is also more efficient for physicians, as they can lower costs by sharing facilities and benefit from synergies in patient traffic and advertising.

*Medical mall: Where several specialized clinics and dispensing pharmacies are located in the same building or area. It is called a medical building when they are in the same building and a medical plaza when they are located in the same area.

Medical malls have different formats. For the building format where tenants are only clinics and dispensing pharmacies, the building is often constructed based on the assumption that clinics will move in, so the floor space and specifications are designed accordingly. Another type is a medical area located within a shopping mall or a commercial facility attached to a train station; since station users and local residents frequent these commercial facilities, they can see their physicians after shopping or on their way home. A third format is a congregation of multiple detached clinics in the same area, often established along suburban main roads where land is easy to acquire.

An example of a medical building developed by the company is the Leben Building in Sapporo, Hokkaido. Standing near a general hospital in Sapporo, in an area where multiple specialty clinics are also located, the building houses four clinics, including surgery and internal medicine, and a Nanohana Pharmacy.

An example of a medical plaza is the Shizunai Aoyagi district, located in Hidaka, Hokkaido, with five clinics, including internal medicine and otolaryngology, and two Nanohana Pharmacies. The company notes the latter is a medical mall with roots in the local community, and has been attracting attention as a model case for supporting regional medical care in cities experiencing depopulation and aging.

Planning and development of long-term care facilities

The company plans and develops serviced elderly housing facilities that collaborate with medical institutions, long-term care centers, and dispensing pharmacies to ensure an environment where residents can live safely with peace of mind. Wisteria N17, located in Sapporo, Hokkaido, is the company's first serviced elderly housing facility. Standard services include daily safety checks and 24-hour on-call emergency service while fee-based services such as meal catering and long-term care services are also available. Wisteria N17 is also networked with local medical institutions such as the general hospital, specialty clinics, dental clinics, and dispensing pharmacies. The company's fourth facility, Wisteria Senri-Chuo (Toyonaka, Osaka Prefecture), was launched in 2016, and the fifth facility, Wisteria Minami Ichijo (Sapporo, Hokkaido), was opened in November 2018. The company commented that Wisteria Minami Ichijo would be the last elderly housing planning and development project for a while, and that it would concentrate on increasing the occupancy rate of existing facilities for now.

According to the company, investment for expansion of serviced elderly housing facilities came to an end in FY03/19, and it is now taking measures to boost occupancy rates at the Wisteria series facilities. The company plans to focus on building a community where medical care and long-term care are offered as one, with dispensing pharmacies, hospitals, and long-term care and childcare facilities surrounding the serviced elderly housing facilities.

Food Service

The company provides meals to hospitals and welfare facilities. The meal catering service is provided by Total Medical Service, Kyushu Iryo Shoku Co., Ltd. (merged with Total Medical Service in April 2018), and Sakura Foods Co., Ltd. (wholly owned subsidiary of Total Medical Service) in the Kyushu and Chugoku areas (Fukuoka, Saga, Nagasaki, Oita, Kumamoto, Miyazaki, Kagoshima, and Yamaguchi prefectures).

Other

The major business in this segment is home-visit nursing care carried out by subsidiary Home-Visit Nursing Station Himawari Co., Ltd. The manufacture and market pharmaceuticals business, conducted by subsidiary Feldsenf Pharma Co., Ltd., was consolidated into the newly established Community Pharmacy Network segment.

The home-visit nursing care business dispatches specialized nurses to patients' homes to check on their conditions, and provides appropriate nursing care and advice. It collaborates with physicians, healthcare and long-term care professionals, and pharmacists at the company's Nanohana Pharmacy.

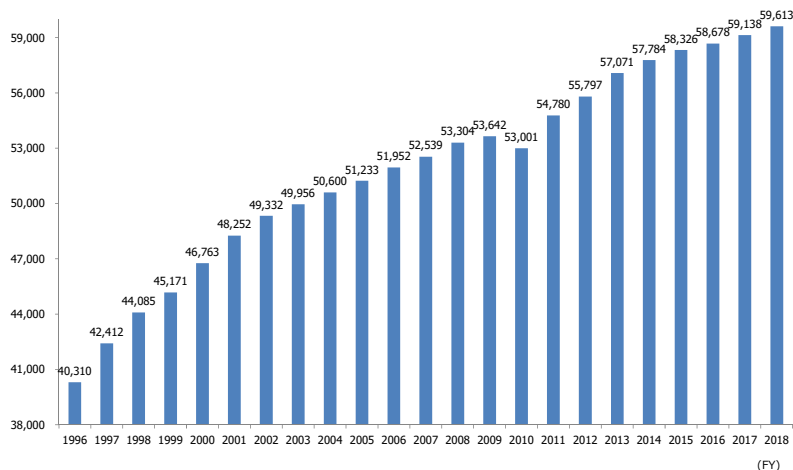
Market and value chain

Continued growth in the dispensing pharmacy market

Dispensing pharmacies fill prescriptions issued by medical institutions. This is based on the separation of prescribing and dispensing functions, in an effort to raise the quality of medical care by letting physicians focus on examining patients and determining appropriate treatment while allowing pharmacists to specialize in dispensing drugs, managing medication history, and providing guidance on usage. According to the Japan Pharmaceutical Association (JPA), the separation accelerated sharply from 1997 when the Ministry of Health and Welfare (the predecessor of MHLW) instructed 37 national hospitals to adopt complete separation (more than 70% of prescriptions must be filled outside the hospital). The out-of-hospital dispensing ratio exceeded 50% nationwide for the first time in 2003. According to JPA estimates, the average ratio rose to 70% by 2016.

The number of dispensing pharmacies steadily increased as separation of prescribing/dispensing advanced and pharmacies that previously marketed OTC drugs became dispensing pharmacies. There was also a pronounced increase in independent pharmacies operating near large hospitals—so-called “monzen” (Japanese meaning “in front of the gate”) pharmacies. Another factor driving growth has been the expansion of drugstores into the dispensary business. Prescription volumes issued by medical institutions have also been rising.

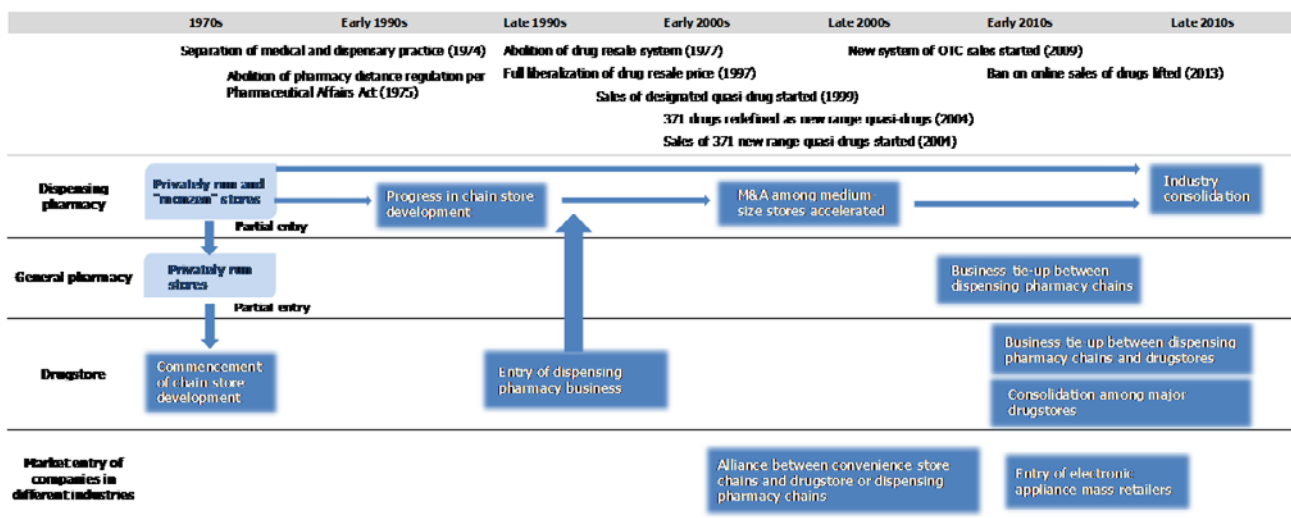
Number of dispensing pharmacies



Source: Shared Research based on MHLW's Report on Public Health Administration and Services

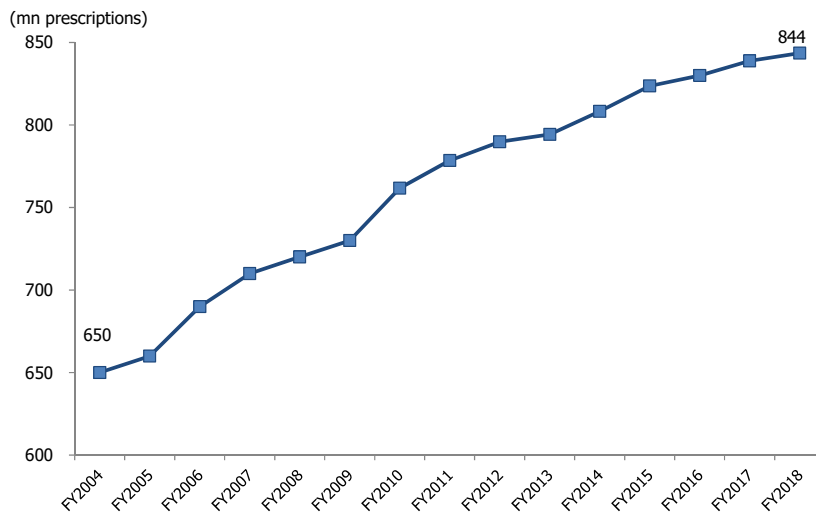
Note: 2010 does not include some of Miyagi or Fukushima Prefectures' data.

Developments surrounding dispensing pharmacies



Source: Shared Research based on MHLW's Report on Public Health Administration and Services

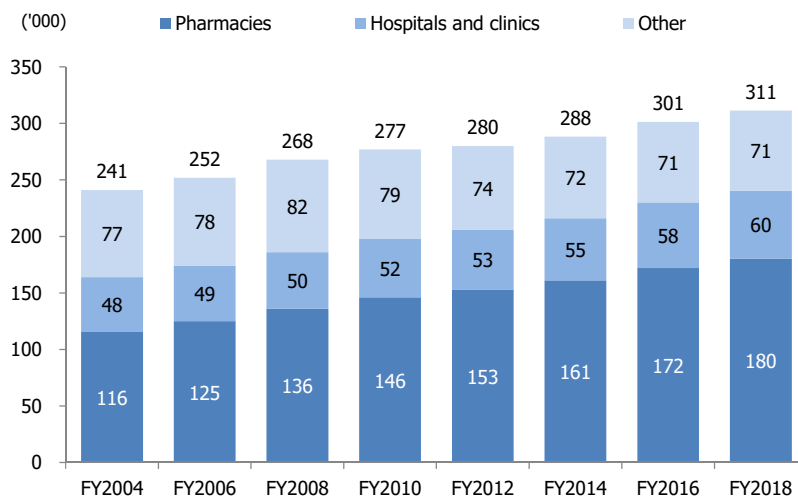
Prescription volume



Source: Shared Research based on MHLW's Trends in Prescription Medicine Costs

Relative to the increase in the elderly population, the number of dispensing pharmacists has not kept pace with the increase in pharmacies, and securing sufficient staffing is a pressing issue, particularly for small and mid-tier pharmacies.

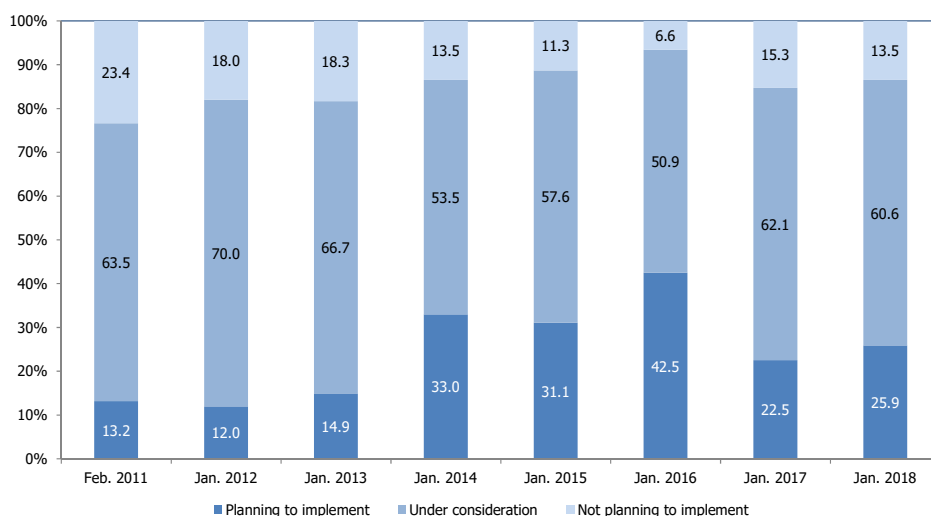
Pharmacist numbers



Source: Shared Research based on MHLW's Report on Survey of Physicians, Dentists and Pharmacists

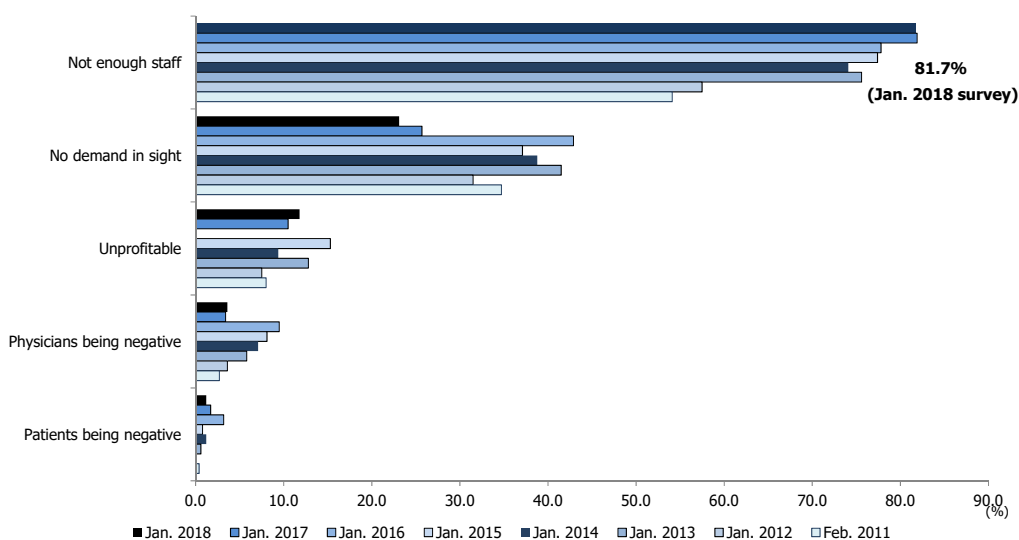
A Nippon Pharmacy Association (NPhA) survey of member pharmacies showed that the percentage of pharmacies planning to embark on home-based medication management and guidance services, one of the new roles being promoted by MHLW, is not expanding. Most respondents cited labor shortages as the main reason. MHLW is also advocating for 24-hour availability as a means to improve patient convenience, but this service will also likely increase labor costs for dispensing pharmacies.

Survey results on home-based medication management service



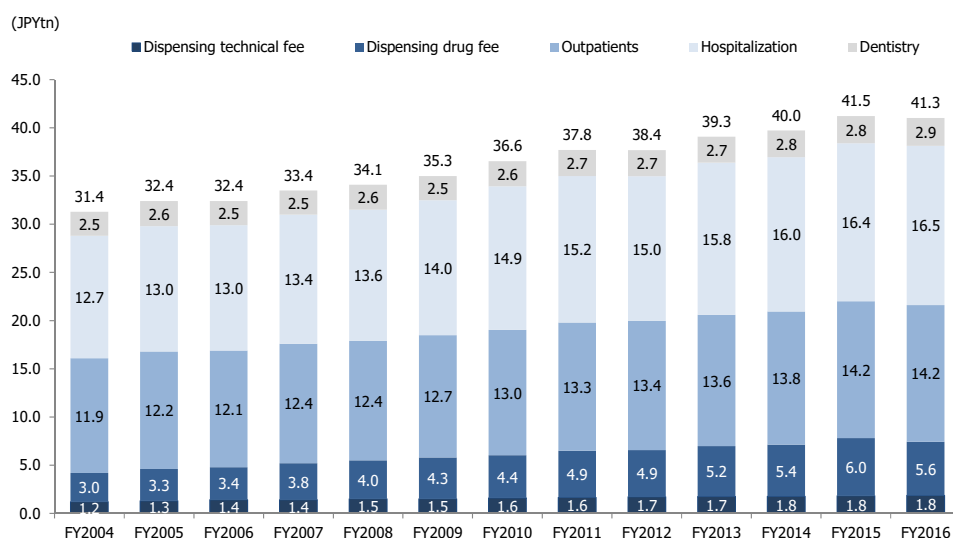
Source: Shared Research based on data from Nippon Pharmacy Association Committee for Expansion of Pharmacist Functionality, Report on 2017 Survey of Member Pharmacists (February 2018)

Reasons cited for not providing home-based medication management service



Source: Shared Research based on data from Nippon Pharmacy Association Committee for Expansion of Pharmacist Functionality, Report on 2017 Survey of Member Pharmacists (February 2018)

The motivation behind MHLW's push to expand these roles for pharmacies is a response to steadily rising medical costs in Japan, and, as the Japanese population ages, reducing unnecessary drug use will be essential to maintaining sound healthcare spending. For the same reason, MHLW is also encouraging pharmacies to take on a more patient-centered approach rather than to focus primarily on pharmaceuticals.

(Reference) Drug expenditures

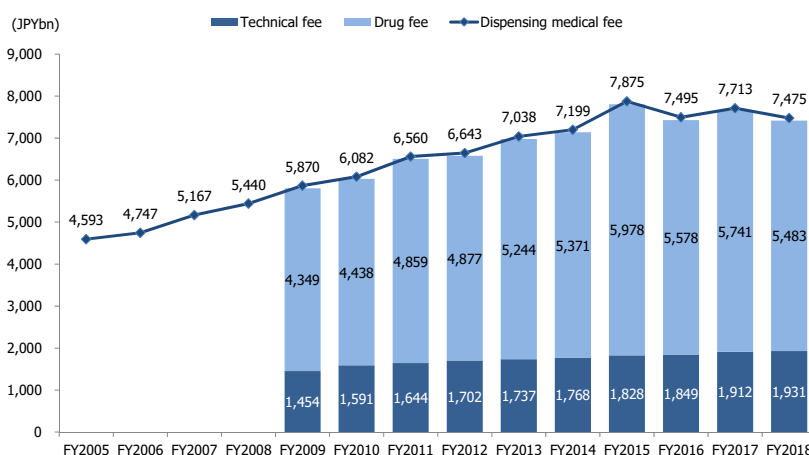
Source: Medical costs and dispensing drug expenditures compiled by Shared Research based on MHLW's Statistics of Medical Care Activities in Public Health Insurance

MHLW wants dispensing pharmacies to expand their role from just filling prescriptions to providing comprehensive care to patients as a family pharmacy. This push has made the shortage of pharmacists an even more pressing issue.

Role of dispensing pharmacies in community-based integrated care system: transforming to family, regional pharmacies

Environment facing smaller pharmacies: dispensing fee revisions

The dispensing fee revision implemented in April 2014 reduced the basic dispensing fee for pharmacies that receive more than 90% of their prescriptions from specific medical institutions. The government enacted the changes after reassessing medical care finances amid chronic fiscal deficits, a health insurance program on the verge of collapse, and continually expanding long-term care expenditures. Further reductions in dispensing fees are likely. In addition, faced with concerns of rising medical costs, the government opted to expand the functions of pharmacies rather than increase physician numbers. Thus, it has promoted home medical care services such as prescription delivery and offered preferential treatment to dispensing pharmacies that can provide a 24-hour on-call service. These trends put smaller pharmacies (such as those near large hospitals) at a disadvantage. At a time of flat dispensing fee expenditures, it is crucial for community pharmacies to strengthen their family pharmacy functions and strengthen services that directly earn revenues such as technical fees.

Dispensary charges

Source: Shared Research based on MHLW's Trends in Prescription Medicine Costs

MHLW initiates "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs"

The "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs" (so-called distribution improvement guidelines) were adopted starting April 2018. Issued by MHLW, the guidelines targeting industry members reflect the ministry's

initiative to shift the role of spearheading improvement in prescription drug distribution from the distributors to the government. Items of note on the relationship between drug wholesalers and medical institutions/dispensing pharmacies include the avoidance of excessive discounts. According to these guidelines, offering prices involving excessive discounts that do not reflect the actual value of pharmaceuticals, such as using a benchmark without considering transaction terms, is incompatible with the current NHI drug price system (where individual drug price reflects the value). The guidelines urge wholesalers and medical institutions/dispensing pharmacies also to consider distribution costs and stable provision/sourcing of pharmaceuticals, and to take a comprehensive perspective on each price negotiation, seeing it as an extension of the price negotiations between drug manufacturers and wholesalers.

Key points from the “distribution improvement guidelines”

- ▷ Items of note between manufacturers and wholesalers:
- ▷ Elimination of negative primary margins, presentation of appropriate prices
- ▷ Items of note between wholesalers and medical institutions/dispensing pharmacies:
- ▷ Rapid settlement of transaction prices and promotion of individual drug unit price transactions
- ▷ In principle, all drugs should have individual drug unit prices (no bundling contracts)
- ▷ At a minimum, the percentage of individual drug unit price contracts must exceed previous year levels
- ▷ Adjustment of excessive price discounts that do not reflect pharmaceuticals value and distribution costs
- ▷ Ensured efficiency and safety of distribution
- ▷ Avoidance of costly practices such as frequent and emergency deliveries that can impede stable supply

MHLW will establish a consultation office to support guideline compliance and plans to proactively disclose cases as they come up. In addition to confirming compliance, it will also check to see if the guidelines’ intent and substance are reflected in medical fees.

FY2020 medical fee revision

The FY2020 medical fee revision called for a 0.46% net medical fee reduction, comprised of a 0.55% increase in core medical fees and 1.01% reduction in NHI drug prices (official price of medicines).

$$\text{Net medical fee revision } -0.46\% = \text{core medical fee } +0.55\% + \text{drug reimbursement price } -1.01\%$$

The increase in the core medical fee includes +0.53% for medical fees, +0.59% for dental fees, and +0.16% for dispensing fees. In contrast, the reduction in the NHI drug prices includes -0.99% for pharmaceuticals prices and -0.02% for medical material prices. The result of the revisions is a shift from a merchandise-based approach to a patient-centered one, evidenced by the expansion of guidance fees for pharmacists who interact with patients, and the recognition of pharmacies that contribute to community-based medical care such as through provision of medication information to hospitals.

Medical fee revision (%)

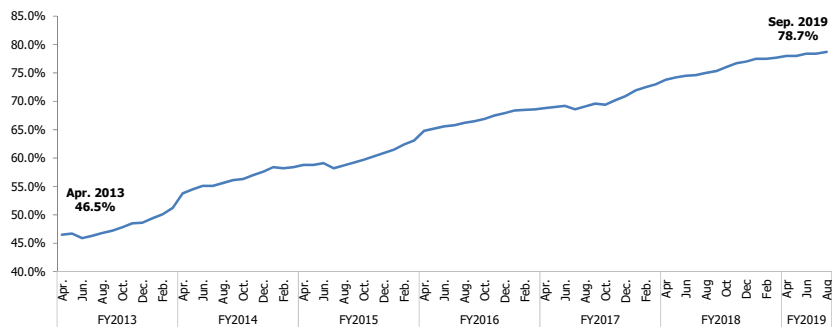
Year of revision	FY2002	FY2004	FY2006	FY2008	FY2010	FY2012	FY2014	FY2016	FY2018	FY2020
Core medical fees (actual)	-1.30	±0.00	-1.36	+0.38	+1.55	+1.379	+0.10	+0.49	+0.55	+0.55
Dispensing fee	-1.30	+0.00	-0.60	+0.17	+0.52	+0.46	+0.04	+0.17	+0.19	+0.16
Drug prices (actual)	-1.40	-1.05	-1.80	-1.20	-1.36	-1.375	-1.36	-1.33	-1.74	-1.01
NHI basis	-6.30	-4.20	-6.70	-5.20	-5.75	-6.00	-5.64	-5.57	-7.48	-4.38
Consumption tax addition	-	-	-	-	-	-	+1.36	-	-	-
Total (nominal)	-2.70	-1.05	-3.16	-0.82	+0.19	+0.004	+0.10	-0.84	-1.19	-0.46

Source: Shared Research based on company data

The key point regarding dispensing fees raised around the time of the FY2018 revision is a reassessment of the role of dispensing pharmacies with an emphasis on patient-centered service. Specifically, it promotes evaluation of family pharmacies and pharmacists, patient-centric businesses and at-home medical care; and promotes the use of generic drugs. It also encourages the

proper assessment of large pharmacies operating near medical institutions. On generic drug utilization, MHLW is continuing efforts to improve utilization rates, and the FY2020 medical fee revision includes components that will further stimulate generic drug use.

Generic drug ratio



Source: Shared Research based on MHLW's Recent Trends of Dispensing Medical Costs (electronically processed)

Key points of medical fee revision

	Pre-revision	Points	Post-revision	Points
Basic dispensing fee	Basic dispensing fee 1 [Pharmacies other than those listed below]	42	Basic dispensing fee 1 [Pharmacies other than those listed below]	42
	Basic dispensing fee 2 1) Prescriptions exceed 4,000 per month and concentration rate exceeds 70% 2) Prescriptions exceed 2,000 per month and concentration rate exceeds 85% 3) Prescriptions from one medical institution exceeds 4,000 per month → For pharmacies sharing a building with multiple medical institutions, total number of prescriptions of all medical institutions is used 4) Prescriptions from one medical institution exceeds 4,000 per month	26	Basic dispensing fee 2 1) Prescriptions exceed 1,800–2,000 per month and concentration rate exceeds 95% 2) Prescriptions total 2,000–4,000 per month and concentration rate exceeds 85% 3) Prescriptions from one medical institution exceeds 4,000 per month → For pharmacies sharing a building with multiple medical institutions, total number of prescriptions of all medical institutions is used 4) Prescriptions from one medical institution exceeds 4,000 per month	26
	Basic dispensing fee 3a) [Pharmacy in a group with 40,000–400,000 prescriptions per month that meets the following criteria] 1) Concentration rate exceeds 85% 2) Has real estate rental transaction with specific medical institution	21	Basic dispensing fee 3a) 1) Prescriptions total 35,000–40,000 per month and concentration rate exceeds 95% 2) Prescriptions total 40,000–400,000 per month and concentration rate exceeds 85% 3) Has real estate rental agreement with specific medical institution (Excludes basic dispensing fee 1 pharmacies)	21
	Basic dispensing fee 3b) [Pharmacy in a group whose prescriptions exceed 40,000 per month that meets one of the following criteria] 1) Concentration rate exceeds 85% 2) Has real estate rental transaction with specific medical institution	16	Basic dispensing fee 3b) [Pharmacy in a group whose prescriptions exceed 40,000 per month that meets one of the following criteria] 1) Concentration rate exceeds 85% 2) Has real estate rental transaction with specific medical institution	16
	Special basic dispensing fee 1. Pharmacy with specific relationship with a hospital (such as real estate rental transaction) and the concentration rate for the hospital exceeds 95% 2. Pharmacy does not meet criteria for Basic dispensing fee 1, 2, 3a) or 3b) (pharmacy that has not submitted notifications)	11	Special basic dispensing fee 1. Pharmacy with specific relationship with a hospital (such as real estate rental transaction) and the concentration rate for the hospital exceeds 70% 2. Pharmacy does not meet criteria for basic dispensing fee 1, 2, 3a) or 3b) (pharmacy that has not submitted notifications)	9
	Subtractions * If generic drug volume dispensing ratio is 20% or lower	-2	* If generic drug volume dispensing ratio is 40% or lower * When prescriptions are received from multiple medical institutions at the same time, points for prescriptions other than the first	-2 -20%
Community support system incentives	Basic dispensing fee 1 Must meet all three criteria below 1) Is a licensed narcotics retailer 2) Has track record of providing in-home services in the past year 3) Has submitted notifications for family pharmacist guidance fees or comprehensive management fees		Basic dispensing fee 1 Must meet criteria 1–3, or criterion 4 or 5 1) Is a licensed narcotics retailer 2) Has provided in-home pharmaceutical management and guidance service 12 or more times 3) Has submitted notifications for family pharmacist guidance fees or comprehensive management fees 4) Has submitted dosing information in writing 12 or more times 5) Certified pharmacist has attended community care conference of medical professionals at least once	
	Other than basic dispensing fee 1 (effective criteria: 1) – 8) per full-time pharmacist in the past year) Has structure for, and substantial track record in, contributing to community care 1) Night-time and holiday service premium (400 times) 2) Premium for narcotics guidance and management (10 times) 3) Premium for prevention of drug duplication/drug interactions (40 times) 4) Family pharmacist guidance fee (40 times) 5) Outpatient medication support fee (12 times) 6) Medication adjustment support fee (once) 7) In-home medication management fee (12 times)	35	Other than basic dispensing fee 1 (effective criteria: 1) – 8) per full-time pharmacist in the past year) Meets eight out of nine criteria below 1) Night-time and holiday service premium (400 times) 2) Premium for narcotics guidance and management (10 times) 3) Premium for prevention of drug duplication/drug interactions (40 times) 4) Family pharmacist guidance fee (40 times) 5) Outpatient medication support fee (12 times) 6) Medication adjustment support fee (once) 7) In-home medication management for single-building medical examination patients (12 times) * Includes service provided by in-home service partner pharmacy or equivalent service provided 8) Fee for providing medication information (60 times) * Includes equivalent service provided 9) Certified pharmacist has attended community care conferences of medical professionals five or more times	38
Generic drug dispensing premiums	Premium 1: Generic drug volume share exceeds 75%	18	Premium 1: Generic drug volume share exceeds 75%	15
	Premium 2: Generic drug volume share exceeds 80%	22	Premium 2: Generic drug volume share exceeds 80%	22
	Premium 3: Generic drug volume share exceeds 85%	26	Premium 3: Generic drug volume share exceeds 85%	28
Dispensing fee	Oral medications One to seven days	5 per day		28
	8–14 days	4 per day		55
	15–21 days			64
	22–30 days			77
Pharmaceutical management fee				
Drug history management and instruction fee	1) In principle, when patient brings back prescription within six months	41	1) In principle, when patient brings back prescription within six months	43
	2) When service is provided to patients other than 1)	53	2) When service is provided to patients other than 1)	57
	3) When visitation service is provided to intensive care homes for the elderly	41	3) When visitation service is provided to intensive care homes for the elderly	43
	Patients with no drug history notebook, other than Basic dispensing fee 1	53	4) When online pharmaceutical guidance service is provided	43
	Pharmacies not considered to have a substantial track record of using drug history notebooks	13	Pharmacies not considered to have a substantial track record of using drug history notebooks	13
Medication adjustment support fee			When six or more oral medications from multiple medical institutions are centrally managed and a written proposal to prevent drug duplication is sent to prescribing physicians	100
Online in-home pharmaceutical guidance fee			Fee paid when pharmacy submits notification for pharmaceutical management and guidance fee 4 and provides online pharmaceutical guidance	57

Source: Shared Research based on company data

Industry peers (dispensing pharmacy chains)

As industry peers we selected listed companies that operate dispensing pharmacies as their mainstay business. Comparing the operating profit margin of the business segments that operated dispensing pharmacies, Ain Holdings (TSEI: 9627) had the highest OPM. Profit margins declined across the board in FY2017 owing to the diminished impact of major drugs for hepatitis C. The whole industry was affected by the NHI medical fee revision in FY2019, with almost all companies recording lower profit margin than in the previous fiscal year. Medical System Network's segment profit for the Dispensing Pharmacy business ranks around the middle among its peers.

Comparison of profit margins of industry peers' pharmacy operation segments

Ticker	Company	FY end	FY2016	FY2017	FY2018	FY2019	FY2020
2796	Pharmarise Holdings	May	2.6%	2.0%	3.5%	2.3%	-
3034	Qol	March	5.8%	5.1%	6.4%	4.7%	4.7%
3341	Nihon Chouzai	March	5.6%	5.0%	6.0%	4.2%	4.2%
4350	Medical System Network *	March	4.2%	2.8%	3.5%	3.6%	3.8%
4775	Sogo Medical Holdings **	March	5.0%	6.3%	6.5%	5.0%	-
7649	Sugi Holdings ***	February	5.6%	5.3%	5.4%	5.3%	5.5%
9627	Ain Holdings	April	9.1%	8.6%	9.5%	7.5%	-

Source: Shared Research based on each company's data and websites (as of end-May 2020)

Notes: * Values for Medical System Network are profit margins of the Community Pharmacy Network business from 2019.

** Sogo Medical: FY2016 earnings are total profit margins as segment information is regional, transitioned to a holding company (9277) in October 2018 and delisted on April 17, 2020.

*** Sugi Holdings: Total company profit margins since there is only one segment.

Main industry peers

Ticker	Company	Latest full-year earnings			Description
		Sales (JPYmn)	OPM	ROE	
2796	Pharmarise Holdings	51,728	1.2%	0.4%	Middle-tier pharmacy chain. Leverages partnerships with regional drug wholesalers to acquire local dispensing chains. Has a reputation for community care support. Established joint ventures with Higuchi and FamilyMart to develop pharmacies. [Consolidated sales] Dispensing Pharmacy 79, Sales 17, Storage and Management of Medical Documents 1, Medical Mall 1
3034	Qol	165,411	4.7%	10.3%	Major pharmacy chain. Started as monzen pharmacy. Opened stores with Lawson and Bic Camera. Also developing MR and pharmacist dispatch business. [Consolidated sales] Insurance pharmacy 93, BPO 7
3341	Nihon Chouzai	222,147	2.8%	15.2%	Second-ranked dispensing pharmacy chain. Nationwide expansion centered on monzen pharmacies in Kanto-Koshinetsu area. Established generic drug manufacturing subsidiary, also developing in-house drugs. Referral & placement of medical staff such as pharmacists. [Consolidated sales] Dispensing Pharmacy 80, Pharmaceutical Manufacturing and Sales 15, Medical Professional Staffing and Placement 5
4350	Medical System Network	98,232	1.5%	4.3%	Dispensing pharmacy holding company that also operates a pharmaceutical information intermediary network business. Started in Hokkaido, but expanding nationwide through M&A. [Consolidated sales] Pharmaceuticals Network 4, Dispensing Pharmacy 90, Leasing and Facility-related 2, Food Service 4, Other 0
7649	Sugi Holdings	541,964	5.5%	11.9%	Developed drugstore/dispensing pharmacy, Sugi Pharmacy, in its stronghold Tokai area. The holding company also has discount stores. [Consolidated sales] Pharmacy 79, Drugstore 21
-	Sogo Medical Holdings	-	-	-	Started with hospital room TV and equipment rental business. Entered dispensing pharmacy business, and expanded from local Kyushu to Kinki, Chubu, and East Japan areas. Also engages in medical practice support and hospital revitalization consulting business. [Consolidated sales] Medical Practice Support 26, Dispensing Pharmacy 73, Other 1
9627	Ain Holdings	275,596	5.8%	9.0%	Top-ranked dispensing pharmacy chain. Originated in Hokkaido, expanded into metropolitan areas, with nationwide coverage of mainly monzen pharmacies. Concluded capital and business tie-up with Seven & i Holdings. [Consolidated sales] Dispensing Pharmacy 89, Drug and Cosmetic Store 9, Other 2

Source: Shared Research based on company data

Note: Sogo Medical (4775) became Sogo Medical HD (9277) in October 2018 and delisted on April 17, 2020.

Medical System Network ranks among the top ten dispensing pharmacy chains by sales. They all have negative cash flow from investment activities, which we attribute to their strategies of achieving growth by absorbing smaller local dispensing pharmacies (these smaller pharmacies account for 90% of the market). In contrast, Medical System Network has two growth options: integrate pharmacies into the Nanohana Pharmacy group through capital investment, or allow the smaller pharmacy to continue operating independently and bring them into the company group as affiliates (i.e., network users).

Financials of industry peers

(JPYmn)	Medical System Network (4350)			Pharmarise Holdings (2796)			Qol (3034)		
	FY03/18	FY03/19	FY03/20	FY05/17	FY05/18	FY05/19	FY03/18	FY03/19	FY03/20
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	93,977	98,232	105,241	52,949	54,562	51,728	145,516	144,783	165,411
Gross profit	36,607	37,271	40,214	7,218	7,950	7,342	19,648	17,863	21,094
SG&A expenses	33,444	35,842	38,599	6,775	6,771	6,702	10,557	10,812	13,361
Operating profit	3,163	1,428	1,615	442	1,179	640	9,091	7,050	7,733
Recurring profit	3,250	1,501	1,560	324	1,092	590	9,333	7,208	8,024
Net income	1,022	462	-895	7	-28	23	4,986	3,970	4,067
ROE	9.8%	4.3%	4.3%	0.1%	-0.5%	0.4%	13.9%	10.5%	10.3%
ROA (RP-based)	5.7%	2.3%	2.3%	1.3%	4.5%	2.4%	10.7%	7.9%	8.1%
OPM	3.4%	1.5%	1.5%	0.8%	2.2%	1.2%	6.2%	4.9%	4.7%
Total assets	62,759	68,935	66,464	24,540	24,265	24,217	87,315	94,236	102,872
Net assets	10,584	10,761	9,418	5,900	5,624	5,619	35,935	39,017	41,001
Equity ratio	16.9%	100.0%	100.0%	21.7%	21.8%	21.9%	41.2%	41.1%	39.4%
Operating CF	6,699	2,840	4,232	2,103	1,330	895	11,116	5,773	4,468
Investing CF	-6,848	-5,921	-2,383	-871	-527	-501	-3,775	-8,287	-8,670
Financing CF	8,050	4,338	-1,687	-816	-894	354	-1,685	2,906	-225
Cash and deposits	10,136	11,520	0	3,734	3,643	4,393	19,800	193	15,766
Interest-bearing debt	33,792	38,897	37,558	10,359	10,550	11,138	22,560	28,873	32,650
Net debt	23,656	27,377	37,558	6,625	6,907	6,745	2,760	28,680	16,884
	Nihon Chouzai (3341)			Sugi Holdings (7649)			Sogo Medical Holdings (9277)		
	FY03/18	FY03/19	FY03/20	FY02/18	FY02/19	FY02/20	FY03/18	FY03/19	FY03/20
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	241,274	245,687	222,147	457,047	488,464	541,964	-	144,630	-
Gross profit	43,837	41,975	46,372	131,565	142,300	162,182	-	22,715	-
SG&A expenses	33,250	35,242	38,779	106,804	116,483	132,420	-	17,303	-
Operating profit	10,587	6,733	7,593	24,760	25,817	29,762	-	5,411	-
Recurring profit	10,138	6,077	7,405	25,900	27,237	31,473	-	5,607	-
Net income	6,104	3,792	6,697	16,411	17,940	20,782	-	3,246	-
ROE	15.7%	9.2%	15.2%	10.1%	10.9%	11.9%	-	8.7%	-
ROA (RP-based)	5.6%	3.3%	4.1%	10.2%	10.5%	10.9%	-	6.1%	-
OPM	4.4%	2.7%	2.8%	5.4%	5.3%	5.5%	-	3.7%	-
Total assets	186,573	178,677	185,551	253,989	265,481	313,757	-	93,560	-
Net assets	41,506	41,073	47,072	162,046	166,563	182,750	-	38,669	-
Equity ratio	22.2%	23.0%	25.4%	63.8%	62.7%	58.2%	-	41.0%	-
Operating CF	23,141	13,572	13,192	27,564	22,894	45,353	-	3,852	-
Investing CF	-13,843	-1,770	-2,731	-17,911	-22,362	-18,422	-	-6,624	-
Financing CF	-2,034	-10,516	-7,955	-3,401	-13,897	-4,895	-	-945	-
Cash and deposits	28,464	29,749	32,254	47,676	34,311	56,347	-	10,733	-
Interest-bearing debt	84,689	82,391	63,624	0	0	0	-	22,373	-
Net debt	56,225	52,642	31,370	-47,676	-34,311	-56,347	-	11,640	-
	Ain Holdings (9627)								
	FY04/17	FY04/18	FY04/19						
	Cons.	Cons.	Cons.						
Sales	248,110	268,386	275,596						
Gross profit	42,093	47,993	45,363						
SG&A expenses	27,529	28,371	29,295						
Operating profit	14,563	19,623	16,067						
Recurring profit	15,081	20,130	16,637						
Net income	7,949	10,567	9,029						
ROE	14.0%	13.5%	9.0%						
ROA (RP-based)	10.2%	11.8%	8.9%						
OPM	5.9%	7.3%	5.8%						
Total assets	156,323	183,435	189,021						
Net assets	60,178	96,733	103,922						
Equity ratio	38.4%	52.7%	54.9%						
Operating CF	18,409	21,657	14,788						
Investing CF	-11,183	-5,282	-19,985						
Financing CF	116	17,623	-10,681						
Cash and deposits	29,234	63,233	47,495						
Interest-bearing debt	25,852	18,861	11,957						
Net debt	-3,382	-44,372	-35,538						

Strengths and weaknesses

Strengths

- Management support network service available to small and mid-tier pharmacies:** Small pharmacies and mid-tier regional chains (90% of the market) fall behind major nationwide chains in buying power versus drug wholesalers and means to optimize pharmaceuticals inventory. However, by joining the company's network and becoming an affiliate, they can tap into majors-class strength and infrastructure without giving up their autonomy to a major pharmacy chain. The process does not involve a business transfer, so the hurdle for joining the network is relatively low. The company has a network system boasting the largest pharmaceuticals order volume in Japan, and negotiates procurement terms with suppliers on behalf of its members. It is also the only company that offers a dead stock clearance service, which matches members' inventory surpluses with deficiencies to reduce costly write-offs. This service cuts operating costs of network members by 1.3% (company estimate) on average even after factoring for the network usage fee. From the company's standpoint, an increase in network members translates to revenue growth from rising commissions and greater buying power in the pharmaceuticals market.
- Certified pharmacist training support system that appeals to pharmacies struggling with pharmacist shortage:** The company's Pharmaceuticals Network business collaborates with a training organization to support pharmacists (both network member pharmacists and others) enrolled in a certification program authorized by the Japan Pharmacists Education Center (JPEC). Aimed at raising the skill level of pharmacists, the JPEC program certifies those pharmacists who have completed their credit requirements through participation in various training courses (40 credits within four years and 30 credits every three years thereafter). The certification is one of the criteria of a "family pharmacist," whose pharmacy becomes eligible to charge an additional family pharmacist guidance fee. The company mainly utilizes its directly operated pharmacies and affiliates to help the training organization Iyaku Sogo Kenkyukai (ISK) run its accredited training courses nationwide. The service strengthens pharmacists' loyalty to their employers and improve recruitment outcomes. ISK is one of the few private-sector organizations registered with JPEC as a training organization and is authorized to issue the proof of attendance stickers that JPEC issues at its training courses.
- Regional dispensing pharmacy strategy in line with administrative guidance:** A distinguishing feature of the company's dispensing pharmacies is their high concentration in medical malls. This is in line with MHLW's vision for the role of pharmacies in the face of an aging society, and the company's outlet-location strategy benefits from the revised insurance point system. MHLW has revised dispensing fees to encourage a shift away from the pharmacy model linked to specific hospitals (pharmacies operating adjacent to large hospitals) and toward the family pharmacy and regional medical care models that accept prescriptions from a wide range of medical institutions. The company's strategy of opening pharmacies in medical complexes is in line with MHLW guidance and works to its favor in terms of dispensing fee eligibility.

Weaknesses

- Potential conflict of interest between M&A-driven pharmacy chain expansion and support services for small pharmacies:** The Pharmaceuticals Network business provides non-group pharmacies access to the company's proprietary system, thus allowing them to maintain management independence, but this has the potential negative effect of impeding growth of the Dispensing Pharmacy business. While the company's peers are expanding through acquisition of smaller pharmacies, the availability of membership to the Pharmaceuticals Network system is a possible lifeline to smaller pharmacies that could encourage them to delay M&A action.
- Low profit margins for dispensing pharmacies without drugstore function:** The Dispensing Pharmacy business OPM of about 3.0% (based on disclosed data through FY03/19) is 2–5pp below that of other major chains. This is mainly because most of the company's dispensing operations are limited to prescription drugs and are not accompanied by drugstore functions handling items such as OTC drugs, long-term care products, and toiletries. Many of the other major chains have adopted the strategy to boost pharmacy profit margins by integrating drugstore operations with added floor space for food products and cosmetics. The company is looking to expand its product offerings to include various long-term care products like adult diapers as part of a family pharmacy service, but it will take time to transition to this business format.
- Relatively small assets a disadvantage in acquisitions:** The company is at a disadvantage versus the major players in terms of asset scale when it comes to acquisitions targeting pharmacy chain expansion. Looking at the M&A-based increases

in outlet numbers over the past three years, industry leader Ain Holdings acquired more than 100 pharmacies while Medical System Network acquired just three pharmacies in FY03/19. From the perspective of regional expansion, about 30% of the company's pharmacies are located in Hokkaido while less than 10% are located in Tokyo and Osaka, despite their high population density. In total assets, an important indicator of the buyer's financial strength in an M&A deal, comparable companies range in the JPY100.0bn mark and over, while Medical System Network significantly falls behind at around JPY65.0bn. In order to advance acquisitions and increase pharmacy outlets in regions other than its home ground Hokkaido, the company will need to be able to demonstrate its financial strength to the sell-side companies' management as well as M&A intermediaries.

Historical performance and financial statements

Income statement

Income statement (JPY/mn)	FY09/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.	FY03/20 Cons.
Sales	46,508	25,411	54,827	66,182	75,548	87,715	88,865	93,977	98,232	105,241
YoY	13.1%	-	-	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%
Cost of sales	30,292	16,451	35,415	43,445	47,072	54,913	54,700	57,369	60,961	65,027
Gross profit	16,217	8,960	19,412	22,737	28,476	32,801	34,164	36,607	37,271	40,214
YoY	15.2%	-	-	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%
GPM	34.9%	35.3%	35.4%	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%
SG&A expenses	13,954	7,603	17,365	20,646	25,835	29,018	32,050	33,444	35,842	38,599
SG&A ratio	30.0%	29.9%	31.7%	31.2%	34.2%	33.1%	36.1%	35.6%	36.5%	36.7%
Operating profit	2,262	1,357	2,047	2,091	2,641	3,783	2,113	3,163	1,428	1,615
YoY	48.0%	-	-	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%
OPM	4.9%	5.3%	3.7%	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%
Non-operating income	100	81	150	250		457	275	378	405	288
Non-operating expenses	223	124	284	321	349	380	279	291	333	343
Recurring profit	2,140	1,315	1,912	2,020	2,540	3,860	2,109	3,250	1,501	1,560
YoY	61.0%	-	-	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%
RPM	4.6%	5.2%	3.5%	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%
Extraordinary gains	111	25	59	155	169	88	57	19	49	48
Extraordinary losses	302	41	65	404	415	470	260	976	128	1,586
Income taxes	801	702	1,018	1,073	1,315	1,599	1,262	1,271	962	918
Implied tax rate	41.1%	54.1%	53.4%	60.6%	57.3%	46.0%	66.2%	55.4%	67.7%	4172.7%
Net income attrib. to non-controlling interests	146	78	133	29	92	158	72	0	-2	0
Net income	1,001	518	756	668	885	1,720	571	1,022	462	-895
YoY	111.5%	-	-	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%	-293.7%
Net margin	2.2%	2.0%	1.4%	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%	-0.9%

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Changed fiscal year-end in FY03/12; started third medium-term plan from March 2013

Medical System Network changed its fiscal year-end from September to March effective FY03/12, resulting in an irregular six-month term for October 2011–March 2012; sales in FY03/12 were approximately half the FY09/11 figure.

The third medium-term plan (FY03/13–FY03/15) began the following year. We believe the company has also applied plan targets to its business strategy from FY03/16 and beyond (the fourth medium-term plan), i.e., to increase the number of network member pharmacies and grow its own dispensing pharmacies. The five key initiatives of the fifth medium-term plan, which started in FY03/19, are as follows. We note that OPM has remained in the 1% range amid a severe business environment such as NHI medical fee revisions and price negotiations with wholesalers.

1. Expand Pharmaceuticals Network business
2. Strengthen family pharmacy functions of company-run dispensing pharmacies
3. Grow generics drugs business
4. Enhance collaboration between group companies to provide community care functions needed under the community-based integrated care system as a group
5. Strengthen financial position

SG&A expenses

SG&A expenses (JPYmn)	FY09/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.
Salaries and allowances	5,217	2,806	6,364	7,489	9,266	10,406	12,088	12,481	13,467
Provision for employee bonuses	554	582	685	724	939	1,062	1,133	1,418	1,333
Retirement benefit expenses	147	88	172	195	264	329	361	466	457
Provision for directors' bonuses	57	32	64	68	76	55	47	35	33
Provision for directors' stock benefits						33	52	38	33
Taxes and dues	1,589	853	1,913	2,350	3,870	4,479	4,374	4,420	4,692
Depreciation	449	270	658	802	945	1,029	1,052	1,491	1,624
Amortization of goodwill	338	177	487	669	849	917	1,009	1,056	1,147
Other	4,380	2,142	5,509	6,612	7,537	8,486	9,630	9,559	15,827
Total SG&A expenses	13,954	7,603	17,365	20,646	25,835	29,018	32,050	33,444	35,842

Source: Shared Research based on company data

Extraordinary losses in excess of JPY400mn were booked in each of the three years between FY03/14–FY03/16; these were mainly impairment losses at pharmacies that failed to reach projected earnings. The company monitors the profitability of each pharmacy based on specific criteria and provides guidance when they are not met. If improvements are not made within a specified period of time, the company closes the pharmacy and sells off the business rights. In FY03/20, the company booked an impairment charge on fixed assets of existing stores and shares in acquired companies to reflect the impact of the spread of COVID-19.

Balance sheet

Balance sheet (JPYmm)	FY09/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.	FY03/20 Cons.
ASSETS										
Cash and deposits	1,329	2,072	2,092	3,106	2,499	2,081	2,252	10,201	11,703	11,722
Notes and accounts receivable	2,238	2,597	1,514	2,802	2,484	2,614	2,223	2,332	2,420	2,313
Inventories	1,776	1,796	2,219	2,732	3,846	3,431	4,053	3,520	4,297	4,452
Other	634	629	614	664	709	927	958	868	1,528	940
Allowance for doubtful accounts	-2	-3	-6	-6	-7	-7	-10	-11	-12	-12
Total current assets	7,787	8,902	8,271	10,941	11,023	10,783	11,098	18,736	21,055	20,578
Total tangible fixed assets	9,163	9,976	11,472	15,976	17,249	20,253	21,246	24,129	25,721	25,126
Total intangible fixed assets	4,983	5,040	8,263	12,399	13,554	13,481	13,833	15,045	16,235	14,615
Investment securities	39		54	179	157	524	583	812	726	483
Long-term loans										
Other	2,607	2,728	2,771	3,645	3,631	3,838	4,008	4,066	5,217	5,686
Allowance for doubtful accounts	-44	-43	-42	-26	-29	-33	-32	-31	-21	-26
Investment and other assets	2,602	2,685	2,783	3,798	3,759	4,329	4,559	4,847	5,922	6,143
Total fixed assets	16,747	17,701	22,518	32,173	34,564	38,063	39,639	44,023	47,879	45,885
Total assets	24,534	26,603	30,789	43,114	45,587	48,847	50,737	62,759	68,935	66,464
LIABILITIES										
Notes and accounts payable	5,026	5,158	5,616	7,798	8,598	9,525	9,144	9,416	10,198	10,021
Short-term debt	2,478	3,856	5,119	12,922	9,214	6,910	3,863	7,463	9,158	8,905
Income taxes payable	590	582	459	578	599	1,065	413	1,135	695	454
Other	2,706	3,097	3,181	3,582	3,215	3,561	3,500	3,755	3,793	3,916
Total current liabilities	10,801	12,693	14,375	24,880	21,626	21,061	16,920	21,769	23,844	23,296
Long-term debt	7,365	7,029	8,758	10,948	15,391	14,859	20,186	26,329	29,739	28,653
Deferred tax assets	1	1	1	1	1	1	1			
Other	1,104	1,200	1,419	1,933	2,434	2,660	2,985	4,075	4,590	5,096
Total fixed liabilities	8,470	8,230	10,178	12,882	17,826	17,520	23,172	30,404	34,329	33,749
Total liabilities	19,271	20,923	24,553	37,762	39,452	38,581	40,092	52,174	58,173	57,045
NET ASSETS										
Capital stock	1,091	1,091	1,091	1,091	1,091	1,932	1,932	2,097	2,128	2,128
Capital surplus	924	924	901	901	901	1,742	1,742	1,160	1,185	1,183
Retained earnings	2,924	3,281	3,836	4,300	4,980	6,467	6,735	7,459	7,616	6,414
Treasury stock	0	0	-45	-1,181	-1,147	-328	-302	-275	-233	-206
Valuation differences on securities	-7	-5	3	2	11	15	49	143	83	-37
Foreign currency translation adjustments										
Other	-58	-52	-40	-31	-28	-17	23	52,316	58,239	56,945
Non-controlling interests	382	436	493	273	338	469	514	2	0	0
Total net assets	5,263	5,680	6,236	5,352	6,136	10,265	10,644	10,584	10,761	9,418
Total liabilities and net assets	24,534	26,603	30,789	43,114	45,588	48,846	50,736	62,759	68,935	66,464
Working capital	-1,011	-765	-1,883	-2,265	-2,268	-3,480	-2,868	-3,564	-3,481	-3,256
Total interest-bearing debt	9,843	10,885	13,877	23,870	24,605	21,769	24,049	33,792	38,897	37,558
Net debt	8,514	8,813	11,785	20,763	22,120	19,708	21,814	23,591	27,194	25,836

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Assets: Assets expanded from 2012–13 on business growth

The company's business transformed in 2012–13, due in part to the formulation of its third medium-term plan. The company's consolidated subsidiary Pharmaholdings Co., Ltd., which operates dispensing pharmacies, entered a business alliance in December 2012 with Hanshin Dispensing Pharmacy Co., Ltd. (now equity-method subsidiary Hanshin Dispensing Holding Co., Ltd.). In July 2013, the two companies established a joint venture, H&M Co., Ltd. The main purpose of the joint venture was joint sourcing and distribution of pharmaceuticals, purchase of medical devices, and clearance of dead stock. H&M's chief goal is not to win pricing concessions from drug wholesalers as a result of buying power due to large-volume procurement, but to collaborate with drug wholesalers to set economically rational prices. This is the core objective of the company's Pharmaceuticals Network business.

Assets have continued to increase under the fourth medium-term plan and beyond. The company has sought to increase the number of dispensing pharmacies by M&A, but has carefully monitored the performance of pharmacies and booked impairment charges or disposed of those whose earnings have not improved. Under the fifth medium-term plan, the company booked an impairment charge of JPY1.5bn in FY03/20 to reflect the impact of the spread of COVID-19.

Liabilities: External financing

Liabilities rose during this period as the number of group pharmacies increased in line with a rising network member count. The increase in current assets, which is working capital, was especially pronounced in FY03/14, when in addition to the increase in current assets, tangible fixed assets increased JPY4.5bn (+JPY2.5bn for buildings, +JPY1.9bn for land) and intangible fixed assets increased JPY4.1bn (JPY4.1bn increase in goodwill). Assets also increased in FY03/15 (buildings and structures +JPY237mn, land +JPY640mn, goodwill +JPY961mn). Growing demand for funds was met primarily through external financing. Short-term borrowings increased by about JPY7.0bn to JPY102.7bn in FY03/14, while long-term borrowings increased by about JPY4.5bn to JPY14.2bn in FY03/15 and has continued to gradually rise. Short- and long-term borrowings have been over JPY30.0bn since FY03/18.

Net assets: Capital stock increase in FY03/16

The company increased capital and retired treasury stock in FY03/16, lifting the equity ratio in line with one of the third medium-term plan targets of achieving a ratio of 20% or higher. At the same time, management shored up the balance sheet through reducing short-term borrowing by JPY6.2bn YoY. Improving its financial position remains a key initiative of its fifth medium-term plan.

Cash flow statement

Cash flow statement (JPYmn)	FY09/11	FY03/12	FY03/13	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Cash flows from operating activities (1)	3,353	1,566	3,790	3,706	3,838	6,409	3,084	6,699	2,840	4,232
Pre-tax profit	1,948	1,298	1,907	1,770	2,294	3,479	1,906	2,293	1,422	22
Depreciation	633	354	841	1,077	1,209	1,362	1,594	1,491	1,624	1,811
Goodwill amortization	337	177	487	669	849	917	1,009	1,056	1,147	1,217
Change in accounts receivable	669	-325	1,739	382	935	191	812	496	500	285
Change in inventories	-181	8	-74	-173	-689	455	-472	759	-620	-140
Change in accounts payable	354	102	-558	365	-295	683	-765	-569	69	-328
Cash flows from investing activities (2)	-2,747	-1,248	-5,425	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383
Purchase of tangible fixed assets	-2,488	-805	-1,625	-4,180	-2,360	-3,674	-2,170	-4,050	-3,094	-1,351
Purchase of intangible fixed assets	-5	-1	-13	-44	-93	-273	-192	-190	-82	-107
Purchase, sale, and redemption of investment securities	10	2	1	129		-267	-19	-39	-16	102
Change in loans (net of long- and short-term)	36	18	-245	-56	-106	-106	-38	-95	-3	-102
Free cash flow (1+2)	606	318	-1,635	-3,853	-120	1,369	-825	-149	-3,081	1,849
Cash flows from financing activities	-1,069	425	1,654	4,864	-483	-1,792	998	8,050	4,338	-1,687
Change in short-term borrowings	175	1,293	685	7,255	-4,334	-2,314	-3,241	2,598	1,471	-505
Change in long-term borrowings	-728	-489	1,846	-250	4,816	-896	5,292	7,292	3,701	-376
Acquisition of treasury stock	0	0	-129	-1,155		1,005	0			
Dividends paid	-117	-162	-276	-221	-190	-229	-297	-297	-304	-305

Source: Shared Research based on company data

Note: Figures may differ from company materials due to differences in rounding methods.

Cash flows from operating activities

Cash flow from operating activities since FY03/12, when the accounting period was changed, has trended around JPY3.7bn–3.8bn, approximately half of which is derived from pre-tax profit, except for FY03/16–FY03/17 when profits fluctuated sharply. FY03/16–FY03/17 earnings were impacted by a number of temporary factors and a changing business environment owing to NHI drug price and dispensing fee revisions. The company notes temporary factors that boosted FY03/16 profits such as JPY242mn in gains from the sale of real estate, JPY100mn in subsidies for opening a serviced elderly housing facility, and a JPY90mn tax benefit from acquisition of subsidiary shares. The decline in FY03/17 profits was exacerbated by factors such as drug price and dispensing fee revisions, a winding down of major hepatitis C drug sales, and the absence of temporary factors that boosted FY03/16 profits. Operating cash flow in FY03/19 declined by half YoY owing to the April 2018 NHI price revision, but turned positive again in FY03/20 as earnings recovered.

Depreciation and goodwill have been steadily increasing (except during the abbreviated accounting period) on business expansion owed to an upswing in the number of group pharmacies, and this has had a positive impact on cash flow. Accounts receivable and accounts payable tend to fluctuate from year-end to year-end, showing no set pattern as the timing of receivable collections and the debt repayment period varies. Further, fiscal years with negative cash flow for inventory assets are common. We think this is due to the nature of Medical System Network's business of handling prescription drugs, which calls for the maintenance of sufficient inventories to avert shortage versus prescriptions.

Cash flows from investing activities

Cash flow from investing activities has been consistently negative for the 10 years through FY03/17 owing to a business expansion strategy that leverages alliances and M&A. The cash flow deficit from investing activities has been especially pronounced since the third medium-term plan was initiated in FY03/13. Prior to that, it was typically in the JPY1.0bn–3.0bn range, but then expanded to the JPY4.0bn–7.0bn range. In FY03/14, the company posted its largest cash flow deficit in 10 years, but this was mostly due to acquisition of tangible fixed assets: JPY4.2bn for serviced elderly housing facilities and land/buildings for new pharmacies and JPY4.2bn for shares acquired through M&A and from business transfers. Even in other fiscal years, the acquisition of land and buildings had a major impact on cash flow from investing activities—JPY3.7bn in FY03/16 and JPY3.1bn in JPY03/19, accounting for the bulk of the deficit in both years. The company commented that Wisteria Minami Ichijo would be the last elderly housing planning and development project for a while.

The company aims to make its network system an industry standard by expanding the number of affiliates and to improve the profitability of the Dispensing Pharmacy business, and these remain objectives of the fourth medium-term plan and fifth medium-term plan starting in FY03/19, which targets expansion of its network and improving profitability of the Dispensing

Pharmacy business. As the company continues to invest in business expansions, free cash flow has been negative since the start of the third medium-term plan, with the exception of FY03/16 when free cash flow turned positive due to temporary factors that sharply lifted profits, and FY03/20, when there were few M&A deals.

Cash flows from financing activities

Financing will be indispensable as the company looks to continue expanding its business. In addition to using internal funds, the company raises funds through short- and long-term borrowing. We list the relatively large-scale financings of the past 10 years below. Most were short- and long-term borrowings, of which a large majority was for business expansion, such as purchase of real estate for new pharmacies and M&A.

In FY03/14, there was a JPY1.2bn cash flow deficit due to a share buyback accompanying the restructuring of an affiliated company. In FY03/16, cash flow saw a JPY2.8bn surplus as the company increased capital and sold treasury shares to improve its financial standing. Total borrowing also increased JPY5.2bn in FY03/19, but JPY3.9bn was invested in M&A, including the acquisition of Nagatomi Pharmacy. There were few M&A deals in FY03/20, because the company prioritized improving profitability of existing stores.

Historical performance

Q3 FY03/20 earnings results (out February 6, 2020)

Overview

Cumulative Q3 FY03/20 (April–December 2019) earnings results

- ▷ Sales: JPY78.9bn (+8.5% YoY)
- ▷ Operating profit: JPY1.2bn (+18.1% YoY)
- ▷ Recurring profit: JPY1.2bn (+19.6% YoY)
- ▷ Net income*: JPY326mn (-12.4% YoY)

*Net income attributable to owners of the parent

- ▷ No changes were made to the full-year FY03/20 earnings forecast.
- ▷ Business environment: NHI drug price and dispensing fee revisions were enacted in April 2018. Dispensing pharmacies had to streamline their management structures following the implementation of the MHLW's "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs," whose purpose was to ensure stable supply of ethical drugs.
- ▷ Company response: The company streamlined and consolidated the former Pharmaceuticals Network and Dispensing Pharmacy businesses into the Community Pharmacy Network business and began disclosure under the new segmentation from FY03/20. In cumulative Q3, sales in the Community Pharmacy Network business increased by 9.1% YoY, reflecting an increase in the number of network members and the steady sales at existing dispensing pharmacies. The segment operating profit margin was 3.7%, an improvement of 0.3pp YoY. These increases drove overall sales and profit growth for the period.

Segment performance

Community Pharmacy Network

This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other.

Cumulative Q3 FY03/20 (April–December 2019) segment earnings results

- ▷ Segment sales: JPY74.6bn (+9.1% YoY; includes internal sales or transfers between segments; same hereafter)
- ▷ Segment profit: JPY2.8bn (+18.5% YoY)
- ▷ Pharmaceuticals Network division: The number of new network members increased driven by the strong need for improved distribution efficiency. At end-December 2019, the number of network members was 4,922 (+1,132 from end-FY03/19), consisting of 421 directly operated pharmacies and 4,501 affiliates. The company aimed to have 5,000 network members by end-FY03/20, but it already reached that target in January 2020. According to the company, referrals from existing network members account for nearly half of all new network members. Of the 58,000 or so dispensing pharmacies in Japan, only about 10% are under the umbrella of major pharmacy chains. As such, Shared Research believes that independent dispensing pharmacies will continue joining its network for the time being. By end-Q3 FY03/20, network pharmacies' pharmaceuticals order value had already exceeded the full-year FY03/19 value of JPY233.7bn, at JPY246.6bn.
- ▷ Dispensing Pharmacy division: In addition to the contribution from stores acquired via M&A, comparable store sales remained steady. As at end-December 2019, there were 421 dispensing pharmacies, one care plan center, and seven drug stores. Affected both by the October 2019 consumption tax hike and NHI drug price and dispensing fee revisions, monthly dispensing fees were up only 2.2% YoY in October, a significant fall from the 10.0% YoY increase in September. Subsequently, monthly dispensing fees picked up and increased 2.8% YoY in November and 5.7% YoY in December, but the recovery in Q3

was only modest. On a comparable store basis, the number of prescriptions was 0.4% higher YoY in cumulative Q3, below the company's target of a 2.4% YoY increase. While initiatives such as automatic ordering systems helped streamline operations in the Dispensing Pharmacy division, Shared Research believes that growth in prescription numbers nonetheless struggled owing to external factors including a relatively low number of influenza diagnoses and bundling of multiple prescriptions.

- ▷ Manufacture and market pharmaceuticals division: This business, operated by consolidated subsidiary Feldsenf Pharma, aims to provide a stable supply of good-quality, low-priced generic drugs. The company sold 23 ingredients and 51 products as of end-December 2019.

Leasing and Facility-related

Cumulative Q3 FY03/20 (April–December 2019) segment earnings results

- ▷ Segment sales: JPY2.7bn (+11.6% YoY)
- ▷ Segment profit: JPY67mn (loss of JPY51mn in cumulative Q3 FY03/19)
- ▷ Reasons for sales and profit growth: Steady inflow of leasing revenue and rise in occupancy at the company's serviced elderly housing facilities contributed to earnings growth. Of the five facilities in the Wisteria serviced elderly housing series, three have occupancy ratios in excess of 90%, contributing to profit. As of end-December 2019, the number of occupied units at the two remaining facilities was 63 out of 82 units total at Wisteria Senri-Chuo, and 67 out of 116 units total at Wisteria Minami Ichijo. The company continued to carry out aggressive sales activities aimed at boosting occupancy. At 76.8%, the end-Q3 occupancy ratio at Wisteria Senri-Chuo was close to 80%, and according to the company this facility was just about breaking even. Wisteria Minami Ichijo seemed to be receiving many inquiries from potential residents, due in part to its favorable location.

Food Service

Cumulative Q3 FY03/20 (April–December 2019) segment earnings results

- ▷ Segment sales: JPY2.1bn (-10.7% YoY)
- ▷ Segment loss: JPY38mn (profit of 28mn in cumulative Q3 FY03/19)
- ▷ Business reforms: Despite withdrawals from unprofitable facilities and pricing adjustments made to contracts, segment earnings were hurt by higher labor costs as the company employed temporary resources in response to staff shortage.

Other

The main business is home-visit nursing care. The company is working out how best to incorporate community healthcare in this business; it believes that synergies can be realized between the home-visit nursing care business and the Community Pharmacy Network segment's Dispensing Pharmacy business.

Cumulative Q3 FY03/20 (April–December 2019) segment earnings results

- ▷ Segment sales: JPY122mn (-26.5% YoY)
- ▷ Segment loss: JPY56mn (loss of JPY82mn in cumulative Q3 FY03/19)

1H FY03/20 earnings results (out November 7, 2019)

Overview

1H FY03/20 (April–September 2019) earnings results

- ▷ Sales: JPY52.2bn (+9.8% YoY)
- ▷ Operating profit: JPY796mn (+67.2% YoY)

- ▷ Recurring profit: JPY784mn (+79.0% YoY)
- ▷ Net income*: JPY218mn (+83.2% YoY)

*Net income attributable to owners of the parent

- ▷ No changes were made to the full-year FY03/20 earnings forecast.
- ▷ Business environment: NHI drug price and dispensing fee revisions were conducted in April 2018. Dispensing pharmacies had to streamline their management structures following the implementation of the MHLW “Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs” (so-called distribution improvement guidelines) whose purpose was to ensure stable supply of ethical drugs. According to the company, the distribution industry as a whole are facing labor shortages and other issues, and there is also a growing understanding of the distribution improvement guidelines within the pharmaceutical industry. In light of these trends, the company has been gradually earning acceptance for the streamlining of drug distribution it has been promoting with wholesalers and others.
- ▷ Company response: 1H FY03/20 sales increased by 9.8% YoY, reflecting increases in the number of network members and dispensing fees at directly operated dispensing pharmacies. 1H FY03/20 operating profit was up 67.2% YoY, and the operating profit margin (OPM) was 1.5%, an improvement of 0.5pp YoY. This was driven by an OPM improvement in the mainstay Community Pharmacy Network business from 2.7% in 1H FY03/19 to 3.5% in 1H FY03/20. (From FY03/20, the company consolidated the Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (formerly in the Other business) to form the Community Pharmacy Network business and began disclosure under the new segmentation from FY03/20.)

Segment performance

Community Pharmacy Network

- ▷ This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other.
- ▷ 1H FY03/20 (April–September 2019) segment earnings results
- ▷ Segment sales: JPY49.3bn (+10.2% YoY; includes internal sales or transfers between segments; same hereafter)
- ▷ Segment profit: JPY1.7bn (+41.5% YoY)
- ▷ Pharmaceuticals Network division: The number of new network members continued to increase, driven by greater need for improved distribution efficiency accompanying NHI drug price and dispensing fee revisions. At end-September 2019, the number of network members was 4,560 (up 770 from end-FY03/19). This consisted of 419 directly operated pharmacies and 4,141 affiliates. The number of network members has continued to increase since the start of Q3, and the company says it rose above 4,800 by November 1, 2019, so Shared Research believes there is a strong likelihood the company will achieve its FY03/20 target of 5,000 members. In 1H FY03/20, the division contributed a JPY330mn increase in sales and a JPY270mn increase in operating profit, so Shared Research believes the business is maintaining its high profitability.
- ▷ Dispensing Pharmacy division: In addition to the contribution from stores acquired via M&A, sales at existing pharmacies remained steady. Across all pharmacies, there were a total of roughly 4.5mn prescriptions handled (+6.3% YoY). At existing pharmacies only, the number of prescriptions was up a relatively stable 1.1% YoY, so newly acquired pharmacies contributed the bulk of the overall increase. In addition, since the price per prescription rose on higher drug prices, total dispensing fees across all pharmacies were up 11.1% YoY. At end-September 2019, there were 419 dispensing pharmacies, one care plan center, and seven drug stores.

- ▷ Manufacture and market pharmaceuticals division: This business aims to provide a stable supply of good-quality, low-priced generic drugs. The company sold 20 ingredients and 45 products as of end-September 2019.

Leasing and Facility-related

1H FY03/20 (April–September 2019) segment earnings results

- ▷ Segment sales: JPY1.8bn (+21.3% YoY)
- ▷ Segment profit: JPY68mn (+580.0% YoY)
- ▷ Reason for sales and profit growth: Steady inflow of leasing revenue and rise in occupancy at the company's serviced elderly housing facilities contributed to earnings growth. Number of occupied units as of end-September 2019 was 62 out of 82 units total at Wisteria Senri-Chuo, and 59 out of 116 units total at Wisteria Minami Ichijo. The company continued to carry out aggressive sales activities. For the time being, the company plans to focus on improving occupancy rates at these facilities.

Food Service

1H FY03/20 (April–September 2019) segment earnings results

- ▷ Segment sales: JPY1.4bn (-9.6% YoY)
- ▷ Segment loss: JPY34mn (vs. profit of 18mn in 1H FY03/19)
- ▷ Business reforms: Despite withdrawal from certain unprofitable facilities, segment profit fell from higher labor costs as the company employed temporary resources in response to staff shortage.

Other

The main business is home-visit nursing care.

1H FY03/20 (April–September 2019) segment earnings results

- ▷ Segment sales: JPY79mn (+16.2% YoY)
- ▷ Segment loss: JPY39mn (vs. a loss of JPY57mn in 1H FY03/19)

Q1 FY03/20 earnings results (out August 6, 2019)

Overview

Q1 FY03/20 (April–June 2019) earnings results

- ▷ Sales: JPY25.6bn (+7.3% YoY)
- ▷ Operating profit: JPY334mn (+57.5% YoY)
- ▷ Recurring profit: JPY323mn (+68.2% YoY)
- ▷ Net income*: JPY97mn (-4.0% YoY)

*Net income attributable to owners of the parent

- ▷ Business environment: Due to the implementation of NHI drug price and dispensing fee revisions in April 2018 as well as the MHLW "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs," whose purpose was to ensure stable supply of ethical drugs, dispensing pharmacy operators had to streamline their management structures even further.
- ▷ Company response: The company consolidated the Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (formerly in the Other business) to form the Community

Pharmacy Network business and began disclosure under the new segmentation from FY03/20. Sales in the Community Pharmacy Network business increased by 7.3% YoY, reflecting an increase in the number of network members and steady sales at existing dispensing pharmacies. The operating profit margin was 1.3% in Q1 FY03/20, an improvement of 0.4pp YoY. This was driven by the OPM improvement in the mainstay Community Pharmacy Network business from 2.8% in Q1 FY03/19 to 3.4% Q1 FY03/20.

Segment performance

Community Pharmacy Network

This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly operated by Feldsenf Pharma) previously included in the Other business.

Q1 FY03/20 (April–June 2019) segment earnings results:

- ▷ Segment sales: JPY24.2bn (+7.4 YoY; includes inter-segment sales and transfers; same hereafter)
- ▷ Segment profit: JPY825mn (+28.5% YoY)
- ▷ Pharmaceuticals Network business: The number of new affiliates increased driven by strong demand for improved drug distribution efficiency. The pace of growth in affiliate numbers appears to slightly exceed the company's prior assumptions. As of end June 2019, the number of network members was 4,118 (+328 from the end FY03/19), comprising 421 directly operated pharmacies and 3,697 affiliates.
- ▷ Dispensing Pharmacy business: In addition to the contribution from stores acquired via M&A, sales at existing pharmacies were steady. As of end June 2019, there were 421 dispensing pharmacies, one care plan center, and eight drug stores. In Q1 FY03/20, although both sales and profit grew and were in line with company forecasts, the company commented that there remained some issues with the details of the earnings results. The company's plan was to increase the number of prescriptions (at existing pharmacies), but the actual outcome was a YoY decline of 0.6%. Sales and profit, however, were in line with plan because of an unexpected 6.7% YoY increase in the drug price, which the company originally expected to be flat YoY, included in the average per prescription price (drug price + technical fees). The company thinks the higher drug prices are attributed to increased drug use accompanying Japan's aging population. In regard to its dispensing pharmacy operation, the company plans to continue to provide guidance on store improvement with a focus on increasing the number of prescriptions and acquiring additional premiums.
- ▷ Manufacture and market pharmaceuticals business: This business aims to provide a stable supply of quality, low-priced generic drugs. The company sold 18 ingredients and 39 products as of end June 2019.

Leasing and Facility-related

Q1 FY03/20 (April–June 2019) segment earnings results:

- ▷ Segment sales: JPY760mn (+26.7% YoY)
- ▷ Segment loss: JPY8mn (loss of JPY32mn in Q1 FY03/19)
- ▷ Reason for increase in sales: Steady inflow of leasing revenue and a rise in occupancy at the company's serviced elderly housing facilities contributed to sales growth.
- ▷ Reason for the segment loss: The segment remained in loss due to depreciation expenses related to Wisteria Minami Ichijo, the serviced elderly housing facility opened in November 2018. According to the company, while there remains room for improvement in the occupancy rate, the number of occupants is steadily increasing.

Food Service

Q1 FY03/20 (April–June 2019) segment earnings results:

- ▷ Segment sales: JPY730mn (-7.4% YoY)
- ▷ Segment loss: JPY12mn (vs. 1mn segment profit in Q1 FY03/19)
- ▷ Business reforms: Despite withdrawal from unprofitable facilities, segment profit fell due to higher labor costs as the company employed temporary resources in response to staff shortage.

Other

The main business is home-visit nursing care.

Q1 FY03/20 (April–June 2019) segment earnings results

- ▷ Segment sales: JPY38mn (+15.2% YoY)
- ▷ Segment loss: JPY21mn (loss of JPY29mn in Q1 FY03/19)

Full-year FY03/19 earnings results (out May 8, 2019)**Overview****Full-year FY03/19 (April 2018 to March 2019) earnings results**

- ▷ Sales: JPY98.2bn (+4.5% YoY)
- ▷ Operating profit: JPY1.4bn (-54.8% YoY)
- ▷ Recurring profit: JPY1.5bn (-53.8% YoY)
- ▷ Net income*: JPY462mn (-54.7% YoY)

*Net income attributable to owners of the parent

- ▷ Business environment: NHI drug price and dispensing fee revisions were implemented in April 2018. Dispensing pharmacies had to streamline their management structures following the implementation of the MHLW “Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs” whose purpose was to ensure stable supply of drugs.
- ▷ Company response: The Pharmaceuticals Network business increased the number of network members (affiliates), mainly among small and mid-tier pharmacies. The company also made changes in the Dispensing Pharmacy business, such as acquiring new pharmacies and closing others, to improve the business makeup of the segment amid an increasingly severe earnings environment.

Segment performance**Pharmaceuticals Network**

FY03/19 (April 2018–March 2019) segment earnings results

- ▷ Segment sales: JPY4.0bn (+8.6% YoY; includes internal sales or transfers between segments; same hereafter)
- ▷ Segment profit: JPY2.3bn (+19.6% YoY)
- ▷ Number of new affiliates: Following the start of distribution improvement guidelines in April 2018, the company surpassed its year-end objective of 3,200 new affiliates for a total of 3,790 as the number of affiliates joining the network was steady amidst growing needs for distribution efficiency. The company is also engaging in initiatives aimed at responding to these needs.
- ▷ Number of affiliates (as of March 31, 2019): The number of affiliates totaled 3,790 (+1,281 compared to end-FY03/18), breaking down to 3,729 dispensing pharmacies and 61 hospitals and clinics. This exceeds the pace of growth envisioned by

the company. The company attributes the growth to the implementation of distribution improvement guidelines and revisions to NHI drug prices and dispensing fees.

Dispensing Pharmacy

FY03/19 (April 2018–March 2019) segment earnings results

- ▷ Segment sales: JPY90.7bn (+4.1% YoY)
- ▷ Segment profit: JPY1.1mn (-65.1% YoY)
- ▷ Dispensing fees: Dispensing fees at existing pharmacies declined 3.8% YoY; prescription volumes were up 0.2% YoY, but prescription values were down 3.9% YoY due to revisions to NHI drug prices and dispensing fees
- ▷ Responses to dispensing fee revisions: Though progress is being made in expanding the number of pharmacies that qualify for higher insurance points, a remaining concern is that even after meeting targets for basic dispensing fees and the generic drug dispensing and community support system premiums, 66% of pharmacies still do not qualify for the community support system premium.
- ▷ Store improvements: In response to dispensing fee revisions, the company encouraged its pharmacies to exercise their functions as local pharmacies that support the health of local residents in a variety of ways and as family pharmacies/pharmacists that engage in at-home medical care initiatives.
- ▷ Review of stores: In addition to opening five dispensing pharmacies during the period, the company acquired two companies (25 pharmacies) through a share acquisition and obtained five other pharmacies through a business transfer. On the other hand, the company closed 11 dispensing pharmacies and three drug stores, and disposed of six pharmacies through a business transfer.
- ▷ Nagatomi Pharmacy Corp., which became a consolidated subsidiary in January 2019 after the company acquired its shares, operates 23 dispensing pharmacies in Oita Prefecture. This has strengthened the company's positioning in the Kyushu area.
- ▷ Number of stores (as of March 31, 2019): 420 dispensing pharmacies, one care plan center, and five drug stores

Leasing and Facility-related

FY03/19 (April 2018–March 2019) segment earnings results

- ▷ Segment sales: JPY3.3bn (+63.5% YoY)
- ▷ Segment loss: JPY84mn (loss of JPY182mn in FY03/18)
- ▷ Reason for sales growth: Steady inflow of leasing revenue and growth in design and construction supervision of medical facilities
- ▷ Reason for increase profit improvement: Operating loss continued due to upfront spending on serviced elderly housing facility Wisteria Minami Ichijo, opened in November 2018. However, at end-FY03/19, the occupancy rate improved as 56 of the 82 units of Wisteria Senri-Chuo and 47 of the 115 units of Wisteria Minami Ichijo were occupied

Food Service

FY03/19 (April 2018–March 2019) segment earnings results

- ▷ Segment sales: JPY3.2bn (-23.0% YoY)
- ▷ Segment profit: JPY34mn (-22.7% YoY)
- ▷ Business reforms: Profit fell due to increased labor costs at some of the facilities, despite progress in withdrawing from unprofitable facilities



Other

FY03/19 (April 2018–March 2019) segment earnings results

- ▷ Segment sales: JPY261mn (+181.2% YoY)
- ▷ Segment loss: JPY136mn (loss of JPY97mn in FY03/18)
- ▷ Manufacture and market pharmaceuticals: Conducted by Feldsenf Pharma Co., Ltd., which sells 34 items based on 17 components as of March 31, 2019 and aims to provide a stable supply of high-quality, low-cost generic drugs

Other information

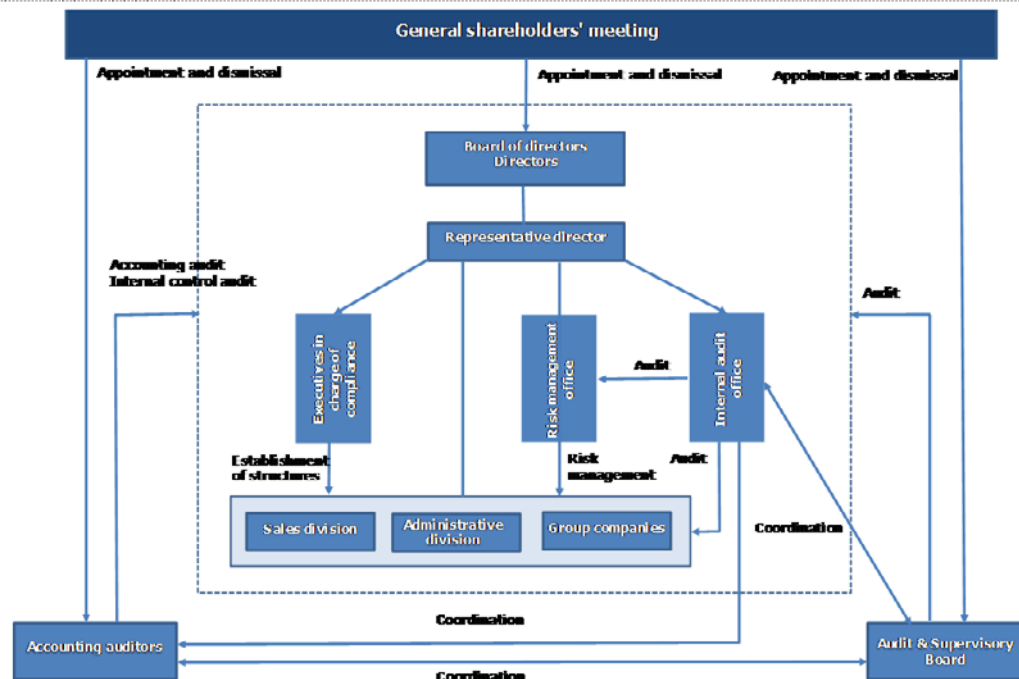
History

Date	Description
Sep 1999	Established Medical System Network (capital stock: JPY10mn) in Chuo Ward, Sapporo, to streamline hospital operation and pharmaceuticals distribution
Mar 2002	Registered shares on Osaka Stock Exchange NASDAQ Japan market (now JASDAQ)
Dec	Acquired 100% of Pharmaholdings and Nihon Leben shares, making them wholly owned subsidiaries
Feb 2005	Established joint venture MM Net with Mitsui & Co. (capital JPY200mn, Medical System Network held 51% equity stake, but dissolved alliance and absorbed MM Net in 2013)
Oct	Pharmaholdings acquired 100% of Sunmedic Co., Ltd. (now Nanohana East Japan Co., Ltd.) shares, making it a wholly owned subsidiary
	Pharmaholdings acquired 100% of Hankyu Kyoei Pharmacy (now Kyoei Pharmacy) shares, making it a wholly owned subsidiary
Jan 2007	Acquired 100% of CR Medical (now Nanohana Central Co., Ltd.), making it a wholly owned subsidiary
Mar	Acquired 100% of Hokkaido Hiclips (now SMO-MDS) shares, making it a wholly owned subsidiary
Sep 2008	Listed shares on the Second Section of the Tokyo Stock Exchange
Jun 2010	Listed shares on the First Section of the Tokyo Stock Exchange
Nov 2012	Formed business alliance with Hanshin Dispensing Pharmacy (switched to alliance with parent Hanshin Pharmacy Holdings when the holding company was established in December 2012)
May 2013	Formed business alliance with FamilyMart
Jul	Pharmaholdings and Hanshin Dispensing Holdings established joint venture, H&M Co.
Nov	Pharmaholdings acquired 98.96% of Total Medical Service shares through public tender offer, making it a subsidiary
Jan 2015	Concluded comprehensive strategic alliance with Fuyo General Lease Co., Ltd
Mar	Formed business alliance with Sogo Clinical Holdings (now EP-Sogo)
Apr	Formed business alliance with EM Systems
May	Concluded capital tie-up with Sogo Clinical Holdings (now EP-Sogo)
Jun	Formed business alliance with Yakuju Corporation
May 2016	Pharmaholdings acquired 100% of Home-Visit Nursing Care Station Himawari Co. shares and entered home-visit nursing care business
Oct	Formed business alliance with Zoo Corporation
Jan 2017	Formed business alliance with Career Brain
May	Formed business alliance with Okura Information System
Jun	Sold shares of SMO-MDS (no longer a subsidiary)
Oct	Absorbed subsidiaries System Four, Pharmaholdings, and Nihon Leben
Jan 2018	Acquired all shares in Apotec and made it a wholly owned subsidiary
	Formed business alliance with Polaris Co., Ltd.
Feb	Feldsenf Pharma Co., Ltd. formed business alliance with Daito Pharmaceutical Co., Ltd.
Jun	Feldsenf Pharma Co., Ltd. started sales of generic drugs
Jan 2019	Acquired all shares in Nagatomi Pharmacy Corporation and made it a wholly owned subsidiary

Source: Shared Research based on company data (as of March 2019)

News and topics

Corporate governance and top management



Source: Shared Research based on company data

Top management

President and director (Representative Director) Inao Tajiri

Mar 1974	Joined Ichino Yamagata Pharmaceutical Co., Ltd.
Jan 1981	Joined Medical Yamagata Pharmaceutical Co., Ltd.
Nov 1989	Representative director of Medical Yamagata Pharmaceutical Co., Ltd.
Jun 1991	Director of Akiyama Aiseikan Co., Ltd. (now Suzuken Co., Ltd)
Sep 1999	Established Medical System Network and became representative director and president (current)
Apr 2000	President (current) of Social Welfare Corporation Nomad-Fukushikai
Dec 2004	Representative director of Nihon Leben Co., Ltd.
Feb 2005	Representative director of MM Net Co., Ltd.
Apr 2013	President and representative director of SMO-MDS Co., Ltd.
Jul 2013	Vice president and representative director of H&M Co., Ltd.
Jun 2015	President and representative director of H&M Co., Ltd.
Jan 2016	President of Social Welfare Corporation Hokushikai
Sep 2016	President and representative director (current) of Feldsenf Pharma Co., Ltd.

Corporate governance

The company recognizes the importance of legal compliance and corporate ethics, and aims to continuously enhance corporate value through rapid decision-making and improved management soundness. While looking to aggressively expand its business in line with growth of the overall medical market, Medical System Network is aware of the importance of ensuring a fair management system and accordingly maintains a flexible meeting of the board of directors, has developed a system to monitor business execution, and has enhanced internal controls. The company further recognizes that management of subsidiaries is

especially crucial to internal control, and thus aims to enhance corporate governance by ensuring thorough compliance, building a risk management system, and establishing a system for reporting financial and other important matters.

Board of directors

A board of directors with 14 members (including three outside directors) was established as the decision-making body. Regular board meetings are held monthly and extraordinary meetings are also conducted as needed. The company adopted an executive officer system in June 2017, and developed a system to enhance and clearly separate management decision-making, management oversight, and business execution functions.

Board of auditors

The board of auditors is comprised of three members (two full-time corporate auditors and one part-time) and meets once monthly in addition to extraordinary meetings as needed. Two of the three members are outside auditors.

Compliance

Management has established the Medical System Network Group Charter of Corporate Behavior, a Code of Conduct for corporate ethics and compliance, and the basic regulations to clarify the company's basic stance on corporate ethics and compliance. The company appoints an officer in charge of compliance as stipulated in its group compliance basic regulations, under whose supervision a compliance department has been established to develop a compliance system for the group.

Risk management

The company has established an organization and management system based on Medical System Network Group Risk Management Basic Rules that enables efficient execution of duties through the clarification of directors' authorities and responsibilities. Discussions of important matters by each group company's board of directors are held after preliminary consultations with the company. In addition, appropriate management control of subsidiaries is conducted in accordance with management regulations for affiliated companies. Reports of business results, financial status, and important matters are received at regularly scheduled Board of Directors and other important meetings. A system is in place for the prompt reporting of serious risk factors such as compliance violations.

Internal and corporate audits

The Internal Audit Office is in charge of internal auditing and its manager is responsible for drafting the basic internal audit plan prior to the start of the fiscal year, obtaining approval by the President and Representative Director, and formulating an implementation agenda based on the basic internal audit plan. Three corporate auditors (including two outside auditors) attend regular and extraordinary meetings of the board of directors to observe the performance of duties by company officers such as directors and Internal Audit Office managers as part of a system to audit performance of directors and the status of internal controls. Auditing efficiency is further enhanced through mutual cooperation and information-sharing with the accounting auditor and the Internal Audit Office.

Dividend policy

The company's basic policy on dividends is to maintain stable disbursements to shareholders in line with earnings while retaining sufficient internal reserves to reinforce its financial position, expand business operations, and develop human resources. Since FY03/13, dividends have been paid twice a year—an interim dividend and a fiscal year-end dividend. The dividend decision-making bodies are the general shareholders meeting for year-end dividends and the board of directors for interim dividends. The articles of incorporation stipulate the board of directors has the authority to decide on interim dividends through a resolution.

Major shareholders

Top shareholders	Shares held	Shareholding ratio
S&S G.K.	2,769,100	9.03%
Yasuyuki Okinaka	2,506,000	8.17%
KBL EPB S.A. 107704	2,443,800	7.97%
Jiro Akino	2,216,500	7.23%
Japan Trustee Services Bank, Ltd. (Trust Account)	1,478,400	4.82%
The Master Trust Bank of Japan, Ltd. (Trust Account)	1,402,900	4.57%
EP-Sogo Co., Ltd.	800,000	2.61%
Inao Tajiri	667,200	2.17%
Medical System Network Employees Stockholding Association	589,300	1.92%
Japan Trustee Services Bank, Ltd. (Trust Account 5)	421,100	1.37%
SUM	15,294,300	49.86%

Source: Shared Research based on company data (as of March 31, 2019)

Employees

Segment	No. of employees	No. of temporary employees	Total
Pharmaceuticals Network	2,755	466	3,221
Pharmacists	1,315	283	1,598
Leasing and Facility-related	116	17	133
Food Service	192	310	502
Other	25	10	35
Corporate (administration)	117	8	125
Total	3,205	812	4,017

Source: Shared Research based on company data (as of March 31, 2020)

Note: The sum of temporary employees does not equal to the total due to differences in rounding methods (based on eight-hour work days).

Profile

Company Name	Head Office
Medical System Network Co., Ltd.	24-3 Kitajujo-Nishi, Chuo-ku, Sapporo, Hokkaido
Phone	Exchange Listing
+81-11-612-1069	First Section of the Tokyo Stock Exchange
Established	Listed On
September 1999	June 2010
Website	Fiscal Year-End
http://www.msnw.co.jp/	March
IR Contact	IR Web
Corporate Planning Department	http://www.msnw.co.jp/ir/

We offer corporate clients comprehensive report coverage, a service that allows them to better inform investors and other stakeholders by presenting a continuously updated third-party view of business fundamentals, independent of investment biases. Shared Research can be found on the web at <https://sharedresearch.jp>.

Current Client Coverage of Shared Research Inc.

Accordia Golf Trust	DIC Corporation	Kanamic Network Co.,LTD	SanBio Company Limited
Advance Create Co., Ltd.	Digital Arts Inc.	Kawanishi Holdings, Inc.	SANIX INCORPORATED
ADJUVANT COSME JAPAN CO., LTD.	Digital Garage Inc.	KFC Holdings Japan, Ltd.	Sanrio Company, Ltd.
Aeon Delight Co., Ltd.	Doshisha Corporation	KI-Star Real Estate Co., Ltd.	SATO HOLDINGS CORPORATION
Aeon Fantasy Co., Ltd.	Dream Incubator Inc.	Kondotec Inc.	SBS Holdings, Inc.
AI Holdings Corporation	Earth Corporation	Kumiai Chemical Industry Co., Ltd.	Seikagaku Corporation
AirTrip Corp.	Edion Corporation	Lasertec Corporation	Seria Co.,Ltd.
and factory, inc.	Elecom Co., Ltd.	Locondo, Inc.	SHIFT Inc.
ANEST IWATA Corporation	en-Japan Inc.	LUCKLAND CO., LTD.	Shikigaku Co., Ltd
AnGes Inc.	euglena Co., Ltd.	MATSUI SECURITIES CO., LTD.	SHIP HEALTHCARE HOLDINGS, INC.
Anicom Holdings, Inc.	FaithNetwork Co., Ltd.	Media Do Holdings Co., Ltd.	SIGMAXYZ Inc.
Arntsui Corporation	Ferrotec Holdings Corporation	Medical System Network Co., Ltd.	SMS Co., Ltd.
Apaman Co., Ltd.	FIELDS CORPORATION	MEDINET Co., Ltd.	Snow Peak, Inc.
ARATA CORPORATION	Financial Products Group Co., Ltd.	MedPeer, Inc.	Solasia Pharma K.K.
Artspark Holdings Inc.	First Brothers Col, Ltd.	Mercuria Investment Co., Ltd.	SOURCENEXT Corporation
AS ONE CORPORATION	FreeBit Co., Ltd.	Micronics Japan Co., Ltd.	Star Mica Holdings Co., Ltd.
Ateam Inc.	FRONTEO, Inc.	MIRAIT Holdings Corporation	Strike Co., Ltd.
Aucfan Co., Ltd.	Fujita Kanko Inc.	Monex Goup Inc.	Symbio Pharmaceuticals Limited
AVANT CORPORATION	Gamecard-Joyco Holdings, Inc.	MORINAGA MILK INDUSTRY CO., LTD.	Synchro Food Co., Ltd.
Axell Corporation	GameWith, Inc.	Mortgage Service Japan Limited.	TAIYO HOLDINGS CO., LTD.
Azbil Corporation	GCA Corporation	NAGASE & CO., LTD	Takashimaya Company, Limited
AZIA CO., LTD.	Good Com Asset Co., Ltd.	NAIGAI TRANS LINE LTD.	Take and Give Needs Co., Ltd.
AZoom, Co., Ltd.	Grandy House Corporation	NanoCarrier Co., Ltd.	Takihyo Co., Ltd.
Base Co., Ltd	Hakuto Co., Ltd.	Net Marketing Co., Ltd.	TEAR Corporation
BEENOS Inc.	Hamee Corp.	Net One Systems Co.,Ltd.	Tenpo Innovation Inc.
Bell-Park Co., Ltd.	Happinet Corporation	Nichi-Iko Pharmaceutical Co., Ltd.	3-D Matrix, Ltd.
Benefit One Inc.	Harmonic Drive Systems Inc.	Nihon Denkei Co., Ltd.	TKC Corporation
B-lot Co.,Ltd.	HOUSEDO Co., Ltd.	Nippon Koei Co., Ltd.	TKP Corporation
Broadleaf Co., Ltd.	H2O Retailing Corporation	NIPPON PARKING DEVELOPMENT Co., Ltd.	Tsuzuki Denki Co., Ltd.
CanBas Co., Ltd.	IDOM Inc.	NIPRO CORPORATION	TOCALO Co., Ltd.
Canon Marketing Japan Inc.	IGNIS LTD.	Nissinbo Holdings Inc.	TOKAI Holdings Corporation
Career Design Center Co., Ltd.	i-mobile Co.,Ltd.	NS TOOL CO., LTD.	Tokyu Construction Co., Ltd.
Carna Biosciences, Inc.	Inabata & Co., Ltd.	OHIZUMI MFG. CO., LTD.	TOYOBO CO., LTD.
CARTA HOLDINGS, INC	Infocom Corporation	Oisix ra daichi Inc.	Toyo Ink SC Holdings Co., Ltd
CERES INC.	Infomart Corporation	Oki Electric Industry Co., Ltd	Toyo Tanso Co., Ltd.
Chiyoda Co., Ltd.	Intelligent Wave, Inc.	ONO SOKKI Co., Ltd.	Tri-Stage Inc.
Chori Co., Ltd.	ipet Insurance CO., Ltd.	ONWARD HOLDINGS CO.,LTD.	TSURUHA Holdings
Chugoku Marine Paints, Ltd.	Itchu Enex Co., Ltd.	Pan Pacific International Holdings Corporation	VISION INC.
cocokara fine Inc.	JMDC Inc.	PARIS MIKI HOLDINGS Inc.	VISIONARY HOLDINGS CO., LTD.
COMSYS Holdings Corporation	JSB Co., Ltd.	PIGEON CORPORATION	WirelessGate, Inc.
COTA CO.,LTD.	JTEC Corporation	QB Net Holdings Co., Ltd.	YELLOW HAT LTD.
CRE, Inc.	J Trust Co., Ltd	RACCOON HOLDINGS, Inc.	YOSHINOYA HOLDINGS CO., LTD.
CREEK & RIVER Co., Ltd.	Japan Best Rescue System Co., Ltd.	Raysum Co., Ltd.	YUMESHIN HOLDINGS CO., LTD.
Daiichi Kigenso Kagaku Kogyo Co., Ltd.	JINS HOLDINGS Inc.	RESORTTRUST, INC.	ZAPPALLAS, INC.
Daiseiki Co., Ltd.	JP-HOLDINGS, INC.	ROUND ONE Corporation	
Demae-Can CO., LTD	KAMEDA SEIKA CO., LTD.	RYOHIN KEIKAKU CO., LTD.	

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