



Medical System Network / 4350

COVERAGE INITIATED ON: 2018.05.08

LAST UPDATE: 2019.12.19

Shared Research Inc. has produced this report by request from the company discussed in the report. The aim is to provide an “owner’s manual” to investors. We at Shared Research Inc. make every effort to provide an accurate, objective, and neutral analysis. In order to highlight any biases, we clearly attribute our data and findings. We will always present opinions from company management as such. Our views are ours where stated. We do not try to convince or influence, only inform. We appreciate your suggestions and feedback. Write to us at sr_inquiries@sharedresearch.jp or find us on Bloomberg.



Research Coverage Report by Shared Research Inc.



INDEX

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.

Executive summary	3
Key financial data	5
Recent updates	7
Highlights	7
Trends and outlook	8
Quarterly trends and results	8
Business	19
Business model	19
Overview of business segments	19
Market and value chain	27
Industry peers (dispensing pharmacy chains)	34
Strengths and weaknesses	36
Historical performance and financial statements	38
Income statement	38
Balance sheet	40
Cash flow statement	42
Historical performance	44
Other information	51
History	51
News and topics	52
Corporate governance and top management	54
Dividend policy	55
Major shareholders	56
Employees	56
Profile	56

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-FY03/19, there were 3,790 network members (+1,281 from end-FY03/18) comprising 420 directly operated pharmacies and 3,370 affiliates (of which 61 were hospitals and clinics). 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 FY03/19, prior to the segment change, Pharmaceuticals Network accounted for 3.9% of sales, Dispensing Pharmacy (which operated the Nanohana Pharmacy chain) 89.5%, Leasing and Facility-related 3.3%, Food Service 3.1%, and Other 0.3%. Operating profit share was 72.6% (unadjusted) for Pharmaceuticals Network, 33.3% for Dispensing Pharmacy, and 2.2% for Food Service. The other two segments were loss-making in FY03/19. Margins were high in the Pharmaceuticals Network business despite its relatively low share of sales, largely due to contributions from inter-segment transactions with the Dispensing Pharmacy business.

Trends and outlook

- FY03/19 sales increased 4.5% YoY to JPY98.2bn while operating profit declined 54.9% YoY to JPY1.4bn, recurring profit was down 53.8% YoY to JPY1.5bn, and net income attributable to owners of the parent fell 54.7% YoY to JPY462mn. Of the two mainstay segments, sales and profit of the Pharmaceuticals Network business were solid, but segment profit fell a sharp 65.1% YoY in the Dispensing Pharmacy business due to the effect of the April 2018 NHI drug reimbursement price and dispensing fee revision, leading to lower operating profit.
- The company forecasts full-year FY03/20 sales of JPY103.0bn (+4.9% YoY), operating profit of JPY2.5bn (+75.0% YoY), recurring profit of JPY2.4bn (+59.9% YoY), and net income attributable to owners of the parent of JPY650mn (+40.4% YoY). With the aim of raising operating profit, the company plans to expand its Pharmaceuticals Network business targeting small and mid-tier pharmacies and to increase the number of prescriptions filled and improve business efficiency in the Dispensing Pharmacy business by harnessing family pharmacy functions (both businesses are under the Community Pharmacy Network segment).
- 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)	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. Est.
Sales	46,508	25,411	54,827	66,182	75,548	87,715	88,865	93,977	98,232	103,000
YoY	13.1%	-	-	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%	4.9%
Gross profit	16,217	8,960	19,412	22,737	28,476	32,801	34,164	36,607	37,271	
YoY	15.2%	-	-	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%	
GPM	34.9%	35.3%	35.4%	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%	
Operating profit	2,262	1,357	2,047	2,091	2,641	3,783	2,113	3,163	1,428	2,500
YoY	48.0%	-	-	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%	75.1%
OPM	4.9%	5.3%	3.7%	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%	2.4%
Recurring profit	2,140	1,315	1,912	2,020	2,540	3,860	2,109	3,250	1,501	2,400
YoY	61.0%	-	-	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%	59.9%
RPM	4.6%	5.2%	3.5%	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%	2.3%
Net income	1,001	518	756	668	885	1,720	571	1,022	462	650
YoY	111.5%	-	-	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%	40.7%
Net margin	2.2%	2.0%	1.4%	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%	0.6%
Per share data (JPY)										
Shares issued (year-end; '000)	6,492	6,492	25,970	25,970	25,970	29,890	29,890	30,523	30,643	
EPS	9.6	5.0	29.1	27.7	37.1	60.1	19.3	34.5	15.3	21.4
EPS (fully diluted)	-	-	-	-	-	-	-	34.3	15.0	
Dividend per share	6.3	3.8	8.0	8.0	8.0	9.5	10.0	10.0	10.0	10.0
Book value per share	47.0	50.5	222.9	214.7	243.3	334.9	345.3	351.4	354.8	
Balance sheet (JPYmn)										
Cash and cash equivalents	1,329	2,072	2,092	3,106	2,499	2,081	2,252	10,201	11,703	
Total current assets	7,787	8,902	8,271	10,941	11,023	10,783	11,098	18,736	21,055	
Tangible fixed assets	9,163	9,976	11,472	15,976	17,249	20,253	21,246	24,129	25,721	
Investments and other assets	2,602	2,685	2,783	3,798	3,759	4,329	4,559	4,847	5,922	
Intangible fixed assets	4,983	5,040	8,263	12,399	13,554	13,481	13,833	15,045	16,235	
Total assets	24,534	26,603	30,789	43,114	45,587	48,847	50,737	62,759	68,935	
Accounts payable	5,026	5,158	5,616	7,798	8,598	9,525	9,144	9,416	10,198	
Short-term debt	2,478	3,856	5,119	12,922	9,214	6,910	3,863	7,463	9,158	
Total current liabilities	10,801	12,693	14,375	24,880	21,626	21,061	16,920	21,769	23,844	
Long-term debt	7,365	7,029	8,758	10,948	15,391	14,859	20,186	26,329	29,739	
Total fixed liabilities	8,470	8,230	10,178	12,882	17,826	17,520	23,172	30,404	34,329	
Total liabilities	19,271	20,923	24,553	37,762	39,452	38,581	40,092	52,174	58,173	
Net assets	5,263	5,680	6,236	5,352	6,136	10,265	10,644	10,584	10,761	
Total interest-bearing debt	9,843	10,885	13,877	23,870	24,605	21,769	24,049	33,792	38,897	
Cash flow statement (JPYmn)										
Cash flows from operating activities	3,353	1,566	3,790	3,706	3,838	6,409	3,084	6,699	2,840	
Cash flows from investing activities	-2,747	-1,248	-5,425	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921	
Cash flows from financing activities	-1,069	425	1,654	4,864	-483	-1,792	998	8,050	4,338	
Financial ratios										
ROA (RP-based)	9.1%	5.1%	6.7%	5.5%	5.7%	8.2%	4.2%	5.7%	2.3%	
ROE	22.6%	10.2%	13.7%	12.2%	16.2%	21.9%	5.7%	9.8%	4.3%	
Equity ratio	19.9%	19.7%	18.8%	11.9%	12.7%	20.3%	20.1%	16.9%	15.6%	

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%	3.9%
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%	89.5%
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%	3.3%
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%	3.1%
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	-3,167
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					
Dispensing Pharmacy	2,377	3,412	2,314	3,060	1,068
YoY	29.2%	43.5%	-32.2%	32.2%	-65.1%
OPM					
Leasing and Facility-related	25	129	-143	-182	-84
YoY	-	416.0%	-	-	-
OPM					
Food Service	-13	-89	-129	45	34
YoY	-	-	-	-	-24.4%
OPM					
Other	-76	-109	-163	-97	-136
YoY	-	-	-	-	-
OPM					
Segment profit adjustments	-1,221	-1,335	-1,482	-1,610	-1,784

Segment sales and profit (JPYmn)	FY03/19 Act.	FY03/20 Est.
Sales	98,232	103,000
YoY	4.5%	4.9%
Community Pharmacy Network	92,284	97,461
YoY	-	5.6%
% of total	93.3%	94.1%
Three other businesses	6,622	6,113
YoY	-	-7.7%
% of total	6.7%	5.9%
	-	-
	-	-
	-	-
	-	-
	-	-
	-	-
	-	-
Segment sales adjustments	-674	-574
Operating profit	1,428	2,500
YoY	-54.9%	75.1%
Community Pharmacy Network	3,313	4,783
YoY	-	44.4%
OPM		
Three other businesses	-150	-240
YoY	-	-
OPM		
	-	-
	-	-
	-	-
	-	-
	-	-
Segment profit adjustments	-1,733	-2,042

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 **December 19, 2019**, Shared Research updated the report following interviews with Medical System Network Co., Ltd.

On **November 7, 2019**, the company announced earnings results for 1H FY03/20; see the results section for details.

On **September 20, 2019**, Shared Research updated the report following interviews with the company.

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

Trends and outlook

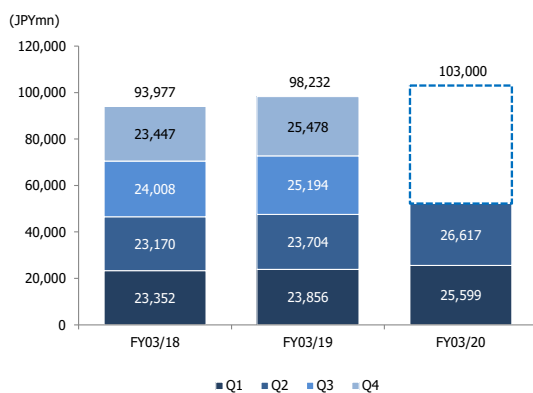
Quarterly trends and results

Cumulative (JPYmn)	FY03/18				FY03/19				FY03/20		FY03/20		FY03/20	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	% of 1H	1H Est.	% of FY	FY Est.
Sales	23,352	46,522	70,530	93,977	23,856	47,560	72,754	98,232	25,599	52,216	103.8%	50,300	50.7%	103,000
YoY	8.6%	7.2%	6.5%	5.8%	2.2%	2.2%	3.2%	4.5%	7.3%	9.8%		5.8%		4.9%
Gross profit	9,069	18,109	27,515	36,607	9,079	17,887	27,527	37,271	9,839	19,819				
YoY	11.0%	10.0%	8.6%	7.2%	0.1%	-1.2%	0.0%	1.8%	8.4%	10.8%				
GPM	38.8%	38.9%	39.0%	39.0%	38.1%	37.6%	37.8%	37.9%	38.4%	38.0%				
SG&A expenses	8,476	16,837	25,226	33,444	8,867	17,410	26,487	35,842	9,504	19,022				
YoY	6.5%	5.8%	4.8%	4.3%	4.6%	3.4%	5.0%	7.2%	7.2%	9.3%				
SG&A ratio	36.3%	36.2%	35.8%	35.6%	37.2%	36.6%	36.4%	36.5%	37.1%	36.4%				
Operating profit	592	1,271	2,288	3,163	212	476	1,040	1,428	334	796	142.1%	560	31.8%	2,500
YoY	179.2%	131.5%	80.7%	49.7%	-64.2%	-62.5%	-54.5%	-54.9%	57.5%	67.2%		17.6%		75.1%
OPM	2.5%	2.7%	3.2%	3.4%	0.9%	1.0%	1.4%	1.5%	1.3%	1.5%				2.4%
Recurring profit	590	1,272	2,334	3,250	192	438	1,010	1,501	323	784	147.9%	530	32.7%	2,400
YoY	196.5%	134.7%	84.4%	54.1%	-67.5%	-65.6%	-56.7%	-53.8%	68.2%	79.0%		21.0%		59.9%
RPM	2.5%	2.7%	3.3%	3.5%	0.8%	0.9%	1.4%	1.5%	1.3%	1.5%				2.3%
Net income	289	363	944	1,022	101	119	372	462	97	218	-	-	33.5%	650
YoY	-	450.0%	185.2%	79.0%	-65.1%	-67.2%	-60.6%	-54.8%	-4.0%	83.2%				40.7%
Net margin	1.2%	0.8%	1.3%	1.1%	0.4%	0.3%	0.5%	0.5%	0.4%	0.4%				0.6%
Quarterly (JPYmn)	FY03/18				FY03/19				FY03/20					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2				
Sales	23,352	23,170	24,008	23,447	23,856	23,704	25,194	25,478	25,599	26,617				
YoY	8.6%	5.8%	5.2%	3.5%	2.2%	2.3%	4.9%	8.7%	7.3%	12.3%				
Gross profit	9,069	9,040	9,406	9,092	9,079	8,808	9,640	9,744	9,839	9,980				
YoY	11.0%	9.1%	6.0%	2.9%	0.1%	-2.6%	2.5%	7.2%	8.4%	13.3%				
GPM	38.8%	39.0%	39.2%	38.8%	38.1%	37.2%	38.3%	38.2%	38.4%	37.5%				
SG&A expenses	8,476	8,361	8,389	8,218	8,867	8,543	9,077	9,355	9,504	9,518				
YoY	6.5%	5.2%	2.8%	2.9%	4.6%	2.2%	8.2%	13.8%	7.2%	11.4%				
SG&A ratio	36.3%	36.1%	34.9%	35.0%	37.2%	36.0%	36.0%	36.7%	37.1%	35.8%				
Operating profit	592	679	1,017	875	212	264	564	388	334	462				
YoY	179.2%	101.5%	41.8%	3.3%	-64.2%	-61.1%	-44.5%	-55.7%	57.5%	75.0%				
OPM	2.5%	2.9%	4.2%	3.7%	0.9%	1.1%	2.2%	1.5%	1.3%	1.7%				
Recurring profit	590	682	1,062	916	192	246	572	491	323	461				
YoY	196.5%	98.8%	46.7%	8.7%	-67.5%	-63.9%	-46.1%	-46.4%	68.2%	87.4%				
RPM	2.5%	2.9%	4.4%	3.9%	0.8%	1.0%	2.3%	1.9%	1.3%	1.7%				
Net income	289	74	581	78	101	18	253	90	97	121				
YoY	-	-1.3%	119.2%	-67.5%	-65.1%	-75.7%	-56.5%	15.4%	-4.0%	572.2%				
Net margin	1.2%	0.3%	2.4%	0.3%	0.4%	0.1%	1.0%	0.4%	0.4%	0.5%				

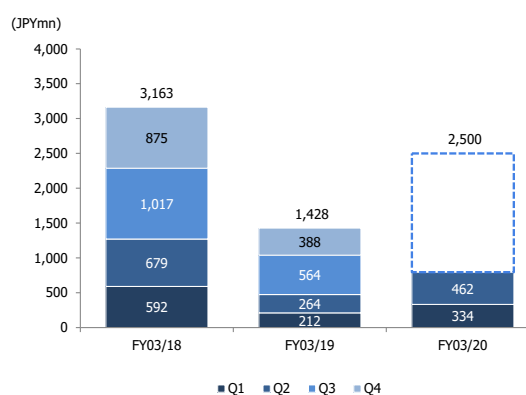
Source: Shared Research based on company data

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

Quarterly sales



Quarterly operating profit

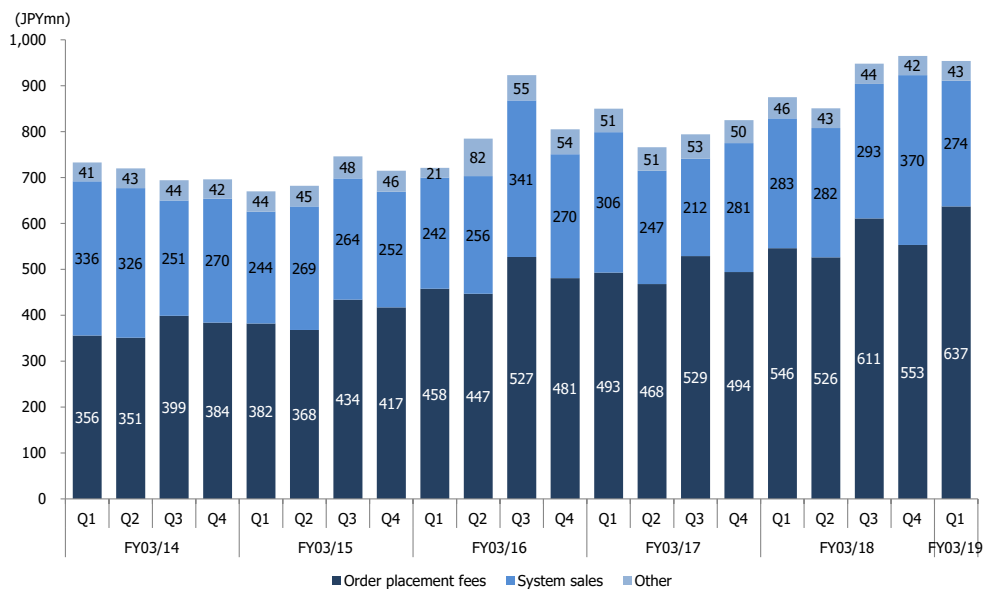


Source: Shared Research based on company data

Quarterly results

By segment (cumulative) (JPYmn)					FY03/19					FY03/19					FY03/20							
					Q1	Q2	Q3	Q4						Q1 retro	Q2 retro							
Sales					23,856	47,560	72,754	98,232	Sales					23,856	47,560	25,599	52,216					
YoY					2.2%	2.2%	3.2%	4.5%	YoY					2.2%	2.2%	7.3%	9.8%					
Pharmaceuticals Network					955	1,818	2,897	3,951	Pharmaceuticals Network					22,564	44,717	24,224	49,290					
YoY					9.1%	5.2%	8.3%	8.6%	YoY					-	-	7.4%	10.2%					
% of total					3.9%	3.7%	3.9%	3.9%	% of total					94.1%	94.7%	94.1%	93.6%					
Dispensing Pharmacy					22,222	44,035	67,291	90,706	Dispensing Pharmacy													
YoY					3.2%	2.7%	3.2%	4.1%	YoY													
% of total					90.3%	89.8%	89.6%	89.5%	% of total													
Leasing and Facility-related					600	1,508	2,382	3,320	Leasing and Facility-related					600	1,508	760	1,829					
YoY					15.2%	38.9%	52.6%	63.5%	YoY					15.2%	38.9%	26.7%	21.3%					
% of total					2.4%	3.1%	3.2%	3.3%	% of total					2.5%	3.1%	3.0%	3.5%					
Food Service					788	1,586	2,382	3,161	Food Service					788	1,586	730	1,434					
YoY					-31.8%	-31.0%	-27.4%	-23.0%	YoY					-31.8%	-31.0%	-7.4%	-9.6%					
% of total					3.2%	3.2%	3.2%	3.1%	% of total					3.3%	3.2%	2.8%	2.7%					
Other					33	91	166	261	Other					33	91	38	79					
YoY					0.0%	71.7%	133.8%	183.7%	YoY					0.0%	71.7%	15.2%	-13.2%					
% of total					0.1%	0.2%	0.2%	0.3%	% of total					0.1%	0.2%	0.1%	0.2%					
Segment sales adjustments					-743	-1,479	-2,365	-3,167	Segment sales adjustments					-130	320	-154	-417					
Operating profit					212	476	1,040	1,428	Operating profit					212	476	334	796					
YoY					-64.2%	-62.5%	-54.5%	-54.9%	YoY					-64.2%	-62.5%	57.5%	67.2%					
Pharmaceuticals Network					554	1,060	1,697	2,331	Pharmaceuticals Network					642	1,227	825	1,736					
YoY					17.6%	13.5%	17.5%	19.6%	YoY					-	-	28.5%	41.5%					
OPM					58.0%	58.3%	58.6%	59.0%	OPM					2.8%	2.7%	3.4%	3.5%					
Dispensing Pharmacy					130	202	712	1,068	Dispensing Pharmacy													
YoY					-78.0%	-83.4%	-67.8%	-65.1%	YoY													
OPM					0.6%	0.5%	1.1%	1.2%	OPM													
Leasing and Facility-related					-32	10	-51	-84	Leasing and Facility-related					-32	10	-8	68					
YoY					-	-	-	-	YoY					-	-	-	580.0%					
OPM					-5.3%	0.7%	-2.1%	-2.5%	OPM					-5.3%	0.7%	-1.1%	3.7%					
Food Service					1	18	28	34	Food Service					1	18	-12	-34					
YoY					-80.0%	-47.1%	-42.9%	-24.4%	YoY					-80.0%	-47.1%	-	-					
OPM					0.1%	1.1%	1.2%	1.1%	OPM					0.1%	1.1%	-1.6%	-2.4%					
Other					-36	-57	-105	-136	Other					-29	-57	-21	-39					
YoY					-	-	-	-	YoY					-	-	-	-					
OPM					-109.1%	-62.6%	-63.3%	-52.1%	OPM					-87.9%	-62.6%	-55.3%	-49.4%					
Segment profit adjustments					-405	-721	-1,240	-1,784	Segment profit adjustments					-369	-721	-447	-934					
By segment (quarterly) (JPYmn)					FY03/19					FY03/19					FY03/20							
					Q1	Q2	Q3	Q4						Q1 retro	Q2 retro							
Sales					23,856	23,704	25,194	25,478	Sales					23,856	23,704	25,599	26,617					
YoY					2.2%	2.3%	4.9%	8.7%	YoY					2.2%	2.3%	7.3%	12.3%					
Pharmaceuticals Network					955	863	1,079	1,054	Pharmaceuticals Network					22,564	22,153	24,224	25,066					
YoY					9.1%	1.2%	13.9%	9.3%	YoY					-	-	7.4%	13.1%					
% of total					4.4%	3.5%	4.1%	4.0%	% of total					94.1%	95.3%	107.3%	93.3%					
Dispensing Pharmacy					22,222	21,813	23,256	23,415	Dispensing Pharmacy													
YoY					3.2%	2.2%	4.0%	6.6%	YoY													
% of total					103.2%	89.3%	89.2%	89.1%	% of total													
Leasing and Facility-related					600	908	874	938	Leasing and Facility-related					600	908	760	1,069					
YoY					15.2%	60.7%	84.0%	99.6%	YoY					-	-	26.7%	17.7%					
% of total					2.8%	3.7%	3.4%	3.6%	% of total					2.5%	3.9%	3.4%	4.0%					
Food Service					788	798	796	779	Food Service					788	798	730	704					
YoY					-31.8%	-30.1%	-18.9%	-5.5%	YoY					-	-	-7.4%	-11.8%					
% of total					3.7%	3.3%	3.1%	3.0%	% of total					3.3%	3.4%	3.2%	2.6%					
Other					33	58	75	95	Other					33	58	38	41					
YoY					0.0%	190.0%	316.7%	352.4%	YoY					-	-	15.2%	-29.3%					
% of total					0.2%	0.2%	0.3%	0.4%	% of total					0.1%	0.2%	0.2%	0.2%					
Segment sales adjustments					2,320	-736	-886	-802	Segment sales adjustments					-130	450	3,013	-263					
Operating profit					212	264	564	388	Operating profit					212	264	334	462					
YoY					-64.2%	-61.1%	-44.5%	-55.7%	YoY					-64.2%	-61.1%	57.5%	75.0%					
Pharmaceuticals Network					554	506	637	634	Pharmaceuticals Network					642	585	825	911					
YoY					17.6%	9.3%	24.9%	25.5%	YoY					-	-	28.5%	80.0%					
OPM					58.0%	58.6%	59.0%	60.2%	OPM					2.8%	2.6%	3.4%	3.6%					
Dispensing Pharmacy					130	72	510	356	Dispensing Pharmacy													
YoY					-78.0%	-88.6%	-48.5%	-58.1%	YoY													
OPM					0.6%	0.3%	2.2%	1.5%	OPM													
Leasing and Facility-related					-32	42	-61	-33	Leasing and Facility-related					-32	42	-8	76					
YoY					-	-	-	-	YoY					-	-	-	-					
OPM					-5.3%	4.6%	-7.0%	-3.5%	OPM					-5.3%	4.6%	-1.1%	7.1%					
Food Service					1	17	10	6	Food Service					1	17	-12	-22					
YoY					-80.0%	-41.4%	-33.3%	-250.0%	YoY					-	-	-	-229.4%					
OPM					0.1%	2.1%	1.3%	0.8%	OPM					0.1%	2.1%	-1.6%	-3.1%					
Other					-36	-21	-48	-31	Other					-29	-28	-21	-18					
YoY					-	-	-	-	YoY					-	-	-	-					
OPM					-109.1%	-36.2%	-64.0%	-32.6%	OPM					-87.9%	-48.3%	-55.3%	-43.9%					
Segment profit adjustments					-405	-316	-519	-544	Segment profit adjustments					-369	-352	-447	-48					

(Reference) Pharmaceuticals Network segment sales

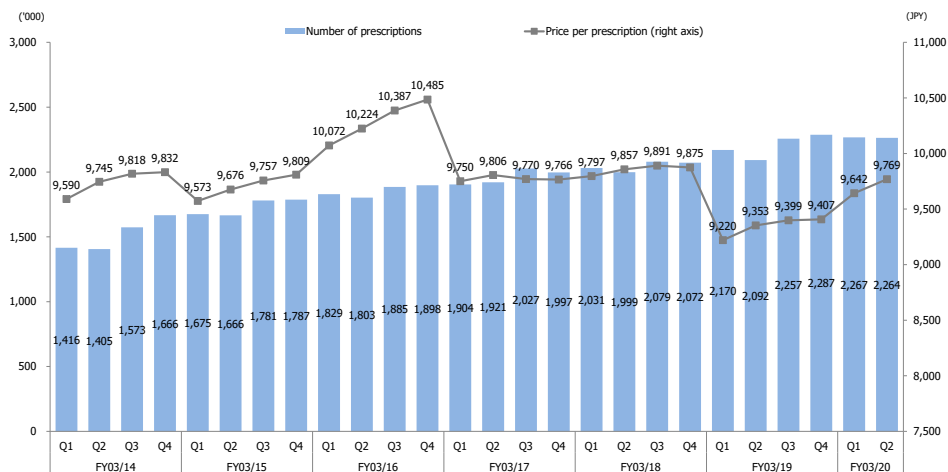


Source: Shared Research based on company data

Notes: *Undisclosed from Q2 FY03/19

*Integrated into the Community Pharmacy Network segment from FY03/20

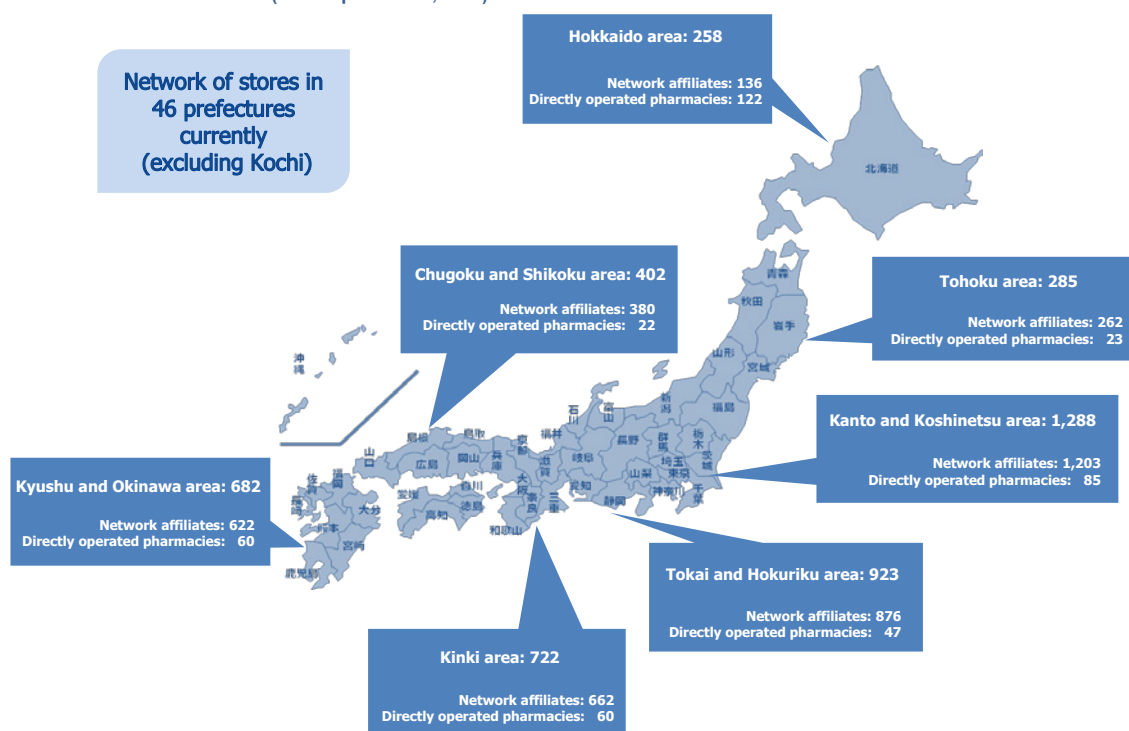
Prescription volume and price per prescription (drug price + technical fees; Dispensing Pharmacy segment; all stores)



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 September 30, 2019)



Source: Shared Research based on company data

Number of dispensing pharmacies by region

Area	Directly operated dispensing pharmacies	Network affiliates	Total
Hokkaido	122	136	258
Tohoku	23	262	285
Kanto and Koshinetsu	85	1,203	1,288
Tokai and Hokuriku	47	876	923
Kinki	60	662	722
Chugoku and Shikoku	22	380	402
Kyushu and Okinawa	60	622	682
Total	419	4,141	4,560

Source: Shared Research based on company data (September 30, 2019)

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

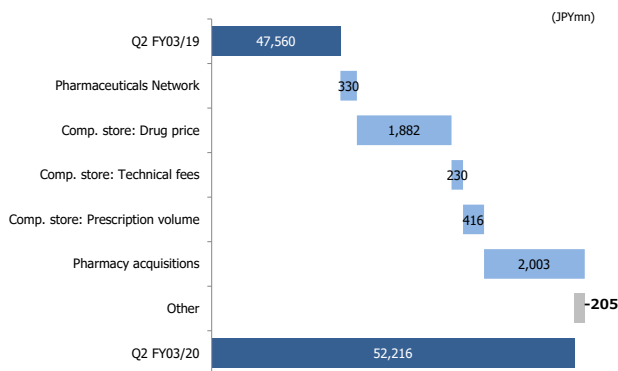
Community Pharmacy Network

- ▷ 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

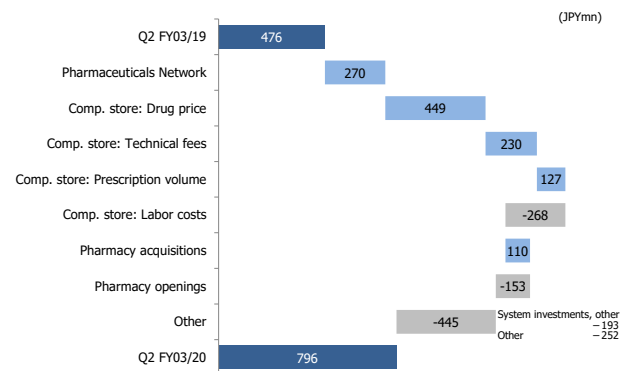
pharmacies only, the number of prescriptions was up a relatively stable 1.1% YoY, so newly acquired pharmacies contributed the bulk of the overall increase. In addition, since the price per prescription rose on higher drug prices, total dispensing fees across all pharmacies were up 11.1% YoY. At end-September 2019, there were 419 dispensing pharmacies, one care plan center, and seven drug stores.

Factors in 1H FY03/20 causing YoY increase/decrease

Sales



Operating profit



Source: Shared Research based on company data

- ▶ 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)

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

Full-year FY03/20 company forecasts

Recent performance and FY03/20 company forecasts

(JPYmn)	FY03/17			FY03/18			FY03/19			FY03/20	
	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	FY Est.
Sales	43,401	45,464	88,865	46,522	47,455	93,977	47,560	50,672	98,232	52,216	103,000
YoY	3.1%	-0.3%	1.3%	7.2%	4.4%	5.8%	2.2%	6.8%	4.5%	9.8%	4.9%
Cost of sales	26,944	27,757	54,701	28,413	28,957	57,370	29,673	31,288	60,961	32,397	
Gross profit	16,457	17,707	34,164	18,109	18,498	36,607	17,887	19,384	37,271	19,819	
GPM	37.9%	38.9%	38.4%	38.9%	39.0%	39.0%	37.6%	38.3%	37.9%	38.0%	
SG&A expenses	15,908	16,142	32,050	16,837	16,607	33,444	17,410	18,432	35,842	19,022	
SG&A ratio	36.7%	35.5%	36.1%	36.2%	35.0%	35.6%	36.6%	36.4%	36.5%	36.4%	
Operating profit	549	1,564	2,113	1,271	1,892	3,163	476	952	1,428	796	2,500
YoY	-68.7%	-23.0%	-44.1%	131.5%	21.0%	49.7%	-62.5%	-49.7%	-54.9%	67.2%	75.1%
OPM	1.3%	3.4%	2.4%	2.7%	4.0%	3.4%	1.0%	1.9%	1.5%	1.5%	2.4%
Recurring profit	542	1,567	2,109	1,272	1,978	3,250	438	1,063	1,501	784	2,400
YoY	-69.0%	-25.8%	-45.4%	134.7%	26.2%	54.1%	-65.6%	-46.3%	-53.8%	79.0%	59.9%
RPM	1.2%	3.4%	2.4%	2.7%	4.2%	3.5%	0.9%	2.1%	1.5%	1.5%	2.3%
Net income	66	505	571	363	659	1,022	119	343	462	218	650
YoY	-91.4%	-46.9%	-66.8%	450.0%	30.5%	79.0%	-67.2%	-48.0%	-54.8%	83.2%	40.7%
Net margin	0.2%	1.1%	0.6%	0.8%	1.4%	1.1%	0.3%	0.7%	0.5%	0.4%	0.6%

Source: Shared Research based on company data

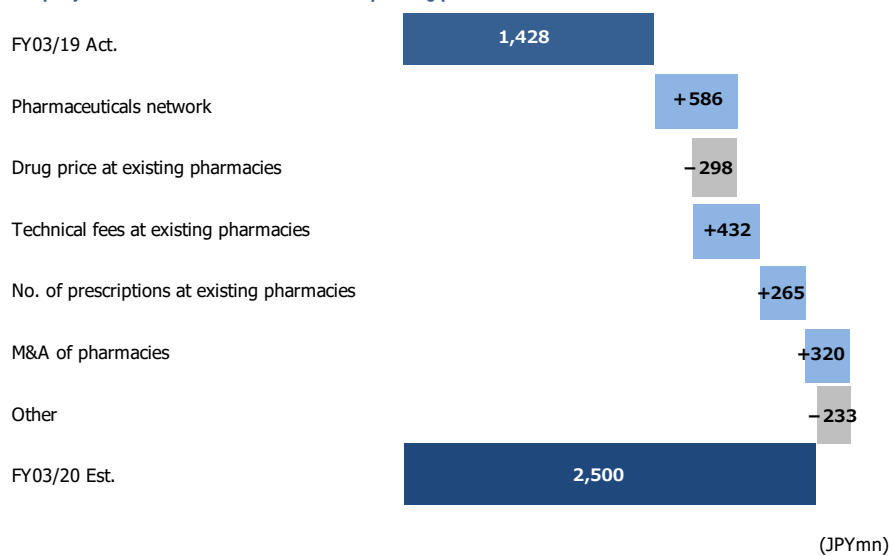
Note: Figures may differ from company materials due to differences in rounding methods.

- On May 8, 2018, Medical System Network announced its fifth medium-term plan starting FY03/19. In line with this plan, forecasts for full-year FY03/20 are sales of JPY103.0bn (+4.9% YoY), operating profit of JPY2.5bn (+75.0% YoY), recurring profit of JPY2.4bn (+59.9% YoY), and net income attributable to owners of the parent of JPY650mn (+40.4% YoY). As of end 1H FY03/20, the company's full-year forecasts remain unchanged. At end-1H, both sales and recurring profit exceeded forecasts, but the company maintained its full-year FY03/20 forecasts, partly because sales and profit forecasts are more weighted toward 2H than 1H.
- The key focus points for Q3 through Q4 FY03/20 are as follows. In the Pharmaceuticals Network business of the mainstay Community Pharmacy Network segment, the number of network members is steadily increasing, and it will be worth watching just how far the company can grow the network. The streamlining of drug distribution operations is a pressing matter for dispensing pharmacies, and we believe it provides the momentum to join the expanding network created by Medical System Network, who had handled drug orders worth JPY233.7bn in FY03/19 (JPY155.0bn through 1H in FY03/20). The number of prescriptions filled during 1H in the Dispensing Pharmacy business fell short of plan for existing pharmacies, so the company plans to focus on increasing the number of prescriptions from Q3 onward. In the manufacture and market pharmaceuticals business, it plans to focus on increasing the lineup of handled products. In the other three segments, 1H performance was favorable, but 2H occupancy trends in serviced elderly housing facilities and industry reforms in the Food Service and home-visit nursing care businesses deserve attention.

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.

Company estimate on FY03/20 consolidated operating profit



Source: Shared Research based on company data

- ▷ 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 to increase the number of prescriptions they handle in order to contribute to profitability. In addition, in the medium term, it 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

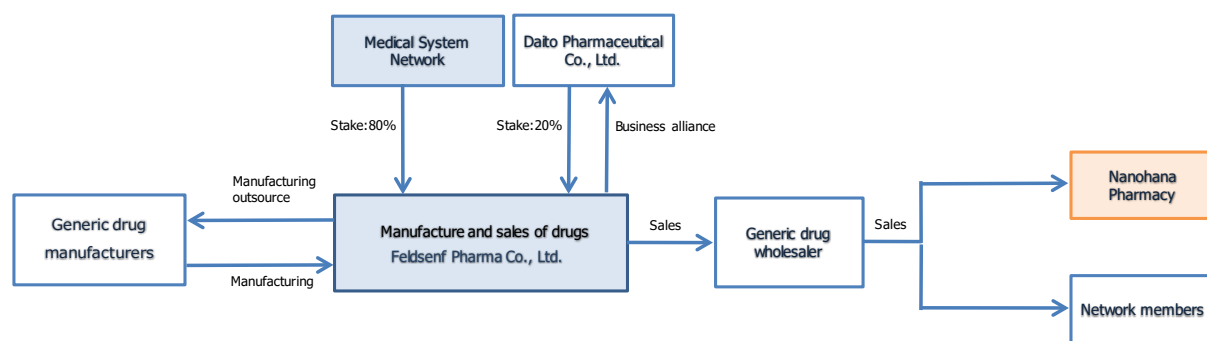
The core strategies of the fifth medium-term plan are as follows. The first four are in response to the NHI drug price and dispensing fee revisions implemented in April 2018. The third strategy is linked to the company's full-scale entry into the generic drug business (manufacture and sales), and the 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, nursing care, and disease prevention) that are considered essential to regional comprehensive care systems.
- ▷ 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.

The company also reorganized its business segments effective FY03/20. It combined the former Pharmaceuticals Network and Dispensing Pharmacy businesses to create a new segment, and to this new segment it added the manufacture and market pharmaceuticals business, which is mainly operated by Feldsenf Pharma.

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. 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. (See News and topics section.)

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 has been on the rise since the April 2018 NHI drug price revision. In response, the company announced that it plans to clear the 5,000-member target in FY03/20, two years earlier than initially planned.

Numerical targets for the fifth medium-term plan

(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. Approximately 90% of the company's sales came from the Dispensing Pharmacy business (operation of dispensing pharmacies) in FY03/19, before business segments were reorganized in FY03/20. The dispensing pharmacy support service (formerly, Pharmaceuticals 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 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 company maintains its medical and nursing-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 31, 2019)

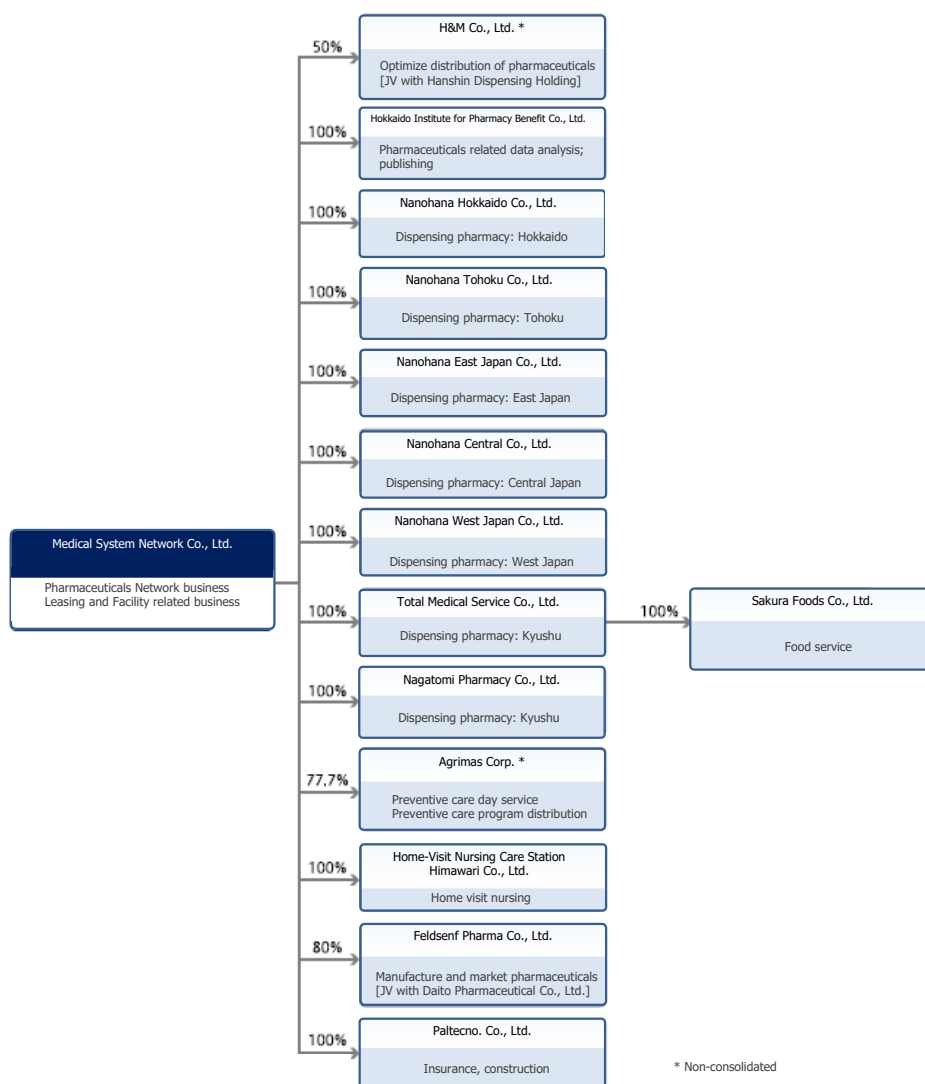
Segment	Company	Location	Ratio of voting rights
Pharmaceuticals Network	H&M Co., Ltd. *	Minato-ku, Tokyo	50.0%
	A-System Co., Ltd.	Hachinohe, Aomori	100.0%
Dispensing Pharmacy	Nanohana Hokkaido Co., Ltd.	Sapporo, Hokkaido	100.0%
	Nanohana Tohoku Co., Ltd.	Hachinohe, Aomori	100.0%
	Nanohana East Japan 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	Palteco 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 April 1, 2019)



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

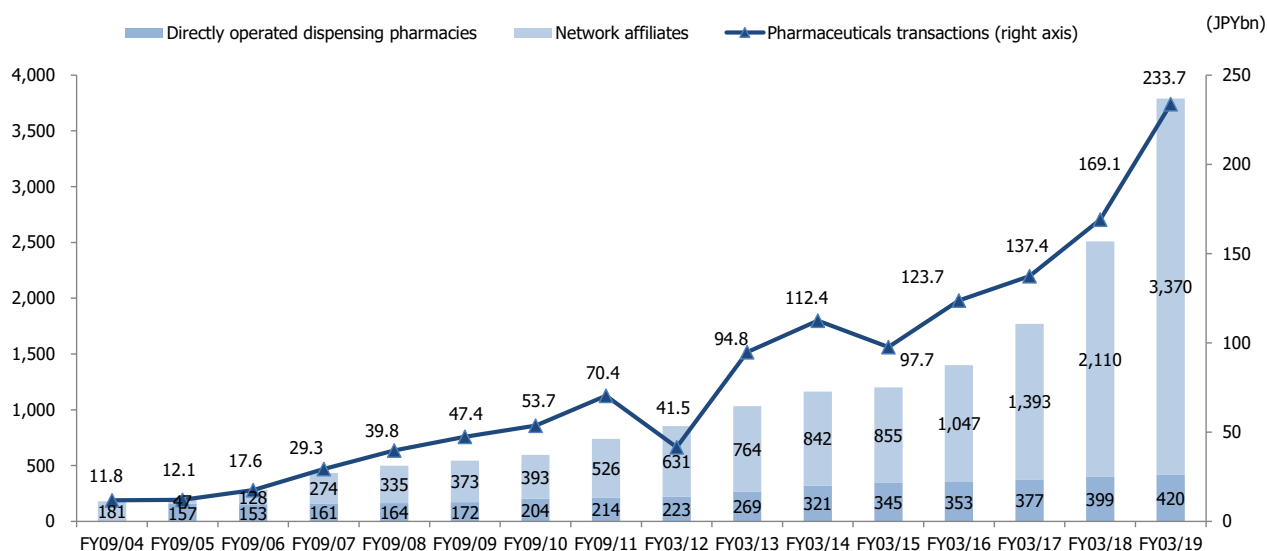
Details of the company business are given in accordance with the former segment classifications of Pharmaceuticals Network, Dispensing Pharmacy, and Other (manufacture and market pharmaceuticals).

Former Pharmaceuticals Network

The core Pharmaceuticals Network business offers comprehensive support for operating pharmacies, ranging from the sourcing of drugs to pharmacist training and financing. Services are provided by the parent and subsidiaries H&M Co., Ltd., and A-System

Co., Ltd. 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.

Former Dispensing Pharmacy

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 May 2019, the number of directly operated pharmacies and affiliates stood at over 4,000, and the number is on track to reaching the 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 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. Although most of its competitors do not disclose a breakdown of stores by format, one of the major dispensing pharmacy chains Nihon Chouzai (TSE1: 3341) stated that it aimed to reduce the number of monzen pharmacies (pharmacies operating near large hospitals) to 50% by 2030 in its FY03/19 briefing material. The weighting of Medical System Network's monzen pharmacies already stands at about 30%.

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 14 outlets while opening five new stores and acquiring 30 through M&A.

Market position of directly operated Nanohana Pharmacy

The number of Nanohana brand pharmacies increased from 399 in March 2018 to 420 by end-March 2019. 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	245,003	1,132
2	Toho Holdings	March	93,222	773
3	Qol	March	134,148	766
4	Sogo Medical	March	106,282	698
5	Suzuken	March	94,657	615
6	Nihon Chouzai	March	208,622	598
7	Kraft*	-	185,700	580
8	Medical System Network	March	90,706	420
9	Aisei Pharmacy	March	61,518	363
10	Pharmarise Holdings	May	43,202	255

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: Adoption of in-house developed automated drug ordering system (scheduled to be introduced at all pharmacies by end-September 2019) 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 nursing care facilities

The company plans and develops serviced elderly housing facilities that collaborate with medical institutions, nursing 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 nursing 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.

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 and nursing care are offered as one, with dispensing pharmacies, hospitals, and nursing 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 professionals, and pharmacists at the company's Nanohana Pharmacy.

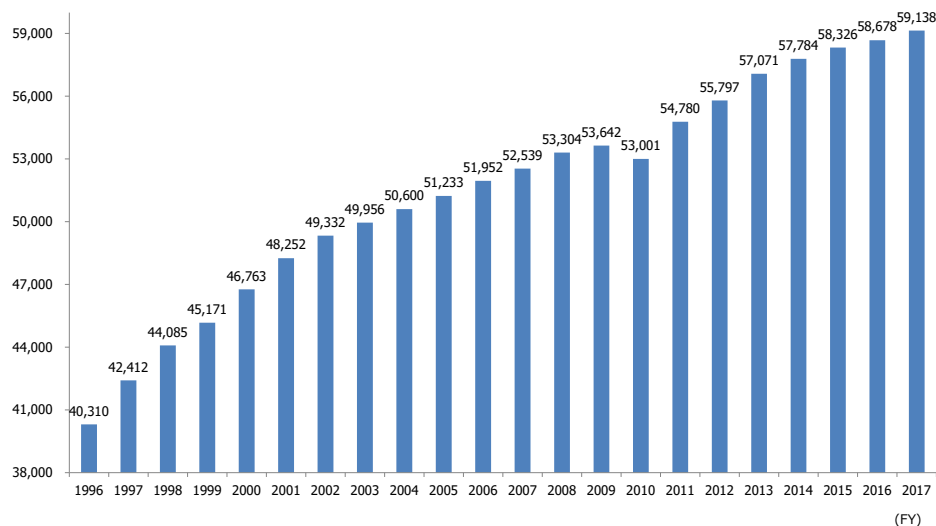
Market and value chain

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.

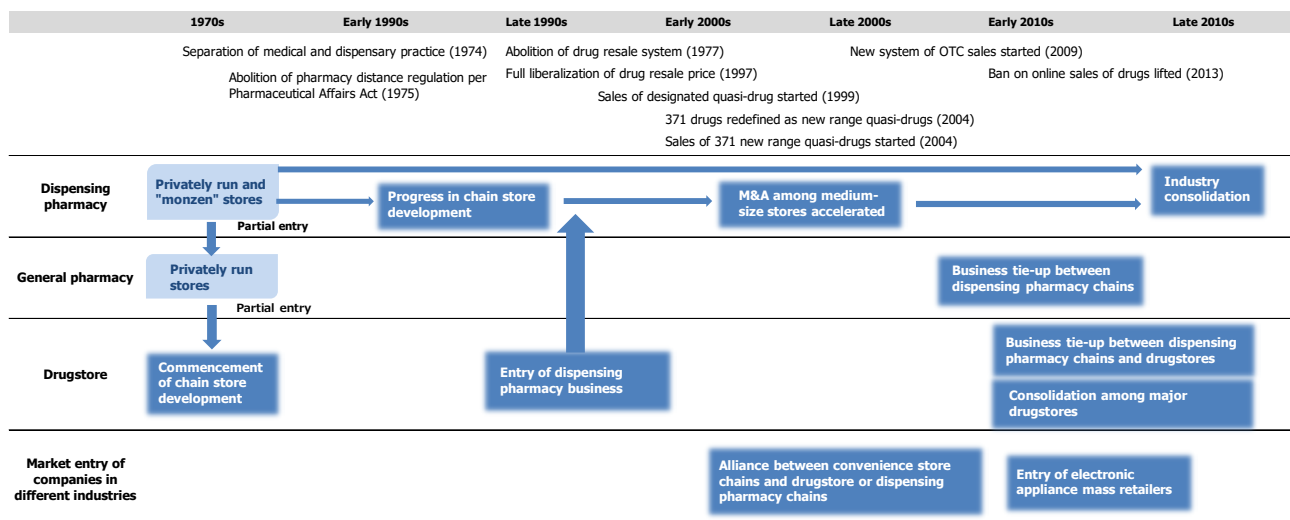
The number of dispensing pharmacies steadily increased as separation of prescribing/dispensing advanced and pharmacies that previously marketed OTC drugs became dispensing pharmacies. There was also a pronounced increase in independent pharmacies operating near large hospitals—so-called “monzen” (Japanese 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.

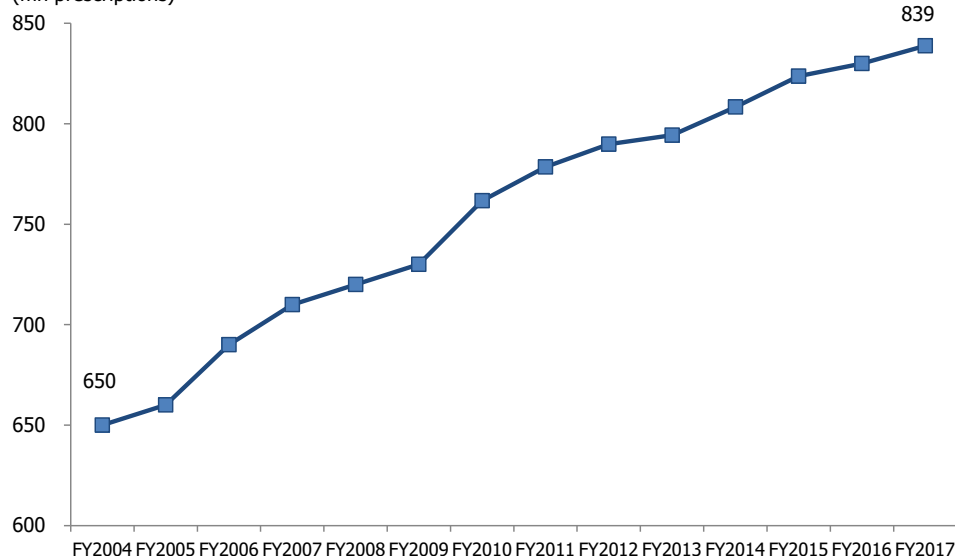
Developments surrounding dispensing pharmacies



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

Prescription volume

(mn prescriptions)



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

That said, the number of 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.

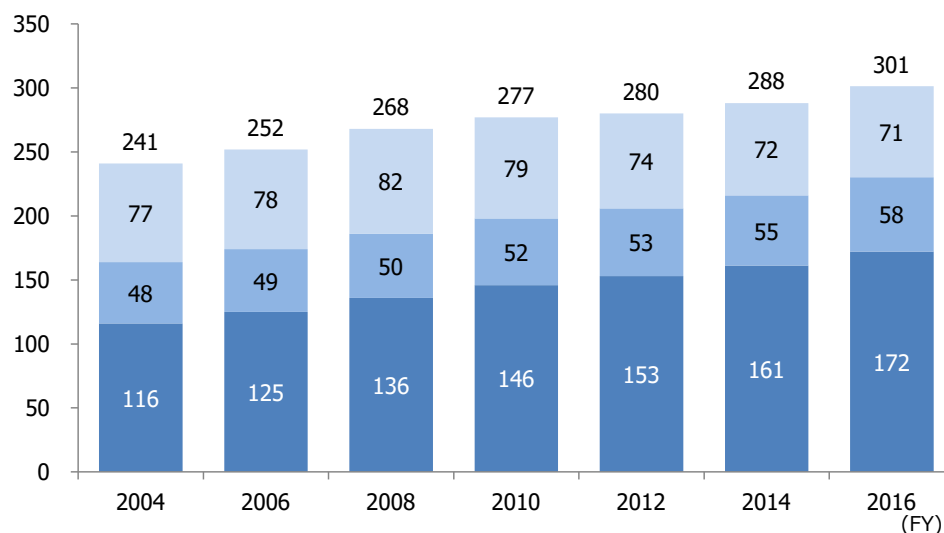
Pharmacist numbers

('000)

■ Pharmacies

■ Hospitals and clinics

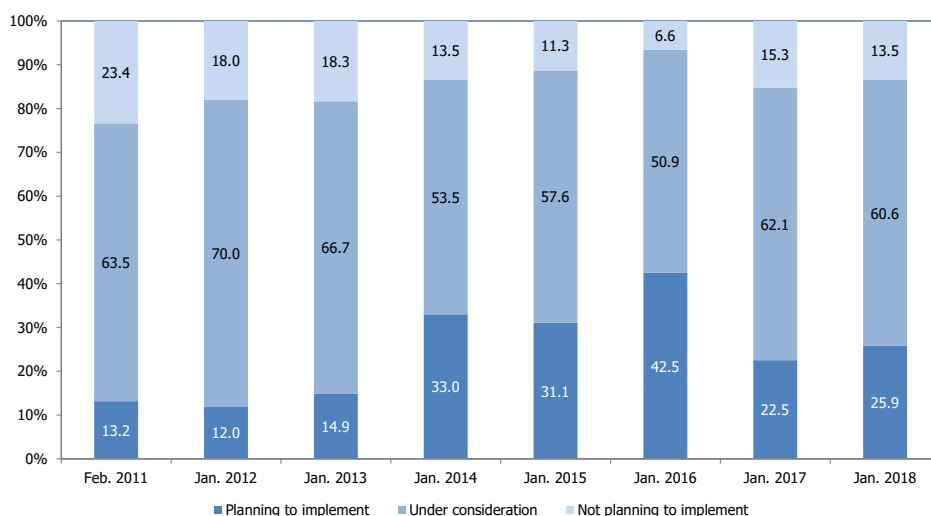
■ Other



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

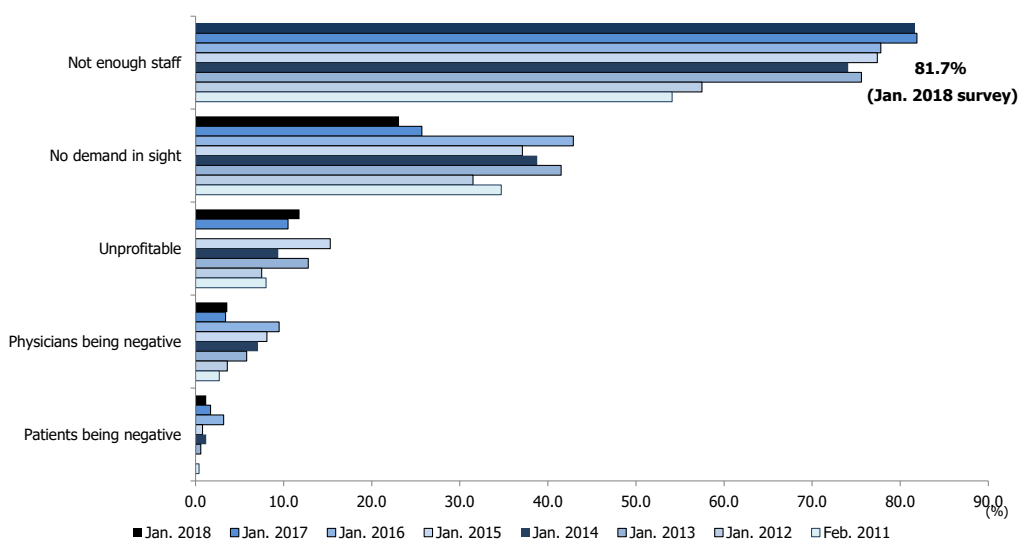
A Nippon Pharmacy Association (NPhA) survey of member pharmacies showed that the percentage of pharmacies planning to embark on home-based medication management and guidance services, one of the new roles being promoted by MHLW, is not expanding. Most respondents cited labor shortages as the main reason. 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

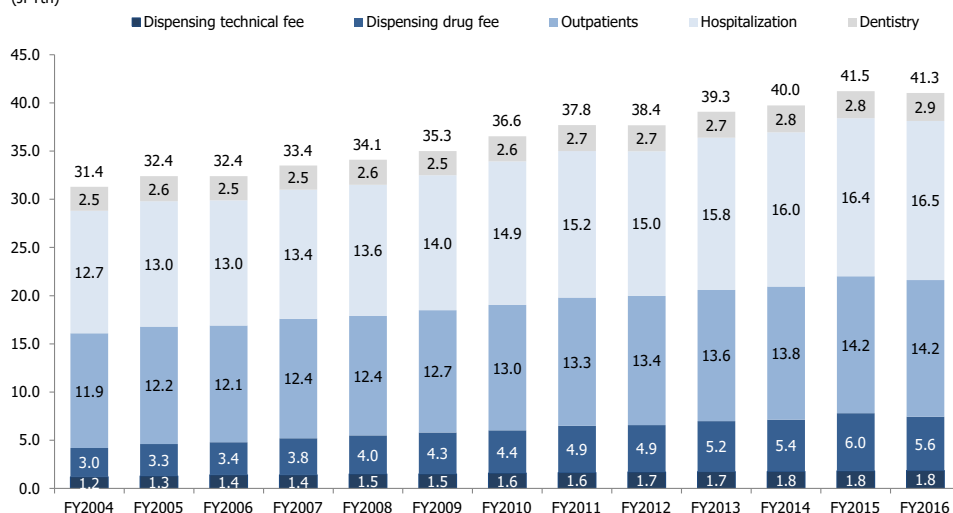


Source: Shared Research based on data from Nippon Pharmacy Association Committee for Expansion of Pharmacist Functionality, Report on 2017 Survey of Member Pharmacists (February 2018)

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.

Drug expenditures

(JPYtn)



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.

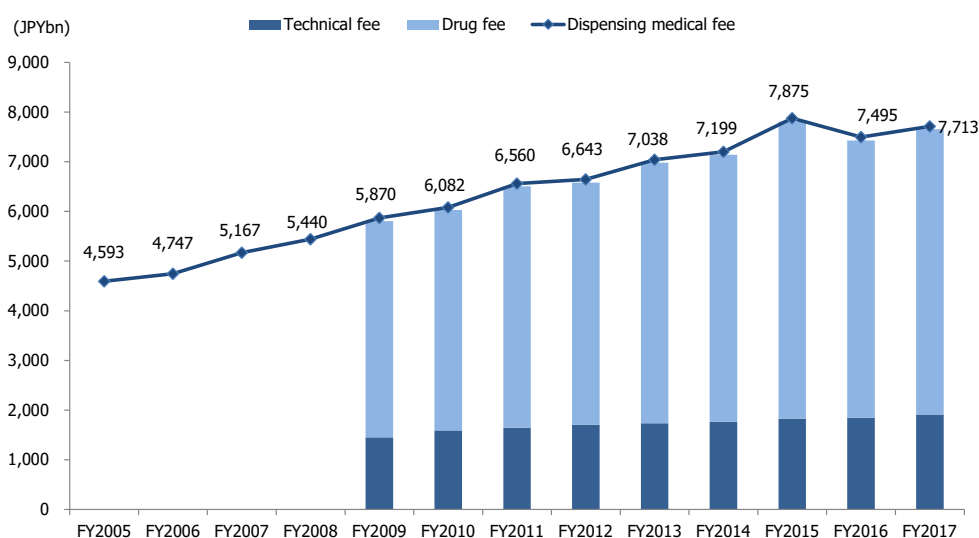
Role of dispensing pharmacies in regional comprehensive care system: transforming to family, regional pharmacies

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 nursing 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 tend to squeeze smaller pharmacies (such as those near large hospitals).

Dispensary charges

(JPYbn)



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.

FY2018 medical fee revision

Medical fees were revised from April 2018. Net medical fees in FY03/19 will be reduced by 1.19%, comprised of a 0.55% increase in core medical fees and 1.74% reduction in NHI drug prices (official price of medicines).

$$\text{Net medical fee revision } -1.19\% = \text{core medical fee } +0.55\% + \text{drug reimbursement price } -1.74\%$$

The increase in the core medical fee includes +0.63% for medical fees, +0.69% for dental fees, and +0.19% for dispensing fees. In contrast, the reduction in the NHI drug prices includes -1.65% for pharmaceuticals prices and -0.09% 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.

2018 medical fee revision (%)

Year of revision	FY2002	FY2004	FY2006	FY2008	FY2010	FY2012	FY2014	FY2016	FY2018
Core medical fees (actual)	-1.30	±0.00	-1.36	+0.38	+1.55	+1.379	+0.10	+0.49	+0.55
Dispensing fee	-1.30	+0.00	-0.60	+0.17	+0.52	+0.46	+0.04	+0.17	+0.19
Drug prices (actual)	-1.40	-1.05	-1.80	-1.20	-1.36	-1.375	-1.36	-1.33	-1.74
NHI basis	-6.30	-4.20	-6.70	-5.20	-5.75	-6.00	-5.64	-5.57	-7.48
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

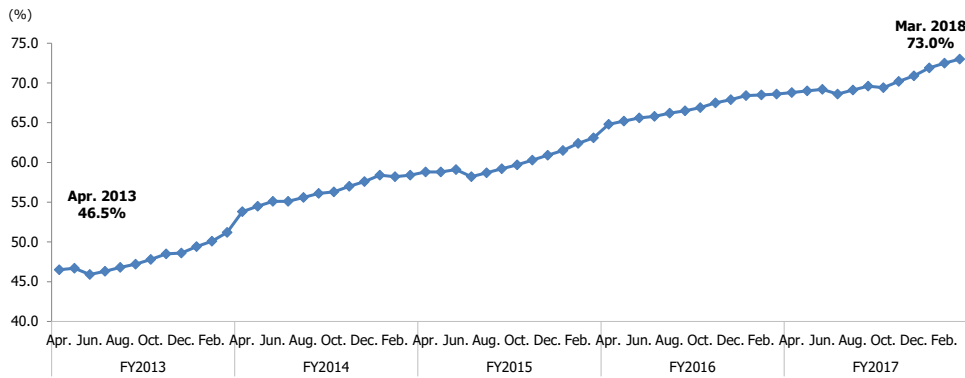
Source: Shared Research based on company data

The key point of this dispensing fee 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. An additional drug price revision is scheduled to take place accompanying a hike in the consumption tax in October 2019.

On generic drug utilization, MHLW targets a generic drug ratio of over 80% by 2020. The generic drug ratio continues to rise in response to this, and the medical fee revision includes components that will further stimulate generic drug use.

Generic drug ratio



Key points of medical fee revision

Issue	Description	Item	Pre-revision points	Post-revision points	Comments
Assess the role of family pharmacists and pharmacies					
1) Assess family pharmacists					
	- Revise eligibility criteria for family pharmacist guidance fee and family pharmacist comprehensive management fee → Check on patient's demand based on his/her condition	- Family pharmacist guidance fee - Family pharmacist comprehensive management fee	70 270	73 280	Working hours: 32hrs/week → 32hrs/week (including cases where "over 24hrs/week and 4 days/week" [per Child Care and Family Care Leave Act] applies); period of service at the pharmacy: 6 months → 12 months
2) Assess pharmacies contributing to community care					
	- Community support system premium (newly established) → Assess pharmacies contributing to community care in regional comprehensive care system → Develop system for medical safety	- Community support system premium	—	35	On the condition that the pharmacy has a track record that meets criteria for contributions to comprehensive community medical care system
	- Can be applied to Basic fee 2 or 3 if criteria are met - Eliminate standard dispensing premium	- Standard dispensing premium	32	—	Establish new assessment on pharmacies' contribution to community support
Enhance assessment of pharmacy interpersonal services					
	- Revise assessment for internal medicine dispensing fee	- Medication history management and guidance fee	38 50 38	41 53 41	1. When service is given to patient who brings back prescription within six months in principle 2. When service is given to patient other than the case "1" 3. When service is given to "intensive-care nursing home patient" → When service is given to "patient at his/her intensive-care nursing home"
	- Enhance pharmaceutical management fee related to interpersonal service → Establish medication adjustment support fee	- Medication adjustment support fee	—	125	Applies once a month to case where number of internal medications prescribed to patient is six or more (excluding specifically designated drugs) and is reduced by two or more in response to written recommendation by pharmacist
Ensure quality of home medical care					
1) Assess in detail home-visit pharmaceutical management guidance fee					
	- Revise patient home-visit medication management and guidance fee → Assess based on number of patients with same residence	- Home-visit medication management and guidance fee	650 300 —	650 320 290	For patients with separate residence → If number of patients at same building is 1 For patients with same residence → If number of patients at same building is 2–9 Other
2) Promote high-quality home-visit medication management and guidance service					
	- Promote home service by family pharmacists → Revise sterile preparation premium	- Sterile preparation premium	65 (130) 75 (140) 65 (130)	67 (135) 77 (145) 67 (135)	Sterile preparation for central parenteral nutrition infusion Sterile preparation for antineoplastic agent Sterile preparation for narcotics (Points in parenthesis for children under six years)
	→ Establish assessment of services for infants	- Infant premium	—	100	When pharmaceutical management and guidance is provided to patient or family members if patient is under six years old and treated at home, having difficulty going to the hospital
Promote generic drugs; optimize pricing					
	- Establish generic drug dispensing premium 3	- Generic drug dispensing premium 1 - Generic drug dispensing premium 2 - Generic drug dispensing premium 3	18 22 —	18 22 26	Tighten eligibility criteria for generic drug dispensing premiums, raising generic drug ratios from 65% to 75% or more for premium 1; 75% to 80% for premium 2; and 85% or more for premium 3
	- Establish reduced basic dispensing fee for pharmacies with exceptionally low generic drug ratio	- Basic dispensing fee	—	-2	Applies to pharmacy with generic drug ratio at 20% and under. Exceptional cases are excluded, but applies to pharmacy not reporting generic drug ratio
Optimize large "monzen" pharmacies					
	- Reduce concentration rate for basic dispensing fee 2 when prescriptions exceed 2,000	- Basic dispensing fee 2	25	25	Applies to pharmacy accepting prescriptions exceeding 2,000 per month; required ratio of prescriptions from specific medical institutions lowered from 90% to over 85% for specific dispensing pharmacies
	- Subdivide prescriptions for basic dispensing fee 3	- Basic dispensing fee 3	20	20 15	When prescriptions from pharmacies in the same group exceed 40,000 but are less than 400,000 When same-group pharmacies' prescriptions exceed 400,000
	- Total prescriptions of all medical institutions is used for pharmacy sharing a building with multiple medical institutions				

Note: *A good outcome would include all of the following

- 1 Nighttime and holiday service 400 times
- 2 Premium for prevention of drug duplication/drug interactions 40 times
- 3 Medication adjustment support fee once
- 4 At-home medication management for single-building medical examination patients 12 times
- 5 Fee for providing medication information 60 times
- 6 Premium for narcotics guidance and management 10 times
- 7 Family pharmacist instruction fee, etc., 40 times
- 8 Outpatient medication support fee 12 times

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. 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
2796	Pharmarise Holdings	May	2.6%	2.0%	3.5%	-
3034	Qol	March	5.8%	5.1%	6.4%	4.7%
3341	Nihon Chouzai	March	5.6%	5.0%	6.0%	4.2%
4350	Medical System Network	March	4.2%	2.8%	3.5%	1.2%
4775	Sogo Medical *	March	5.0%	6.3%	6.5%	5.0%
7649	Sugi Holdings **	February	5.6%	5.3%	5.4%	5.3%
9627	Ain Holdings	April	9.1%	8.6%	9.5%	-

Source: Shared Research based on each company's data and websites (as of end-March 2019)

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

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

Main industry peers

Ticker	Company	Latest full-year earnings			Description
		Sales (JPY mn)	OPM	ROE	
2796	Pharmarise Holdings	54,562	2.2%	-0.5%	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 Mail 1
3034	Qol	144,783	4.9%	10.5%	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	245,687	2.7%	9.2%	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	488,464	5.3%	10.9%	Developed drugstore/dispensing pharmacy, Sugi Pharmacy, in its stronghold Tokai area. The holding company also has discount stores. [Consolidated sales] Pharmacy 79, Drugstore 21
9277	Sogo Medical	144,630	3.7%	8.7%	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	268,386	7.3%	13.5%	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.

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)		
	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.	FY05/16 Cons.	FY05/17 Cons.	FY05/18 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.
Sales	88,865	93,977	98,232	48,511	52,949	54,562	131,502	145,516	144,783
Gross profit	34,164	36,607	37,271	6,929	7,218	7,950	16,876	19,648	17,863
SG&A expenses	32,050	33,444	35,842	6,116	6,775	6,771	10,010	10,557	10,812
Operating profit	2,113	3,163	1,428	813	442	1,179	6,865	9,091	7,050
Recurring profit	2,109	3,250	1,501	659	324	1,092	7,065	9,333	7,208
Net income	571	1,022	462	382	7	-28	4,353	4,986	3,970
ROE	5.7%	9.8%	4.3%	7.0%	0.1%	-0.5%	20.4%	13.9%	10.5%
ROA (RP-based)	4.2%	5.7%	2.3%	2.6%	1.3%	4.5%	8.7%	10.7%	7.9%
OPM	2.4%	3.4%	1.5%	1.7%	0.8%	2.2%	5.2%	6.2%	4.9%
Total assets	50,736	62,759	68,935	25,667	24,540	24,265	81,290	87,315	94,236
Net assets	10,644	10,584	10,761	6,237	5,900	5,624	21,632	35,935	39,017
Equity ratio	20.1%	16.9%	100.0%	21.1%	21.7%	21.8%	26.2%	41.2%	41.1%
Operating CF	3,084	6,699	2,840	-272	2,103	1,330	5,813	11,116	5,773
Investing CF	-3,909	-6,848	-5,921	-773	-871	-527	-15,392	-3,775	-8,287
Financing CF	998	8,050	4,338	492	-816	-894	7,435	-1,685	2,906
Cash and deposits	2,235	10,136	11,520	3,319	3,734	3,643	14,144	19,800	20,193
Interest-bearing debt	21,725	33,792	38,897	10,852	10,359	10,550	33,607	22,560	28,873
Net debt	19,490	23,656	27,377	7,533	6,625	6,907	19,463	2,760	8,680
	Nihon Chouzai (3341)			Sugi Holdings (7649)			Sogo Medical Holdings (9277)		
	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.	FY02/17 Cons.	FY02/18 Cons.	FY02/19 Cons.	FY03/17 Cons.	FY03/18 Cons.	FY03/19 Cons.
Sales	223,468	241,274	245,687	430,795	457,047	488,464	-	-	144,630
Gross profit	39,258	43,837	41,975	120,008	131,565	142,300	-	-	22,715
SG&A expenses	30,738	33,250	35,242	97,176	106,804	116,483	-	-	17,303
Operating profit	8,519	10,587	6,733	22,832	24,760	25,817	-	-	5,411
Recurring profit	7,976	10,138	6,077	23,875	25,900	27,237	-	-	5,607
Net income	4,638	6,104	3,792	14,947	16,411	17,940	-	-	3,246
ROE	13.5%	15.7%	9.2%	10.0%	10.1%	10.9%	-	-	8.7%
ROA (RP-based)	4.7%	5.6%	3.3%	10.4%	10.2%	10.5%	-	-	6.1%
OPM	3.8%	4.4%	2.7%	5.3%	5.4%	5.3%	-	-	3.7%
Total assets	178,347	186,573	178,677	230,664	253,989	265,481	-	-	93,560
Net assets	36,447	41,506	41,073	148,782	162,046	166,563	-	-	38,669
Equity ratio	20.4%	22.2%	23.0%	64.5%	63.8%	62.7%	-	-	41.0%
Operating CF	-940	23,141	13,572	16,912	27,564	22,894	-	-	3,852
Investing CF	-28,444	-13,843	-1,770	-18,439	-17,911	-22,362	-	-	-6,624
Financing CF	18,205	-2,034	-10,516	-3,506	-3,401	-13,897	-	-	-945
Cash and deposits	21,200	28,464	29,749	41,425	47,676	34,311	-	-	10,733
Interest-bearing debt	84,089	84,689	82,391	0	0	0	-	-	22,373
Net debt	62,889	56,225	52,642	-41,425	-47,676	-34,311	-	-	11,640
	Ain Holdings (9627)								
	FY04/16 Cons.	FY04/17 Cons.	FY04/18 Cons.						
Sales	234,843	248,110	268,386						
Gross profit	38,535	42,093	47,993						
SG&A expenses	23,916	27,529	28,371						
Operating profit	14,619	14,563	19,623						
Recurring profit	15,158	15,081	20,130						
Net income	7,917	7,949	10,567						
ROE	14.9%	14.0%	13.5%						
ROA (RP-based)	10.8%	10.2%	11.8%						
OPM	6.2%	5.9%	7.3%						
Total assets	139,888	156,323	183,435						
Net assets	53,324	60,178	96,733						
Equity ratio	38.1%	38.4%	52.7%						
Operating CF	21,352	18,409	21,657						
Investing CF	-20,877	-11,183	-5,282						
Financing CF	2,028	116	17,623						
Cash and deposits	21,892	29,234	63,233						
Interest-bearing debt	20,544	25,852	18,861						
Net debt	-1,348	-3,382	-44,372						

Source: Shared Research based on each company's data

Note: *Sogo Medical (4775) became Sogo Medical HD (9277) in October 2018.

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 segment OPM of about 3.0% 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, nursing 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 nursing 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 137 pharmacies while Medical System Network acquired just 30 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 JPY50.0bn. 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)	FY09/10 Cons.	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.
Sales	41,132	46,508	25,411	54,827	66,182	75,548	87,715	88,865	93,977	98,232
YoY	11.8%	13.1%	-	-	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%
Cost of sales	27,061	30,292	16,451	35,415	43,445	47,072	54,913	54,700	57,369	60,961
Gross profit	14,071	16,217	8,960	19,412	22,737	28,476	32,801	34,164	36,607	37,271
YoY	10.4%	15.2%	-	-	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%
GPM	34.2%	34.9%	35.3%	35.4%	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%
SG&A expenses	12,542	13,954	7,603	17,365	20,646	25,835	29,018	32,050	33,444	35,842
SG&A ratio	30.5%	30.0%	29.9%	31.7%	31.2%	34.2%	33.1%	36.1%	35.6%	36.5%
Operating profit	1,528	2,262	1,357	2,047	2,091	2,641	3,783	2,113	3,163	1,428
YoY	6.1%	48.0%	-	-	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%
OPM	3.7%	4.9%	5.3%	3.7%	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%
Non-operating income	51	100	81	150	250	457	275	378	405	
Non-operating expenses	250	223	124	284	321	349	380	279	291	333
Recurring profit	1,329	2,140	1,315	1,912	2,020	2,540	3,860	2,109	3,250	1,501
YoY	5.0%	61.0%	-	-	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%
RPM	3.2%	4.6%	5.2%	3.5%	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%
Extraordinary gains	1	111	25	59	155	169	88	57	19	49
Extraordinary losses	35	302	41	65	404	415	470	260	976	128
Income taxes	716	801	702	1,018	1,073	1,315	1,599	1,262	1,271	962
Implied tax rate	55.3%	41.1%	54.1%	53.4%	60.6%	57.3%	46.0%	66.2%	55.4%	67.7%
Net income attrib. to non-controlling interests	105	146	78	133	29	92	158	72	0	-2
Net income	473	1,001	518	756	668	885	1,720	571	1,022	462
YoY	9.7%	111.5%	-	-	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%
Net margin	1.2%	2.2%	2.0%	1.4%	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%

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. The plan breaks down into four key initiatives. We believe the company has also applied these concepts to its business strategy from FY03/16 and beyond.

- ▷ Expand Pharmaceuticals Network business, which has substantial growth potential, to 46 prefectures nationwide and become the dominant leader in total value of drug orders
- ▷ Pursue acquisition of family pharmacies that are useful, necessary, trusted, and loved by local residents
- ▷ Develop medical/nursing care zones from the standpoint of “community planning” in anticipation of a super-aging society
- ▷ Balance sustainable growth and financial stability

Sales have risen steadily over the past 10 years with the exception of the period when the fiscal year-end was changed. We attribute this to the company’s growth strategy that promotes expansion of network members and new openings of directly operated pharmacies through measures such as M&A. Of the targets laid out in the third medium-term plan, the company surpassed the FY03/15 sales target of JPY75.0bn.

Improved profit margins

One target of the third medium-term plan that proved elusive, however, was lifting RPM above 5.0%; the RPM finished at 3.4% in FY03/15 (the final year of the plan). This shortfall was in large a result of government efforts to curb pharmaceutical costs by cutting dispensing fees, which resulted in a harsher-than-expected business environment for the company’s mainstay Dispensing Pharmacy business. A breakdown of SG&A expenses further reveals reductions of personnel-related expenses, the largest cost factor, were below plan as cost-savings from measures such as integration of back-office functions and optimization of pharmacy



staffing came up short of projections. Labor costs, which account for a large percentage of SG&A expenses, and high fixed costs such as rents also impeded efforts to cut costs.

SG&A expenses

SG&A expenses (JPYmn)	FY09/09 Cons.	FY09/10 Cons.	FY09/11 Cons.	FY03/12 Cons.	FY03/13 Cons.	FY03/14 Cons.	FY03/15 Cons.	FY03/16 Cons.	FY03/17 Cons.	FY03/18 Cons.
Provision for doubtful accounts										
Salaries and allowances	4,144	4,734	5,217	2,806	6,364	7,489	9,266	10,406	12,088	12,481
Provision for employee bonuses	495	668	554	582	685	724	939	1,062	1,133	1,418
Retirement benefit expenses	107	111	147	88	172	195	264	329	361	466
Provision for directors' bonuses	44	55	57	32	64	68	76	55	47	35
Provision for directors' stock benefits								33	52	38
Taxes and dues	1,361	1,484	1,589	853	1,913	2,350	3,870	4,479	4,374	4,420
Rents	1,009	1,081	1,225	653	1,512	1,736	2,089	2,222	2,304	2,480
Shipping and storage charges										
R&D expenses										
Other	3,464	3,696	4,380	2,142	5,509	6,612	7,537	8,486	9,630	12,106
Total SG&A expenses	11,305	12,542	13,954	7,603	17,365	20,646	25,835	29,018	32,050	33,444

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.

Balance sheet

Balance sheet (JPYmn)	FY09/10 Cons.	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.
ASSETS										
Cash and deposits	1,792	1,329	2,072	2,092	3,106	2,499	2,081	2,252	10,201	11,703
Notes and accounts receivable	2,803	2,238	2,597	1,514	2,802	2,484	2,614	2,223	2,332	2,420
Inventories	1,551	1,776	1,796	2,219	2,732	3,846	3,431	4,053	3,520	4,297
Other	578	634	629	614	664	709	927	958	868	1,528
Allowance for doubtful accounts	-3	-2	-3	-6	-6	-7	-7	-10	-11	-12
Total current assets	8,071	7,787	8,902	8,271	10,941	11,023	10,783	11,098	18,736	21,055
Total tangible fixed assets	6,753	9,163	9,976	11,472	15,976	17,249	20,253	21,246	24,129	25,721
Total intangible fixed assets	5,210	4,983	5,040	8,263	12,399	13,554	13,481	13,833	15,045	16,235
Investment securities	54	39		54	179	157	524	583	812	726
Long-term loans										
Other	2,471	2,607	2,728	2,771	3,645	3,631	3,838	4,008	4,066	5,217
Allowance for doubtful accounts	-77	-44	-43	-42	-26	-29	-33	-32	-31	-21
Investment and other assets	2,448	2,602	2,685	2,783	3,798	3,759	4,329	4,559	4,847	5,922
Total fixed assets	14,411	16,747	17,701	22,518	32,173	34,564	38,063	39,639	44,023	47,879
Total assets	22,482	24,534	26,603	30,789	43,114	45,587	48,847	50,737	62,759	68,935
LIABILITIES										
Notes and accounts payable	4,596	5,026	5,158	5,616	7,798	8,598	9,525	9,144	9,416	10,198
Short-term debt	2,099	2,478	3,856	5,119	12,922	9,214	6,910	3,863	7,463	9,158
Income taxes payable	371	590	582	459	578	599	1,065	413	1,135	695
Other	2,344	2,706	3,097	3,181	3,582	3,215	3,561	3,500	3,755	3,793
Total Total current liabilities	9,410	10,801	12,693	14,375	24,880	21,626	21,061	16,920	21,769	23,844
Long-term debt	7,857	7,365	7,029	8,758	10,948	15,391	14,859	20,186	26,329	29,739
Deferred tax assets	0	1	1	1	1	1	1	1		
Other	918	1,104	1,200	1,419	1,933	2,434	2,660	2,985	4,075	4,590
Total fixed liabilities	8,775	8,470	8,230	10,178	12,882	17,826	17,520	23,172	30,404	34,329
Total liabilities	18,184	19,271	20,923	24,553	37,762	39,452	38,581	40,092	52,174	58,173
Net assets										
Capital stock	1,091	1,091	1,091	1,091	1,091	1,091	1,932	1,932	2,097	2,128
Capital surplus	924	924	924	901	901	901	1,742	1,742	1,160	1,185
Retained earnings	2,040	2,924	3,281	3,836	4,300	4,980	6,467	6,735	7,459	7,616
Treasury stock	0	0	0	-45	-1,181	-1,147	-328	-302	-275	-233
Valuation differences on securities	-7	-7	-5	3	2	11	15	49	143	83
Foreign currency translation adjustments										
Other	-68	-58	-52	-40	-31	-28	-17	23	52,316	58,239
Non-controlling interests	310	382	436	493	273	338	469	514	2	0
Total net assets	4,298	5,263	5,680	6,236	5,352	6,136	10,265	10,644	10584	10761
Total liabilities and net assets	22,482	24,534	26,603	30,789	43,114	45,588	48,846	50,736	62,759	68,935
Working capital	-241	-1,011	-765	-1,883	-2,265	-2,268	-3,480	-2,868	-3,564	-3,481
Total interest-bearing debt	9,956	9,843	10,885	13,877	23,870	24,605	21,769	24,049	33,792	38,897
Net debt	8,163	8,514	8,813	11,785	20,763	22,120	19,708	21,814	23,591	27,194

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.

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 debt



increased by about JPY7.0bn to JPY102.7bn in FY03/14, while long-term debt increased by about JPY4.5bn to JPY14.2bn in FY03/15 and has continued to gradually rise.

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.

Cash flow statement

Cash flow statement (JPYmn)	FY09/10 Cons.	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.
Cash flows from operating activities (1)	2,273	3,353	1,566	3,790	3,706	3,838	6,409	3,084	6,699	2,840
Pre-tax profit	1,295	1,948	1,298	1,907	1,770	2,294	3,479	1,906	2,293	1,422
Depreciation	603	633	354	841	1,077	1,209	1,362	1,594	1,491	1,624
Goodwill amortization	303	337	177	487	669	849	917	1,009	1,056	1,147
Change in accounts receivable	-195	669	-325	1,739	382	935	191	812	496	500
Change in inventories	128	-181	8	-74	-173	-689	455	-472	759	-620
Change in accounts payable	373	354	102	-558	365	-295	683	-765	-569	69
Cash flows from investing activities (2)	-2,784	-2,747	-1,248	-5,425	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921
Purchase of tangible fixed assets	-1,125	-2,488	-805	-1,625	-4,180	-2,360	-3,674	-2,170	-4,050	-3,094
Purchase of intangible fixed assets	-3	-5	-1	-13	-44	-93	-273	-192	-190	-82
Purchase, sale, and redemption of investment securities	0	10	2	1	129	-267	-19	-39	-39	-16
Change in loans (net of long- and short-term)	27	36	18	-245	-56	-106	-106	-38	-95	-3
Free cash flow (1+2)	-511	606	318	-1,635	-3,853	-120	1,369	-825	-149	-3,081
Cash flows from financing activities	774	-1,069	425	1,654	4,864	-483	-1,792	998	8,050	4,338
Change in short-term borrowings	-695	175	1,293	685	7,255	-4,334	-2,314	-3,241	2,598	1,471
Change in long-term borrowings	1,276	-728	-489	1,846	-250	4,816	-896	5,292	7,292	3,701
Acquisition of treasury stock	82	0	0	-129	-1,155	1,005	0	0	0	0
Dividends paid	-83	-117	-162	-276	-221	-190	-229	-297	-297	-304

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.

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 JPY2.2bn in JPY03/17, accounting for the bulk of the deficit in both years.

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. 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.

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 for business expansion.

Short-term borrowing:

FY03/12 (acquisition of land, etc., for new pharmacies)

FY03/14 (acquisition of land for serviced elderly housing facilities and new pharmacies)

FY03/18 (funding for M&A and in preparation for future M&A and capital expenditures)

Long-term borrowing:

FY03/13 (acquisition of consolidated subsidiary, etc.)

FY03/15 (acquisition of land for new pharmacies)

FY03/17 (acquisition of land for pharmacies, funding for M&A activities such as share/business acquisitions)

FY03/18 (funding for M&A and in preparation for future M&A and capital expenditures)

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.

Historical performance

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

Q3 FY03/19 earnings results (out February 6, 2019)**Overview****Cumulative Q3 FY03/19 (April-December 2018) earnings results**

- ▷ Sales: JPY72.8bn (+3.2% YoY)
- ▷ Operating profit: JPY1.0bn (-54.5% YoY)
- ▷ Recurring profit: JPY1.0bn (-56.7% YoY)
- ▷ Net income*: JPY372mn (-60.6% YoY)

*Net income attributable to owners of the parent

Regarding the business environment in FY03/19, its profits continued to face harsh circumstances primarily in the Dispensing Pharmacy business, due to NHI drug price and dispensing fee revisions implemented in April 2018. However, the number of network members in the Pharmaceuticals Network business continued to expand at a brisk pace, with harsh negotiations continued between drug wholesalers and dispensing pharmacies over terms of business. The number of members as of end-Q3 FY03/19 reached 3,430, surpassing the full-year target of 3,200 and up 921 over end-FY03/18. Medical System Network continues to expand Pharmaceuticals Network business membership amid the harsh business climate for dispensing pharmacies while also providing guidance and promoting improvement at dispensing pharmacies to align with the revised dispensing fee schedule. The company is also making progress in reshuffling its dispensing pharmacies through acquisition of new stores, including M&A, and closure of others.

Segment performance

Pharmaceuticals Network

Cumulative Q3 FY03/19 segment earnings results

- ▷ Segment sales: JPY2.9bn (+8.3% YoY; includes internal sales or transfers between segments; same hereafter)
- ▷ Segment profits: JPY1.7bn (+17.5% YoY)

MHLW applied guidelines promoting improvement of drug distribution by drug manufacturers, drug wholesalers, and medical institutions/dispensing pharmacies (issued on January 23, 2018 "Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs") from April 2018. The start of the government-led initiative to resolve issues with drug distribution has increased the need for improving drug distribution efficiency undertaken by Medical System Network and this has led to a brisk expansion in the number of its new members from Q3 FY03/19. The company has already reached its full-year target of 3,200 members. The number of network members as of December 31, 2018 stood at 3,369 dispensing pharmacies and total 3,430 including hospitals and clinics (up 921 over end-FY03/18). The company noted this rising trend has continued in Q4 FY03/19.

Dispensing Pharmacy

Cumulative Q3 FY03/19 segment earnings results

- ▷ Segment sales: JPY67.3bn (+3.2% YoY)
- ▷ Segment profit: JPY712mn (-67.8% YoY)

In response to the April 2018 dispensing fee revisions, the company encouraged group dispensing 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 in-home medical treatment initiatives. On improvements at existing pharmacies, it will take time to meet some of the requirements for community support premiums (e.g., number of years pharmacist has been employed), but overall progress is in line with initial plans as shown in the following table. As regards to reassessing pharmacies, in addition to opening five pharmacies in cumulative Q3, the company acquired one company (two pharmacies) through a share acquisition and obtained five other pharmacies through business transfers. On the other hand, the company closed five dispensing pharmacies and one drug store. In January 2019, Medical System Network acquired Nagatomi Pharmacy Corp., which operates 23 dispensing pharmacies in Oita Prefecture and has excellent operational knowhow for regional pharmacies and a solid financial position, to facilitate expansion in the Kyushu area and the continued growth of its group dispensing pharmacy structure.

Number of locations (as of December 31, 2018): 406 dispensing pharmacies, one care plan center, and seven drug stores

Leasing and Facility-related

Cumulative Q3 FY03/19 segment earnings results

- ▷ Segment sales: JPY2.4bn (+52.6% YoY)
- ▷ Segment loss: JPY51mn (loss of JPY109mn in cumulative Q3 FY03/18)

The company posted operating losses for Q3, despite a sharp expansion in sales supported by firm leasing revenues and growth in business overseeing design and construction of medical facilities in cumulative Q3 FY03/19 (Apr–Dec 2018), due to upfront expenses on a serviced elderly housing facility Wisteria Minami Ichijo, which opened in November 2018. The occupancy rate improved as 53 of the 82 units (64.6% as of end-Q3 from 54.9% as of end-Q2) of Wisteria Senri Chuo and 38 of the 115 units (versus 21 contracted units as of November 2, 2018) of Wisteria Minami Ichijo were occupied.

Food Service

Cumulative Q3 FY03/19 segment earnings results

- ▷ Segment sales: JPY2.4bn (-27.4% YoY)
- ▷ Segment profits: JPY28mn (-42.9% YoY)

Profits fell as a staffing shortage boosted labor costs at some facilities, despite progress in restructuring efforts through withdrawal from unprofitable facilities.

Other

Cumulative Q3 FY03/19 segment earnings results

- ▷ Segment sales: JPY166mn (+133.8% YoY)
- ▷ Segment loss: JPY105mn (JPY75mn segment loss in cumulative Q3 FY03/18)

Manufacture and market pharmaceuticals business is conducted by Feldsenf Pharma Co., Ltd. The company aims to sell 16 generic active pharmaceutical ingredients (APIs) and 32 products and provide a stable supply of high-quality, low-cost generic drugs. It posted a modest operating loss in Q3.

1H FY03/19 earnings results

Overview: 1H results achieve targets

In 1H FY03/19, the company posted JPY47.6bn (+2.2% YoY) in sales owing to steady performances in the mainstay Pharmaceuticals Network business and contributions from new pharmacies and pharmacies acquired through M&A in the Dispensing Pharmacy business. However, unsuccessful price negotiations with drug wholesalers as a result of the NHI drug price and dispensing fee revisions implemented in April 2018 weighed heavily on earnings. As a result, operating profit came in at JPY476mn (-62.5% YoY), recurring profit JPY438mn (-65.6% YoY), and net income attributable to owners of the parent JPY119mn (-67.2% YoY). Sales and profits reached initial forecasts for 1H FY03/19 (target sales of JPY46.5bn, operating profit of JPY450mn, and recurring profit of JPY400mn).

Segment performance

Pharmaceuticals Network

Sales were JPY1.8bn (+5.2% YoY) and operating profit JPY1.1bn (+13.5% YoY). The number of member pharmacies and affiliates increased at a steady pace in 1H FY03/19. As of September 30, 2018, the total—including pharmacies, hospitals, and clinics—was 2,976 (+467 from end-FY03/18). Verses the year-end target of 3,200, the number of network members came to 2,976 in September 2018 and to 3,207 in October, surpassing the target. The company noted an ongoing trend in dispensing pharmacies to join the network as a means of supporting their businesses in response to the April 2018 NHI drug price revisions and the ensuing uncertainty over price negotiations with drug wholesalers as a result of the revisions. The network system was affected by the earthquake that struck Hokkaido in early September 2018, but the overall impact was minimized as service was restored the following day supported by the company's backup system.

Dispensing Pharmacy

Sales were JPY44.0bn (+2.7% YoY) and operating profit JPY202mn (-83.4% YoY). In 1H, Medical System Network opened two new dispensing pharmacies, added five through acquisition, and closed one dispensing pharmacy and one drug store. As a result, the company had 405 dispensing pharmacies, one care plan center, and seven drugstores as of September 30, 2018. While new pharmacy openings and additions through acquisitions contributed to sales, operating profit dropped due to the impact of NHI drug price and dispensing fee revisions.

Although the company is advising pharmacies on how to respond to the dispensing fee revisions, the eligibility criteria for the generic drug dispensing premiums were raised substantially, thereby leading to an increase in the number of pharmacies that do not qualify. Prescription volumes at existing pharmacies had been projected to increase 2.4% YoY in 1H, but in fact declined by 0.3% YoY. This is attributable to the YoY decline in the number of operating days at existing pharmacies in Hokkaido due to the Hokkaido earthquake and subsequent blackouts that occurred throughout the region.

Leasing and Facility-related

In this segment, the company posted sales of JPY1.5bn (+38.9% YoY) and an operating profit of JPY10mn (operating loss of JPY73mn in 1H FY03/18). Reasons for the increased sales include steady inflow of leasing revenue and increased business overseeing design and construction of medical facilities. The company was able to bring operating profit into the black due to higher sales, despite upfront spending on serviced elderly housing facility Wisteria Minami Ichijo, opened in November 2018. Another facility, Wisteria Senri-Chuo, that opened in May 2016 saw 45 of the 82 units occupied (occupancy rate of 54.9%) as of September 30, 2018. Occupancy rates for the other three Wisteria facilities in operation exceeded 90%.

Food Service

Sales were JPY1.6bn (-31.0% YoY) and operating profit JPY18mn (-47.1% YoY). Sales fell owing to withdrawal from unprofitable facilities. Increased labor costs at some of the facilities caused operating profit to drop.

Other

Sales were JPY91mn (+71.7% YoY), but the company reported an operating loss of JPY73mn (operating loss of JPY58mn in 1H FY03/18). Consolidated subsidiary Feldsenf Pharma Co., Ltd. (manufactures and sells pharmaceuticals) began sales of generic drugs in June 2018.

Financial condition

Total assets as of end-1H FY03/19 were JPY61.7bn (-JPY1.1bn versus end-FY03/18). Current assets fell by JPY1.2bn versus end-FY03/18 due to a decline in cash and deposits, but fixed assets increased by JPY132mn versus end-FY03/18 on an increase in deferred tax assets among other factors.

Liabilities fell JPY1.2bn versus end-FY03/18 to JPY51.0bn due to a JPY468mn drop in current liabilities and a JPY716mn drop in fixed liabilities. The decline in liabilities was largely attributable to a drop in accounts payable, income taxes payable, and long-term borrowing.

Net assets were up JPY108mn versus end-FY03/18 to JPY10.7bn on increases in shareholders' equity and accumulated other comprehensive income.

Cash flow

Cash and cash equivalents totaled JPY8.5bn at end-1H FY03/19, a JPY1.7bn decrease from end-FY03/18.

Cash flow from operating activities

Cash outflow from operating activities was JPY48mn (cash inflow of JPY3.4bn in FY03/18), mainly due to an increase in inventory assets and income tax paid.

Cash flow from investing activities

Cash outflow from investing activities was JPY1.5bn (cash outflow of JPY2.8bn in FY03/18), mainly due to expenditure for the acquisition of tangible fixed assets and the acquisition of businesses.

Cash flow from financing activities

Cash outflow from financing activities was JPY274mn (cash inflow of JPY4.8bn in FY03/18), mainly due to repayments of long-term borrowing and lease obligations.

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

February 2019

On **February 15, 2019**, the company announced an absorption-type merger with A-System Co., Ltd., a consolidated subsidiary, and revisions to the trade names of two other subsidiaries: Apotec and Kyoei Pharmacy.

The company says the goal of the merger (scheduled tentatively for April 1, 2019) is to consolidate corporate resources, improve operational efficiency, and accelerate decision-making. A-System is already collaborating with Medical System Network on the development and maintenance of pharmaceutical systems.

Apotec and Kyoei Pharmacy operate dispensing pharmacies in Tohoku and West Japan, respectively. Trade names of the two subsidiaries were changed to align with Medical System Network's Nanohana Pharmacy chain so as to improve name recognition and strengthen the business base. Apotec was renamed to Nanohana Tohoku and Kyoei Pharmacy to Nanohana West Japan (scheduled to be effective from April 1, 2019).

January 2019

On **January 8, 2019**, the company announced the latest opening and closure of its dispensing pharmacies.

The company announced that it acquired all shares in Nagatomi Pharmacy Corporation (headquarters: Oita, Oita Prefecture), which operates 23 dispensing pharmacies, as of January 8, 2019 and that it sold two dispensing pharmacies as of January 1, 2019. These transactions brought the group's total store count to 438, breaking down to 427 dispensing pharmacies, one care plan center (Hokkaido), seven drugstores (three in Ibaraki, four in Osaka), and three visiting nurse stations (two in Tokyo, one in Miyagi).

December 2018

On **December 13, 2018**, the company announced the launch of new generic drugs by Feldsenf Pharma Co., Ltd.

The following four APIs and eight products will be included in the NHI drug price list on December 14 and will be successively marketed by consolidated subsidiary Feldsenf Pharma Co., Ltd.

Newly listed drugs for December 2018

Brand name	Therapeutic category	Originator/alternatives
Clarithromycin tablet 200mg (Feldsenf)	Macrolide antibiotic formulation	Clarith tablet 200mg Klaricid tablet 200mg
Paroxetine tablet 5mg / 10mg / 20mg (Feldsenf)	Selective serotonin reuptake inhibitor	Paxil tablet 5mg / 10mg / 20mg
Mirtazapine tablet 15mg / 30mg (Feldsenf)	Noradrenergic and serotonergic antidepressant	Reflex tablet 15mg / 30mg Remeron tablet 15mg / 30mg
Rosuvastatin tablet 2.5mg / 5mg (Feldsenf)	HMG-CoA reductase inhibitor	Crestor tablet 2.5mg / 5mg

Source: Shared Research based on company data

Note: Rosuvastatin tablet 2.5mg/5mg (Feldsenf) is scheduled for commercialization in or after January 2019.

On **December 6, 2018**, the company announced the acquisition of shares in Nagatomi Pharmacy Corp.

At a Board of Directors meeting held on December 6, 2018, the company resolved to acquire all shares of Nagatomi Pharmacy Corp. (HQ: Oita, Oita Prefecture; Representative Director and President: Shigeru Nagatomi) and make it a consolidated subsidiary.

Nagatomi Pharmacy operates 23 dispensing pharmacies in Oita, and of which, three are certified as health support pharmacies*. It is known for its community-based operation of pharmacies as it engages in community activities such as health-related events (e.g., on exercise and diet) and rolls out health-awareness and promotion initiatives focused on regional communities. Medical System Network aims to further improve the quality of family pharmacies it operates by welcoming Nagatomi Pharmacy to the group. Further, by including Nagatomi's pharmacies to the company's network of pharmacies it has already built in Kyushu, an

area of focus for the company in its effort to become the dominant pharmacy operator, it aims to further expand the number of pharmacies under its operation. By doing so, the company thinks it can establish an efficient management structure and boost profitability.

*Health support pharmacies: As pharmacies that satisfy certain requirements set by the Minister of Health, Labour and Welfare, health support pharmacies provide consultations on nursing care, diet, and nutrition as well as on over-the-counter drugs and health food, in addition to fulfilling functions of family pharmacists and pharmacies.

Details of the share acquisition

Number of shares to be acquired	600 common shares (number of voting rights: 600)
Acquisition price	Approximately JPY3,494mn (including advisory fees and other expenses of roughly JPY303mn)
Schedule	Date resolved by the Board of Directors: December 6, 2018 Date share transfer agreement was concluded: December 6, 2018 Date of share transfer: January 8, 2019 (tentative)

Overview of Nagatomi Pharmacy Corp.

Business	Dispensing pharmacy operation
Capital	JPY30mn
Date established	October 1, 1982
Operating results and financial position (FY09/18)	Net assets: JPY2.8bn Total assets: JPY3.7bn Sales: JPY3.8bn (-1.8% YoY) Operating profit: JPY172mn (-10.4% YoY) Recurring profit: JPY151mn (-31.4% YoY) Net income: JPY109mn (-25.9% YoY)

On **December 3, 2018**, the company announced the latest opening and closure of its dispensing pharmacies.

The company announced that it opened one new dispensing pharmacy on December 3, 2018 and that it closed two on November 30 of the same year. These changes bring the group's store count to 417, breaking down to 406 dispensing pharmacies, one care plan center (Hokkaido), seven drugstores (three in Ibaraki, four in Osaka), and three visiting nurse stations (two in Tokyo, one in Miyagi).

New dispensing pharmacy (opened on December 3, 2018)

Store name: Nanohana Pharmacy Sapporo Nijuyonken Store

Location: Nishi-ku, Sapporo

Operating company: Nanohana Hokkaido Co., Ltd

Closures (effective November 30, 2018)

Store name: Nanohana Pharmacy Shizuoka Naka-Cho Store

Location: Aoi-ku, Shizuoka

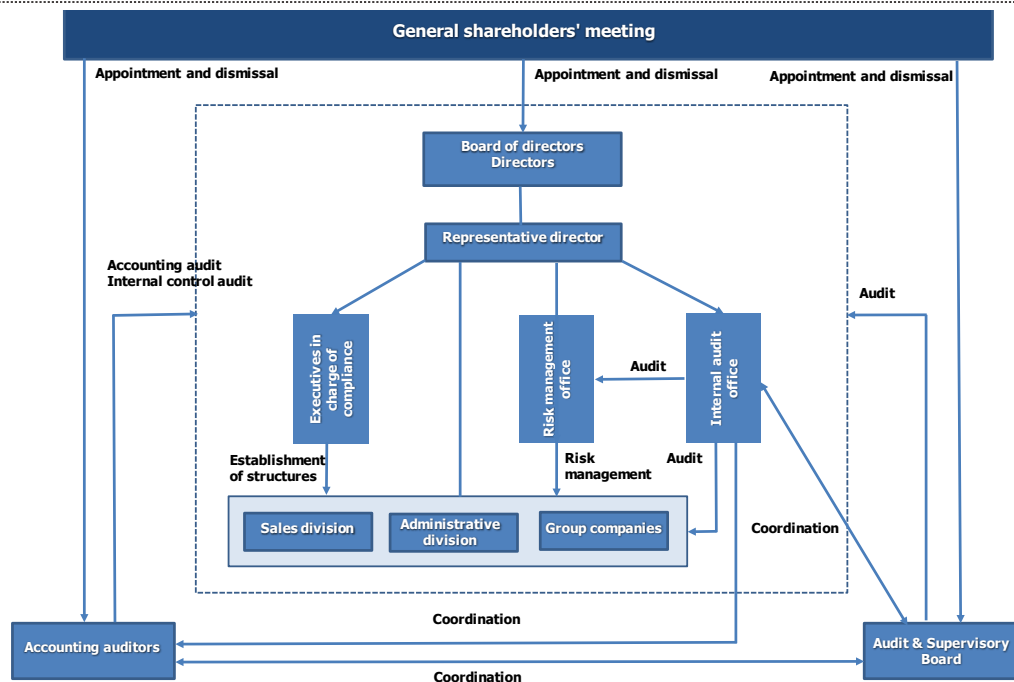
Operating company: Nanohana Central Co., Ltd

Store name: Nanohana Pharmacy Nagoya Fushiya Store

Location: Nakagawa-ku, Nagoya

Operating company: Nanohana Central Co., Ltd

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	20	2	22
Dispensing Pharmacy	2,594	468	3,062
Pharmacists	1,243	260	1,503
Leasing and Facility-related	119	25	144
Food Service	203	374	577
Other	28	9	37
Corporate (administration)	112	7	119
Total	3,076	885	3,961

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

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 Kitajuku-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	Digital Garage Inc.	KFC Holdings Japan, Ltd.	SanBio Company Limited
Advance Create Co., Ltd.	Dream Incubator Inc.	KI-Star Real Estate Co., Ltd.	SANIX INCORPORATED
ADJUVANT COSME JAPAN CO., LTD.	Earth Corporation	Kondotec Inc.	Sanrio Company, Ltd.
Aeon Delight Co., Ltd.	Elecom Co., Ltd.	Kumiai Chemical Industry Co., Ltd.	SATO HOLDINGS CORPORATION
Aeon Fantasy Co., Ltd.	en-Japan Inc.	Lasertec Corporation	SBS Holdings, Inc.
Ai Holdings Corporation	euglena Co., Ltd.	LUCKLAND CO., LTD.	Seikagaku Corporation
and factory, inc.	Evolable Asia Corp.	MATSUI SECURITIES CO., LTD.	Seria Co.,Ltd.
ANEST IWATA Corporation	FaithNetwork Co., Ltd.	Medical System Network Co., Ltd.	SHIFT Inc.
AnGes Inc.	Ferrotec Holdings Corporation	MEDINET Co., Ltd.	SHIP HEALTHCARE HOLDINGS, INC.
Anicom Holdings, Inc.	FIELDS CORPORATION	MedPeer, Inc.	SIGMAXYZ Inc.
Anritsu Corporation	Financial Products Group Co., Ltd.	Mercuria Investment Co., Ltd.	SMS Co., Ltd.
Apaman Co., Ltd.	FreeBit Co., Ltd.	Micronics Japan Co., Ltd.	Snow Peak, Inc.
ARATA CORPORATION	FRONTEO, Inc.	Milbon Co., Ltd.	Solasia Pharma K.K.
Artspark Holdings Inc.	Fujita Kanko Inc.	MIRAIT Holdings Corporation	SOURCENEXT Corporation
AS ONE CORPORATION	Gamecard-Joyco Holdings, Inc.	Monex Goup Inc.	Star Mica Holdings Co., Ltd.
Ateam Inc.	GameWith, Inc.	MORINAGA MILK INDUSTRY CO., LTD.	Strike Co., Ltd.
Aucfan Co., Ltd.	GCA Corporation	NAGASE & CO., LTD	Symbio Pharmaceuticals Limited
AVANT CORPORATION	Good Com Asset Co., Ltd.	NAIGAI TRANS LINE LTD.	Synchro Food Co., Ltd.
Axell Corporation	Grandy House Corporation	NanoCarrier Co., Ltd.	TAIYO HOLDINGS CO., LTD.
Azbil Corporation	Hakuto Co., Ltd.	Net Marketing Co., Ltd.	Takashimaya Company, Limited
AZIA CO., LTD.	Hamee Corp.	Net One Systems Co.,Ltd.	Take and Give Needs Co., Ltd.
AZoom, Co., Ltd.	Happinet Corporation	Nichi-Iko Pharmaceutical Co., Ltd.	Takihyo Co., Ltd.
BEENOS Inc.	Harmonic Drive Systems Inc.	Nihon Denkei Co., Ltd.	TEAR Corporation
Bell-Park Co., Ltd.	HOUSEDO Co., Ltd.	Nippon Koei Co., Ltd.	Tempo Innovation Inc.
Benefit One Inc.	IDOM Inc.	NIPPON PARKING DEVELOPMENT Co., Ltd.	3-D Matrix, Ltd.
B-lot Co.,Ltd.	IGNIS LTD.	NIPRO CORPORATION	TKC Corporation
Broadleaf Co., Ltd.	i-mobile Co.,Ltd.	Nisshinbo Holdings Inc.	TKP Corporation
Canon Marketing Japan Inc.	Inabata & Co., Ltd.	NS TOOL CO., LTD.	TOCALO Co., Ltd.
Career Design Center Co., Ltd.	Infocom Corporation	OHIZUMI MFG. CO., LTD.	TOKAI Holdings Corporation
Carna Biosciences, Inc.	Infomart Corporation	Oisix ra daichi Inc.	TOYOBO CO., LTD.
CARTA HOLDINGS, INC	Intelligent Wave, Inc.	Ok Electric Industry Co., Ltd	Toyo Ink SC Holdings Co., Ltd
CERES INC.	ipet Insurance CO., Ltd.	ONO SOKKI Co., Ltd.	Toyo Tanso Co., Ltd.
Chiyoda Co., Ltd.	istyle Inc.	ONWARD HOLDINGS CO.,LTD.	Tri-Stage Inc.
Chugoku Marine Paints, Ltd.	Itochu Enex Co., Ltd.	Pan Pacific International Holdings Corporation	VISION INC.
cocokara fine Inc.	JSB Co., Ltd.	PARIS MIKI HOLDINGS Inc.	VISIONARY HOLDINGS CO., LTD.
COMSYS Holdings Corporation	JTEC Corporation	PIGEON CORPORATION	WirelessGate, Inc.
CRE, Inc.	J Trust Co., Ltd	QB Net Holdings Co., Ltd.	YELLOW HAT LTD.
CREEK & RIVER Co., Ltd.	Japan Best Rescue System Co., Ltd.	RACCOON HOLDINGS, Inc.	YOSHINOYA HOLDINGS CO., LTD.
Daiichi Kigenso Kagaku Kogyo Co., Ltd.	JINS HOLDINGS Inc.	Raysum Co., Ltd.	YUMESHIN HOLDINGS CO., LTD.
Daiseiki Co., Ltd.	JP-HOLDINGS, INC.	RESORTTRUST, INC.	Yume no Machi Souzou Iinkai Co., Ltd.
Demae-Can CO., LTD	KAMEDA SEIKA CO., LTD.	ROUND ONE Corporation	Yushiro Chemical Industry Co., Ltd.
DIC Corporation	Kanamic Network Co.,LTD	RVH Inc.	ZAPPALLAS, INC.
Digital Arts Inc.	Kawanishi Holdings, Inc.	RYOHIN KEIKAKU CO., LTD.	

Attention: If you would like to see companies you invest in on this list, ask them to become our client, or sponsor a report yourself.

Disclaimer: This document is provided for informational purposes only. No investment opinion or advice is provided, intended, or solicited. Shared Research Inc. offers no warranty, either expressed or implied, regarding the veracity of data or interpretations of data included in this report. We shall not be held responsible for any damage caused by the use of this report. The copyright of this report and the rights regarding the creation and exploitation of the derivative work of this and other Shared Research Reports belong to Shared Research. This report may be reproduced or modified for personal use; distribution, transfer, or other uses of this report are strictly prohibited and a violation of the copyright of this report. Our officers and employees may currently, or in the future, have a position in securities of the companies mentioned in this report, which may affect this report's objectivity.

Japanese Financial Instruments and Exchange Law (FIEL) Disclaimer: The report has been prepared by Shared Research under a contract with the company described in this report ("the company"). Opinions and views presented are ours where so stated. Such opinions and views attributed to the company are interpretations made by Shared Research. We represent that if this report is deemed to include an opinion from us that could influence investment decisions in the company, such an opinion may be in exchange for consideration or promise of consideration from the company to Shared Research.

Contact Details

Shared Research Inc.
 3-31-12 Sendagi Bunkyo-ku Tokyo, Japan
<https://sharedresearch.jp>
 Phone: +81 (0)3 5834-8787
 Email: info@sharedresearch.jp