



4350

Medical System Network

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.



INDEX

| | |
|--------------------------------------------------------------|-----------|
| Executive summary | 3 |
| Key financial data | 5 |
| Recent updates | 7 |
| Trends and outlook | 8 |
| Quarterly trends and results | 8 |
| Business | 16 |
| Business model | 16 |
| Market and value chain | 25 |
| Industry peers (dispensing pharmacy chains) | 30 |
| Strengths and weaknesses | 32 |
| Historical performance and financial statements | 34 |
| Income statement | 34 |
| Balance sheet | 35 |
| Cash flow statement | 36 |
| Historical performance | 37 |
| News and topics | 45 |
| Other information | 46 |
| Company profile | 50 |

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-FY03/21, there were 6,116 network members (+871 from end-FY03/20) comprising 416 directly operated pharmacies and 5,700 affiliates. The company has reorganized its business segments in FY03/20, moving the Pharmaceuticals Network and Dispensing Pharmacy businesses, as well as the manufacture and market pharmaceuticals business previously included in the Other business, under the Community Pharmacy Network segment. The Leasing and Facility-related business and the Food Service business are unchanged. In the Other business, since the manufacture and market pharmaceuticals business is transferred out, the main business comprises home-visit nursing care.

Nanohana Pharmacies, the company's directly operated pharmacies, are generally located near large medical institutions or in medical malls or complexes that integrate multiple clinics and hospitals. According to the Ministry of Health, Labour and Welfare, there were 60,171 dispensing pharmacies in Japan at end-March 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. Through this increase in affiliates to the Pharmaceuticals Network, the number of network members as of end-March 2021 had exceeded 10% of the market share.

In FY03/21, Community Pharmacy Network accounted for 95.2% of sales, Leasing and Facility-related 2.2%, Food Service 2.4%, and Other 0.2%. The Community Pharmacy Network segment is a new segment following a segment change in FY03/20 that initially combined the former Pharmaceuticals Network and Dispensing Pharmacy segments with manufacture and market pharmaceuticals business (previously part of Other segment), but the digital shift business was added from FY03/21. The Community Pharmacy Network segment comprises the Pharmaceuticals Network, Dispensing Pharmacy, and manufacture and market pharmaceuticals, and digital shift businesses. The company discloses operating status of each business under the Community Pharmacy Network segment, but does not provide a sales and profit breakdown by business.

Trends and outlook

FY03/21 results: For FY03/21, the company reported full-year consolidated sales of JPY104.3bn (-0.9% YoY), operating profit of JPY3.4bn (+112.3% YoY), recurring profit of JPY3.5bn (+123.0% YoY), and net income attributable to owners of the parent of JPY2.2bn (versus loss of JPY895mn in FY03/20). Performance was strong at the mainstay Community Pharmacy Network segment's Pharmaceuticals Network business, and while the Dispensing Pharmacy business saw a YoY decline in the number of prescriptions filled due to the COVID-19 pandemic, it benefited from efficiency gains. As a consequence, operating profit was 2.1x the prior-year figure. The company also turned into the black at the net income level, thanks in part to JPY907mn in proceeds from the sale of shares in a non-equity-method affiliate, booked as an extraordinary gain.

At the time of the Q3 results announcement on February 4, 2022, the company made upward revisions to its FY03/22 earnings forecast. The revised forecast calls for sales of JPY106.5bn (+2.2% YoY), EBITDA of JPY6.8bn (+5.8% YoY), operating profit of JPY3.8bn (+10.8% YoY), recurring profit of JPY4.2bn (+20.7% YoY), and net income attributable to owners of the parent of JPY2.3bn (+4.6% YoY). In the dispensing pharmacy industry, earnings traditionally have been at the mercy of biennial NHI drug price revisions, but the first-ever "off-year" revision took place in April 2021. Going forward, drug price revisions will take place annually, and Medical System Network foresees further deterioration in the business climate for dispensing pharmacies. However, the company's current business performance has been favorable, with the prescription unit price at its directly operated pharmacies and the pharmaceutical transaction volume at its network members trending above initial plan. The company therefore raised its full-year sales forecast by JPY800mn compared to the initial plan. In the Leasing and Facility-related business, the company continues to aim for 90% occupancy rates for serviced elderly housing facilities. On the profit front, the company revised up its forecast for operating profit by JPY300mn as it successfully curbed travel and transportation expenses. It has revised up the net income forecast by JPY500mn in light of a gain on the sale of investment

securities and a lower tax burden due to the absorption of a subsidiary. From FY03/22, Medical System Network has adopted EBITDA as one of its profitability yardsticks.

Medical System Network announced its fifth medium-term plan spanning a four-year period ending FY03/22 (previous plans covered three-year periods). The latest plan sets out five basic policies: (1) expansion of the Pharmaceuticals Network business with a view to offering greater support for community-based medical care and streamlining drug distribution; (2) raising the caliber of group pharmacies; (3) expanding manufacture and sales of quality generic drugs; (4) strengthening collaboration among group businesses in order to better provide community care functions considered essential to a community-based integrated care system; and (5) improving cash flows as a means of fortifying the financial base.

Strengths and weaknesses

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

Key financial data

| Income statement (JPYmn) | FY03/13 Cons. | FY03/14 Cons. | FY03/15 Cons. | FY03/16 Cons. | FY03/17 Cons. | FY03/18 Cons. | FY03/19 Cons. | FY03/20 Cons. | FY03/21 Cons. | FY03/22 Est. |
|--------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|-----------------|
| Sales | 54,827 | 66,182 | 75,548 | 87,715 | 88,865 | 93,977 | 98,232 | 105,241 | 104,257 | 106,500 |
| YoY | - | 20.7% | 14.2% | 16.1% | 1.3% | 5.8% | 4.5% | 7.1% | -0.9% | 2.2% |
| Gross profit | 19,412 | 22,737 | 28,476 | 32,801 | 34,164 | 36,607 | 37,271 | 40,214 | 42,412 | |
| YoY | - | 17.1% | 25.2% | 15.2% | 4.2% | 7.2% | 1.8% | 7.9% | 5.5% | |
| Gross profit margin | 35.4% | 34.4% | 37.7% | 37.4% | 38.4% | 39.0% | 37.9% | 38.2% | 40.7% | |
| Operating profit | 2,047 | 2,091 | 2,641 | 3,783 | 2,113 | 3,163 | 1,428 | 1,615 | 3,429 | 3,800 |
| YoY | - | 2.2% | 26.3% | 43.2% | -44.1% | 49.7% | -54.9% | 13.1% | 112.3% | 10.8% |
| Operating profit margin | 3.7% | 3.2% | 3.5% | 4.3% | 2.4% | 3.4% | 1.5% | 1.5% | 3.3% | 3.6% |
| Recurring profit | 1,912 | 2,020 | 2,540 | 3,860 | 2,109 | 3,250 | 1,501 | 1,560 | 3,479 | 4,200 |
| YoY | - | 5.6% | 25.8% | 52.0% | -45.4% | 54.1% | -53.8% | 3.9% | 123.0% | 20.7% |
| Recurring profit margin | 3.5% | 3.1% | 3.4% | 4.4% | 2.4% | 3.5% | 1.5% | 1.5% | 3.3% | 3.9% |
| Net income | 756 | 668 | 885 | 1,720 | 571 | 1,022 | 462 | -895 | 2,198 | 2,300 |
| YoY | - | -11.6% | 32.4% | 94.4% | -66.8% | 79.0% | -54.8% | - | - | 4.6% |
| Net margin | 1.4% | 1.0% | 1.2% | 2.0% | 0.6% | 1.1% | 0.5% | - | 2.1% | 2.2% |
| Per-share data | | | | | | | | | | |
| Shares issued (year-end; '000) | 25,970 | 25,970 | 25,970 | 29,890 | 29,890 | 30,523 | 30,643 | 30,643 | 30,643 | - |
| EPS | 29.1 | 27.7 | 37.1 | 60.1 | 19.3 | 34.5 | 15.3 | -29.5 | 72.5 | 76.2 |
| EPS (fully diluted) | - | - | - | - | - | 34.3 | 15.0 | - | - | - |
| Dividend per share | 8.0 | 8.0 | 8.0 | 9.5 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 | 12.0 |
| Book value per share | 222.9 | 214.7 | 243.3 | 334.9 | 345.3 | 351.4 | 354.8 | 310.4 | - | - |
| Balance sheet (JPYmn) | | | | | | | | | | |
| Cash and cash equivalents | 2,092 | 3,106 | 2,499 | 2,081 | 2,252 | 10,201 | 11,703 | 11,722 | 10,118 | |
| Total current assets | 8,271 | 10,941 | 11,023 | 10,783 | 11,098 | 18,736 | 21,055 | 20,578 | 19,313 | |
| Tangible fixed assets | 11,472 | 15,976 | 17,249 | 20,253 | 21,246 | 24,129 | 25,721 | 25,126 | 24,634 | |
| Investments and other assets | 2,783 | 3,798 | 3,759 | 4,329 | 4,559 | 4,847 | 5,922 | 6,143 | 6,926 | |
| Intangible assets | 8,263 | 12,399 | 13,554 | 13,481 | 13,833 | 15,045 | 16,235 | 14,615 | 13,572 | |
| Total assets | 30,789 | 43,114 | 45,587 | 48,847 | 50,737 | 62,759 | 68,935 | 66,464 | 64,448 | |
| Accounts payable | 5,616 | 7,798 | 8,598 | 9,525 | 9,144 | 9,416 | 10,198 | 10,021 | 9,258 | |
| Short-term debt | 5,119 | 12,922 | 9,214 | 6,910 | 3,863 | 7,463 | 9,158 | 8,905 | 10,210 | |
| Total current liabilities | 14,375 | 24,880 | 21,626 | 21,061 | 16,920 | 21,769 | 23,844 | 23,296 | 25,418 | |
| Long-term debt | 8,758 | 10,948 | 15,391 | 14,859 | 20,186 | 26,329 | 29,739 | 28,653 | 22,348 | |
| Total fixed liabilities | 10,178 | 12,882 | 17,826 | 17,520 | 23,172 | 30,404 | 34,329 | 33,749 | 27,841 | |
| Total liabilities | 24,553 | 37,762 | 39,452 | 38,581 | 40,092 | 52,174 | 58,173 | 57,045 | 53,260 | |
| Total net assets | 6,236 | 5,352 | 6,136 | 10,265 | 10,644 | 10,584 | 10,761 | 9,418 | 11,187 | |
| Total interest-bearing debt | 13,877 | 23,870 | 24,605 | 21,769 | 24,049 | 33,792 | 38,897 | 37,558 | 32,558 | |
| Cash flow statement (JPYmn) | | | | | | | | | | |
| Cash flows from operating activities | 3,790 | 3,706 | 3,838 | 6,409 | 3,084 | 6,699 | 2,840 | 4,232 | 5,205 | |
| Cash flows from investing activities | -5,425 | -7,559 | -3,958 | -5,040 | -3,909 | -6,848 | -5,921 | -2,383 | -1,485 | |
| Cash flows from financing activities | 1,654 | 4,864 | -483 | -1,792 | 998 | 8,050 | 4,338 | -1,687 | -5,312 | |
| Financial ratios | | | | | | | | | | |
| ROA (RP-based) | 6.7% | 5.5% | 5.7% | 8.2% | 4.2% | 5.7% | 2.3% | 2.3% | 5.3% | |
| ROE | 13.7% | 12.2% | 16.2% | 21.9% | 5.7% | 9.8% | 4.3% | -8.9% | 19.7% | |
| Equity ratio | 18.8% | 11.9% | 12.7% | 20.3% | 20.1% | 16.9% | 15.6% | 14.2% | 17.3% | |

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. | Segment sales and profit (JPYmn) | FY03/19 Act. | FY03/20 Act. | FY03/21 Act. | FY03/22 Est. |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------------------------|-----------------|-----------------|-----------------|-----------------|
| Sales | 75,548 | 87,715 | 88,865 | 93,977 | 98,232 | Sales | 98,232 | 105,241 | 104,257 | 106,500 |
| YoY | 14.2% | 16.1% | 1.3% | 5.8% | 4.5% | YoY | 4.5% | 7.1% | -0.9% | 2.2% |
| Pharmaceuticals Network | 2,814 | 3,235 | 3,237 | 3,639 | 3,951 | Community Pharmacy Network | 92,284 | 99,617 | 99,214 | 101,119 |
| YoY | -1.0% | 15.0% | 0.1% | 12.4% | 8.6% | YoY | - | 7.9% | -0.4% | 1.9% |
| % of total | 3.6% | 3.6% | 3.5% | 3.8% | 4.0% | % of total | 93.3% | 94.7% | 95.2% | 94.9% |
| Dispensing Pharmacy | 71,743 | 82,002 | 81,650 | 87,172 | 90,706 | Three other businesses | 6,622 | 6,389 | 5,644 | 5,381 |
| YoY | 13.9% | 14.3% | -0.4% | 6.8% | 4.1% | YoY | - | -3.5% | -11.7% | -4.7% |
| % of total | 91.8% | 90.5% | 89.0% | 89.8% | 91.7% | % of total | 6.7% | 6.1% | 5.4% | 5.1% |
| Leasing and Facility-related | 1,517 | 2,430 | 2,046 | 2,031 | 3,320 | | | | | |
| YoY | 15.1% | 60.2% | -15.8% | -0.7% | 63.5% | | | | | |
| % of total | 1.9% | 2.7% | 2.2% | 2.1% | 3.4% | | | | | |
| Food Service | 1,932 | 2,830 | 4,667 | 4,103 | 3,161 | | | | | |
| YoY | 218.3% | 46.5% | 64.9% | -12.1% | -23.0% | | | | | |
| % of total | 2.5% | 3.1% | 5.1% | 4.2% | 3.2% | | | | | |
| Other | 182 | 143 | 163 | 92 | 261 | | | | | |
| YoY | -55.3% | -21.4% | 14.0% | -43.6% | 183.7% | | | | | |
| % of total | 0.2% | 0.2% | 0.2% | 0.1% | 0.3% | | | | | |
| Segment sales adjustments | -2,641 | -2,926 | -2,900 | -3,063 | -674 | Segment sales adjustments | -674 | -764 | -601 | -612 |
| Operating profit | 2,641 | 3,783 | 2,113 | 3,163 | 1,428 | Operating profit | 1,428 | 1,615 | 3,429 | 3,800 |
| YoY | 26.3% | 43.2% | -44.1% | 49.7% | -54.9% | YoY | -54.9% | 13.1% | 112.3% | 10.8% |
| Operating profit margin | 3.5% | 4.3% | 2.4% | 3.4% | 1.5% | Operating profit margin | 1.5% | 1.5% | 3.3% | 3.6% |
| Pharmaceuticals Network | 1,549 | 1,776 | 1,718 | 1,949 | 2,331 | Community Pharmacy Network | 3,313 | 3,743 | 5,703 | 6,070 |
| YoY | 5.0% | 14.7% | -3.3% | 13.4% | 19.6% | YoY | - | 13.0% | 52.4% | 6.4% |
| Operating profit margin | 55.0% | 54.9% | 53.1% | 53.6% | 59.0% | Operating profit margin | 3.6% | 3.8% | 5.7% | 6.0% |
| Dispensing Pharmacy | 2,377 | 3,412 | 2,314 | 3,060 | 1,068 | Three other businesses | -150 | -70 | -20 | 68 |
| YoY | 29.2% | 43.5% | -32.2% | 32.2% | -65.1% | YoY | - | - | - | - |
| Operating profit margin | 3.3% | 4.2% | 2.8% | 3.5% | 1.2% | Operating profit margin | - | - | -0.4% | 1.3% |
| Leasing and Facility-related | 25 | 129 | -143 | -182 | -84 | | | | | |
| YoY | - | 416.0% | - | - | - | | | | | |
| Operating profit margin | 1.6% | 5.3% | -7.0% | -9.0% | -2.5% | | | | | |
| Food Service | -13 | -89 | -129 | 45 | 34 | | | | | |
| YoY | - | - | - | - | -24.4% | | | | | |
| Operating profit margin | -0.7% | -3.1% | -2.8% | 1.1% | 1.1% | | | | | |
| Other | -76 | -109 | -163 | -97 | -101 | | | | | |
| YoY | - | - | - | - | - | | | | | |
| Operating profit margin | -41.8% | -76.2% | -100.0% | -105.4% | -38.7% | | | | | |
| Segment profit adjustments | -1,221 | -1,335 | -1,482 | -1,610 | -1,733 | Segment profit adjustments | -1,733 | -2,057 | -2,253 | -2,338 |

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

Revision to its full-year earnings forecast and year-end dividend forecast

2022-02-07

On February 4, 2022, Medical System Network Co., Ltd. announced revisions to its full-year earnings forecast and year-end dividend forecast.

Trends and outlook

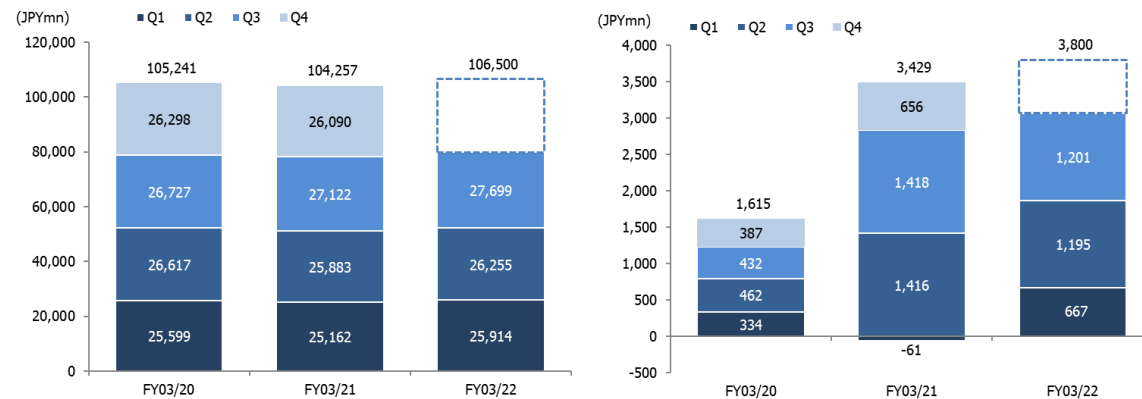
Quarterly trends and results

| Cumulative (JPYmn) | FY03/20 | | | | FY03/21 | | | | FY03/22 | | | FY03/22 | |
|-------------------------|---------|--------|--------|---------|---------|--------|----------|---------|---------|--------|--------|-----------|---------|
| | Q1 | Q1-Q2 | Q1-Q3 | Q1-Q4 | Q1 | Q1-Q2 | Q1-Q3 | Q1-Q4 | Q1 | Q1-Q2 | Q1-Q3 | % of Est. | FY Est. |
| Sales | 25,599 | 52,216 | 78,943 | 105,241 | 25,162 | 51,045 | 78,167 | 104,257 | 25,914 | 52,169 | 79,868 | 75.0% | 106,500 |
| YoY | 7.3% | 9.8% | 8.5% | 7.1% | -1.7% | -2.2% | -1.0% | -0.9% | 3.0% | 2.2% | 2.2% | | 2.2% |
| Gross profit | 9,839 | 19,819 | 30,225 | 40,214 | 9,704 | 20,502 | 31,665 | 42,412 | 10,738 | 21,861 | 33,443 | | |
| YoY | 8.4% | 10.8% | 9.8% | 7.9% | -1.4% | 3.4% | 4.8% | 5.5% | 10.7% | 6.6% | 5.6% | | |
| Gross profit margin | 38.4% | 38.0% | 38.3% | 38.2% | 38.6% | 40.2% | 40.5% | 40.7% | 41.4% | 41.9% | 41.9% | | |
| SG&A expenses | 9,504 | 19,022 | 28,997 | 38,599 | 9,765 | 19,147 | 28,892 | 38,982 | 10,071 | 19,999 | 30,379 | | |
| YoY | 7.2% | 9.3% | 9.5% | 7.7% | 2.7% | 0.7% | -0.4% | 1.0% | 3.1% | 4.4% | 5.1% | | |
| SG&A ratio | 37.1% | 36.4% | 36.7% | 36.7% | 38.8% | 37.5% | 37.0% | 37.4% | 38.9% | 38.3% | 38.0% | | |
| Operating profit | 334 | 796 | 1,228 | 1,615 | -61 | 1,355 | 2,773 | 3,429 | 667 | 1,862 | 3,063 | 80.6% | 3,800 |
| YoY | 57.5% | 67.2% | 18.1% | 13.1% | - | 70.2% | 125.8% | 112.3% | - | 37.4% | 10.5% | | 10.8% |
| Operating profit margin | 1.3% | 1.5% | 1.6% | 1.5% | - | 2.7% | 3.5% | 3.3% | 2.6% | 3.6% | 3.8% | | 3.6% |
| Recurring profit | 323 | 784 | 1,208 | 1,560 | -62 | 1,397 | 2,770 | 3,479 | 935 | 2,235 | 3,485 | 83.0% | 4,200 |
| YoY | 68.2% | 79.0% | 19.6% | 3.9% | - | 78.2% | 129.3% | 123.0% | - | 60.0% | 25.8% | | 20.7% |
| Recurring profit margin | 1.3% | 1.5% | 1.5% | 1.5% | - | 2.7% | 3.5% | 3.3% | 3.6% | 4.3% | 4.4% | | 3.9% |
| Net income | 97 | 218 | 326 | -895 | -201 | 578 | 2,013 | 2,198 | 583 | 1,431 | 2,144 | 93.2% | 2,300 |
| YoY | -4.0% | 83.2% | -12.4% | - | - | 165.1% | 517.5% | - | - | 147.6% | 6.5% | | 4.6% |
| Net margin | 0.4% | 0.4% | 0.4% | - | - | 1.1% | 2.6% | 2.1% | 2.2% | 2.7% | 2.7% | | 2.2% |
| Quarterly (JPYmn) | FY03/20 | | | | FY03/21 | | | | FY03/22 | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | | |
| Sales | 25,599 | 26,617 | 26,727 | 26,298 | 25,162 | 25,883 | 27,122 | 26,090 | 25,914 | 26,255 | 27,699 | | |
| YoY | 7.3% | 12.3% | 6.1% | 3.2% | -1.7% | -2.8% | 1.5% | -0.8% | 3.0% | 1.4% | 2.1% | | |
| Gross profit | 9,839 | 9,980 | 10,406 | 9,989 | 9,704 | 10,798 | 11,163 | 10,747 | 10,738 | 11,123 | 11,582 | | |
| YoY | 8.4% | 13.3% | 7.9% | 2.5% | -1.4% | 8.2% | 7.3% | 7.6% | 10.7% | 3.0% | 3.8% | | |
| Gross profit margin | 38.4% | 37.5% | 38.9% | 38.0% | 38.6% | 41.7% | 41.2% | 41.2% | 41.4% | 42.4% | 41.8% | | |
| SG&A expenses | 9,504 | 9,518 | 9,975 | 9,602 | 9,765 | 9,382 | 9,745 | 10,090 | 10,071 | 9,928 | 10,380 | | |
| YoY | 7.2% | 11.4% | 9.9% | 2.6% | 2.7% | -1.4% | -2.3% | 5.1% | 3.1% | 5.8% | 6.5% | | |
| SG&A ratio | 37.1% | 35.8% | 37.3% | 36.5% | 38.8% | 36.2% | 35.9% | 38.7% | 38.9% | 37.8% | 37.5% | | |
| Operating profit | 334 | 462 | 432 | 387 | -61 | 1,416 | 1,418 | 656 | 667 | 1,195 | 1,201 | | |
| YoY | 57.5% | 75.0% | -23.4% | -0.3% | - | 206.5% | 228.2% | 69.5% | - | -15.6% | -15.3% | | |
| Operating profit margin | 1.3% | 1.7% | 1.6% | 1.5% | - | 5.5% | 5.2% | 2.5% | 2.6% | 4.6% | 4.3% | | |
| Recurring profit | 323 | 461 | 424 | 352 | -62 | 1,459 | 1,373 | 709 | 935 | 1,300 | 1,250 | | |
| YoY | 68.2% | 87.4% | -25.9% | -28.3% | - | 216.5% | 223.8% | 101.4% | - | -10.9% | -9.0% | | |
| Recurring profit margin | 1.3% | 1.7% | 1.6% | 1.3% | - | 5.6% | 5.1% | 2.7% | 3.6% | 5.0% | 4.5% | | |
| Net income | 97 | 121 | 108 | -1,221 | -201 | 779 | 1,435 | 185 | 583 | 848 | 713 | | |
| YoY | -4.0% | 572.2% | -57.3% | - | - | 543.8% | 1,228.7% | - | - | 8.9% | -50.3% | | |
| Net margin | 0.4% | 0.5% | 0.4% | - | - | 3.0% | 5.3% | 0.7% | 2.2% | 3.2% | 2.6% | | |

Source: Shared Research based on company data

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

Quarterly sales and operating profit



Source: Shared Research based on company data


Quarterly results

| By segment (cumulative) (JPYmn) | FY03/20 | | | | FY03/21 | | | | FY03/22 | | |
|------------------------------------|---------|--------|--------|---------|---------|--------|--------|---------|---------|--------|--------|
| | Q1 | Q1-Q2 | Q1-Q3 | Q1-Q4 | Q1 | Q1-Q2 | Q1-Q3 | Q1-Q4 | Q1 | Q1-Q2 | Q1-Q3 |
| Sales | 25,599 | 52,216 | 78,943 | 105,241 | 25,162 | 51,045 | 78,167 | 104,257 | 25,914 | 52,169 | 79,868 |
| YoY | 7.3% | 9.8% | 8.5% | 7.1% | -1.7% | -2.2% | -1.0% | -0.9% | 3.0% | 2.2% | 2.2% |
| Community Pharmacy Network | 24,224 | 49,290 | 74,637 | 99,617 | 23,922 | 48,539 | 74,368 | 99,214 | 24,657 | 49,663 | 75,986 |
| YoY | 7.4% | 10.2% | 9.1% | 7.9% | -1.2% | -1.5% | -0.4% | -0.4% | 3.1% | 2.3% | 2.2% |
| % of total | 94.1% | 93.6% | 93.8% | 94.0% | 94.5% | 94.5% | 94.6% | 94.6% | 94.6% | 94.6% | 94.5% |
| Leasing and Facility-related | 760 | 1,829 | 2,659 | 3,425 | 723 | 1,438 | 2,194 | 2,940 | 739 | 1,536 | 2,461 |
| YoY | 26.7% | 21.3% | 11.6% | 3.2% | -4.9% | -21.4% | -17.5% | -14.2% | 2.2% | 6.8% | 12.2% |
| % of total | 3.0% | 3.5% | 3.3% | 3.2% | 2.9% | 2.8% | 2.8% | 2.8% | 2.8% | 2.9% | 3.1% |
| Food Service | 730 | 1,434 | 2,128 | 2,797 | 612 | 1,248 | 1,874 | 2,474 | 586 | 1,166 | 1,752 |
| YoY | -7.4% | -9.6% | -10.7% | -11.5% | -16.2% | -13.0% | -11.9% | -11.5% | -4.2% | -6.6% | -6.5% |
| % of total | 2.8% | 2.7% | 2.7% | 2.6% | 2.4% | 2.4% | 2.4% | 2.4% | 2.2% | 2.2% | 2.2% |
| Other | 38 | 79 | 122 | 165 | 51 | 110 | 171 | 229 | 74 | 152 | 232 |
| YoY | 15.2% | -13.2% | -26.5% | -36.8% | 34.2% | 39.2% | 40.2% | 38.8% | 45.1% | 38.2% | 35.7% |

Medical System Network/ 4350

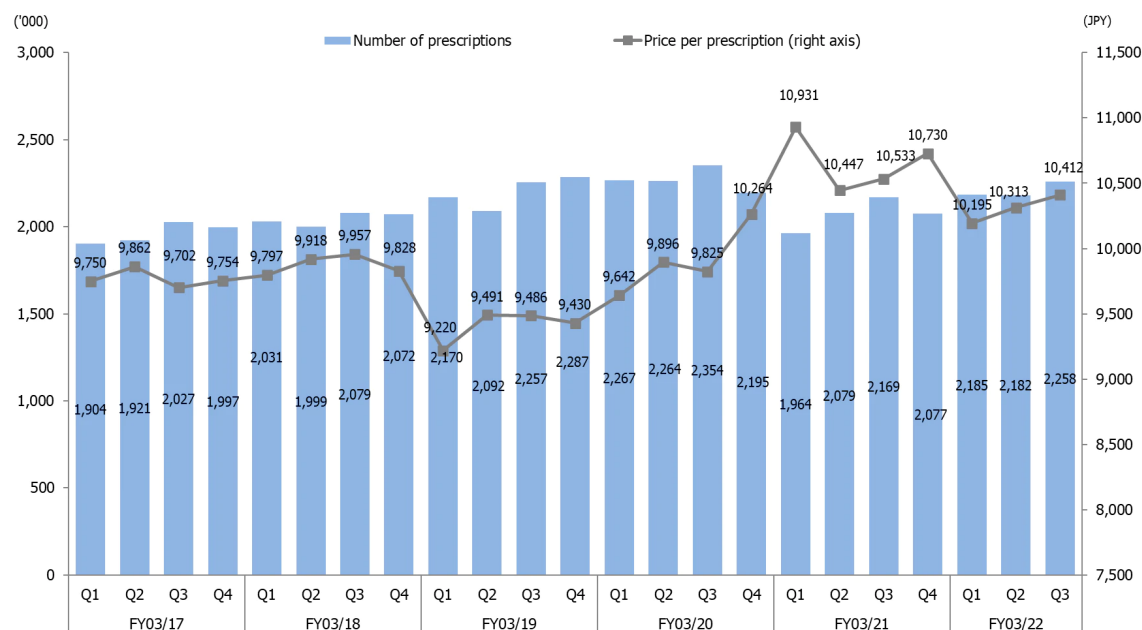
Source: Shared Research based on company data
Note: Figures may differ from company materials due to differences in rounding methods.

| Quarter | Order placement fees | System sales | Other |
|------------|----------------------|--------------|-------|
| FY03/14 Q1 | 356 | 336 | 41 |
| FY03/14 Q2 | 351 | 326 | 43 |
| FY03/14 Q3 | 399 | 251 | 44 |
| FY03/14 Q4 | 384 | 270 | 42 |
| FY03/15 Q1 | 382 | 244 | 44 |
| FY03/15 Q2 | 368 | 269 | 45 |
| FY03/15 Q3 | 434 | 264 | 48 |
| FY03/15 Q4 | 417 | 252 | 46 |
| FY03/16 Q1 | 458 | 242 | 21 |
| FY03/16 Q2 | 447 | 256 | 82 |
| FY03/16 Q3 | 527 | 341 | 55 |
| FY03/16 Q4 | 481 | 270 | 54 |
| FY03/17 Q1 | 493 | 306 | 51 |
| FY03/17 Q2 | 468 | 247 | 51 |
| FY03/17 Q3 | 529 | 212 | 53 |
| FY03/17 Q4 | 494 | 281 | 50 |
| FY03/18 Q1 | 546 | 283 | 46 |
| FY03/18 Q2 | 526 | 382 | 43 |
| FY03/18 Q3 | 611 | 293 | 44 |
| FY03/18 Q4 | 553 | 370 | 42 |
| FY03/19 Q1 | 637 | 274 | 43 |


Shared Research

Medical System Network/ 4350
 Research Coverage Report by Shared Research Inc. | <https://sharedresearch.jp>

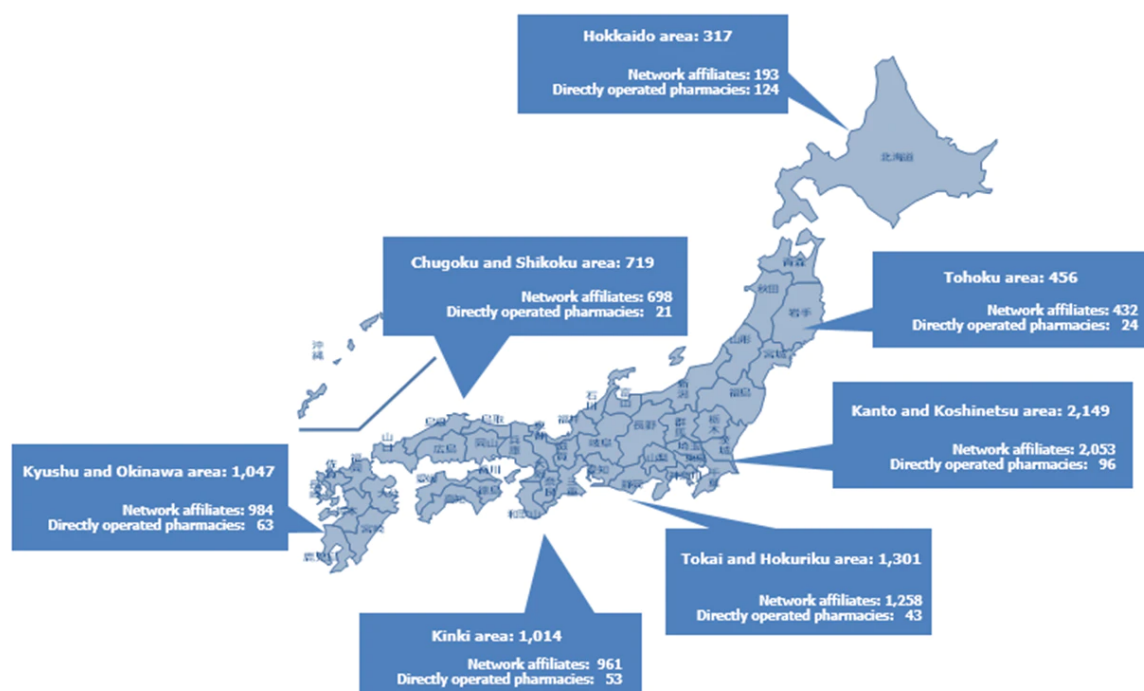
Quarterly trends in prescription volume and price per prescription (drug price + technical fees; Dispensing Pharmacy business; all stores)



Source: Shared Research based on company data

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

Distribution of network members (as of December 31, 2021)



Source: Shared Research based on company data

Number of dispensing pharmacies by region

| Area | Directly operated pharmacies | Affiliates | Total |
|----------------------|------------------------------|--------------|--------------|
| Hokkaido | 124 | 193 | 317 |
| Tohoku | 24 | 432 | 456 |
| Kanto and Koshinetsu | 96 | 2,053 | 2,149 |
| Tokai and Hokuriku | 43 | 1,258 | 1,301 |
| Kinki | 53 | 961 | 1,014 |
| Chugoku and Shikoku | 21 | 698 | 719 |
| Kyushu and Okinawa | 63 | 984 | 1,047 |
| Total | 424 | 6,579 | 7,003 |

Source: Shared Research based on company data (as of December 31, 2021)

Q3 FY03/22 earnings results (out February 4, 2022)

Overview

Q3 FY03/22 (April–December 2021) earnings results

- Sales: JPY79.9bn (+2.2% YoY)
- Operating profit: JPY3.1bn (+10.5% YoY)
- Recurring profit: JPY3.5bn (+25.8% YoY)
- Net income attributable to owners of the parent: JPY2.1bn (+6.5% YoY)

Company response and business conditions

Performance was steady in the core Community Pharmacy Network segment, with sales growing 2.2% YoY over cumulative Q3. The trend in the main business areas was as follows. In the Pharmaceuticals Network business, the number of new network members increased steadily. In the Dispensing Pharmacy business, the average prescription price dropped, but the number of prescriptions filled recovered to some extent.

Gross profit increased 5.6% YoY to JPY33.4bn, and GPM improved 1.4pp to 41.9% due to profit growing in the Pharmaceuticals Network business on an increase in the number of network members. According to the company, increased profitability of dispensing operations (due to a rise in the ratio of technical fees in the breakdown of prescription unit price) in the Dispensing Pharmacy business contributed to GPM improving, in addition to growth in sales and profit in the Pharmaceuticals Network business. SG&A expenses also increased 5.1% or JPY1.5bn YoY to JPY30.4bn due to expenses rising with the opening of new dispensing pharmacies, but the impact was offset by higher gross profit. As a result, operating profit grew 10.5% YoY and OPM rose 0.3pp to 3.8%. Meanwhile, net income attributable to owners of the parent increased 6.5% YoY as a result of gains on the sale of investment securities and tax benefits from the absorption-type merger with consolidated subsidiary Home-Visit Nursing Care Station Himawari Co., Ltd. in July 2021.

Breakdown of Q3 FY03/22 (April–December 2021) results by segment

Community Pharmacy Network

- Segment sales: JPY76.0bn (+2.2% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY4.7bn (+7.7% YoY)
- 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. A digital shift business that utilizes instant messaging app LINE was added to the segment from FY03/21.

Pharmaceuticals Network

The number of new network members continued to increase, driven by the need for improved operating stability for dispensing pharmacies amid harsh business conditions in the industry, including annual NHI drug price revisions starting in April 2021. As of end-December 2021, network members numbered 7,003 (+887 versus end-FY03/21), consisting of 424 directly operated pharmacies and 6,579 affiliates. This was 74.9% of the company's target of 1,184 network members by end-March 2022.

Dispensing Pharmacy

The average prescription price dropped due to the drug charge per prescription decreasing, but the number of prescriptions filled during the period recovered to some extent. As a result, dispensing fees increased 3.4% YoY across all stores and 2.0% YoY at existing stores. As of end-December 2021, the group had 424 dispensing pharmacies, one care plan center, and eight cosmetics/drug stores.

Manufacture and market pharmaceuticals

This business aims to provide a stable supply of good-quality, low-priced generic drugs. As of end-December 2021, the company was selling 41 different ingredients and 80 products. The company plans to increase the number of clients it sells to, starting with stores it operates directly, before expanding sales to network members.

Digital shift

Subsidiary PharmaShift Co., Ltd. was established on October 1, 2020, to create a "new pharmaceutical platform" for the digital age. In March 2021, the subsidiary launched the "Tsunagaru (connected) Pharmacy" service utilizing its official LINE account. The introduction of this service is designed to support the "family pharmacy" functions of dispensing pharmacies. At end-December 2021, the official LINE account had more than 250,000 registered users, with 745 stores having introduced the service. These numbers continue to grow, with the number of registered users having reached 271,000 and stores 788 at end-January 2022.

Leasing and Facility-related

- Segment sales: JPY2.5bn (+12.2% YoY)
- Segment profit: JPY53mn (+55.9% YoY)

Operating conditions of serviced elderly housing facilities

Property leasing revenue was generally strong and orders for construction projects increased. However, occupancy rates at the company's serviced elderly housing facilities remained sluggish. As of end-December 2021, the company reported stable occupancy rates at three of its five properties, while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 78.1% (with 64 out of 82 units occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 69.8% (with 81 out of 116 units occupied).

Food Service

- Segment sales: JPY1.8bn (-6.5% YoY)
- Segment profit: JPY7mn (versus a loss of JPY2mn in the previous year)

Segment turns profitable

Despite a drop in the number of meals supplied due to the pandemic, the segment turned profitable in Q2 as the company revised its operations and changed its suppliers. The segment remained in the black in Q3.

Other (mostly home-visit nursing care)

- Segment sales: JPY232mn (+35.7% YoY)
- Segment loss: JPY10mn (versus a loss of JPY17mn in the same period last year)

Company forecast for FY03/22

Recent performance and FY03/22 company forecast

| | FY03/20 | | | FY03/21 | | | FY03/22 | | |
|-------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| (JPYmn) | 1H Act. | 2H Act. | FY Act. | 1H Act. | 2H Act. | FY Act. | 1H Act. | 2H Est. | FY Est. |
| Sales | 52,216 | 53,025 | 105,241 | 51,045 | 53,212 | 104,257 | 52,169 | 54,331 | 106,500 |
| YoY | 9.8% | 4.6% | 7.1% | -2.2% | 0.4% | -0.9% | 2.2% | 2.1% | 2.2% |
| Cost of sales | 32,397 | 32,630 | 65,027 | 30,542 | 31,303 | 61,845 | 30,307 | | |
| Gross profit | 19,819 | 20,395 | 40,214 | 20,502 | 21,910 | 42,412 | 21,861 | | |
| Gross profit margin | 38.0% | 38.5% | 38.2% | 40.2% | 41.2% | 40.7% | 41.9% | | |
| SG&A expenses | 19,022 | 19,577 | 38,599 | 19,147 | 19,835 | 38,982 | 19,999 | | |
| SG&A ratio | 36.4% | 36.9% | 36.7% | 37.5% | 37.3% | 37.4% | 38.3% | | |
| Operating profit | 796 | 819 | 1,615 | 1,355 | 2,074 | 3,429 | 1,862 | 1,938 | 3,800 |
| YoY | 67.2% | -14.0% | 13.1% | 70.2% | 153.2% | 112.3% | 37.4% | -6.6% | 10.8% |
| Operating profit margin | 1.5% | 1.5% | 1.5% | 2.7% | 3.9% | 3.3% | 3.6% | 3.6% | 3.6% |
| Recurring profit | 784 | 776 | 1,560 | 1,397 | 2,082 | 3,479 | 2,235 | 1,965 | 4,200 |
| YoY | 79.0% | -27.0% | 3.9% | 78.2% | 168.3% | 123.0% | 60.0% | -5.6% | 20.7% |
| Recurring profit margin | 1.5% | 1.5% | 1.5% | 2.7% | 3.9% | 3.3% | 4.3% | 3.6% | 3.9% |
| Net income | 218 | -1,113 | -895 | 578 | 1,620 | 2,198 | 1,431 | 869 | 2,300 |
| YoY | 83.2% | - | - | 165.1% | - | - | 147.6% | -46.4% | 4.6% |
| Net margin | 0.4% | -2.1% | -0.9% | 1.1% | 3.0% | 2.1% | 2.7% | 1.6% | 2.2% |

Source: Shared Research based on company data

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

- Sales: JPY106.5bn (versus previous forecast of JPY105.7bn)
- EBITDA: JPY6.8bn (versus previous forecast of JPY6.5bn; adopted as a new yardstick for profitability)
- Operating profit: JPY3.8bn (versus previous forecast of JPY3.5bn)
- Recurring profit: JPY4.2bn (versus JPY4.0bn)
- Net income attributable to owners of the parent: JPY2.3bn (JPY1.8bn)
- EPS: JPY76.23 (JPY59.69)

At the time of the Q3 results announcement (February 4, 2022), the company revised its full-year earnings forecast as above. This was mainly to reflect the higher-than-expected average prescription price in the Dispensing Pharmacy business of the Community Pharmacy Network segment.

Forecast by segment

Community Pharmacy Network business: sales of JPY101.1bn (+1.9% YoY; JPY100.1bn previously), segment profit of JPY6.1bn (+6.4% YoY; JPY5.7bn previously)

Other three businesses: sales of JPY6.1bn (+7.9% YoY; JPY6.2bn previously), segment profit of JPY67mn (versus a loss of JPY20mn in FY03/21; JPY167mn previously)

Adjustment: JPY707mn for sales (JPY612mn previously), JPY2.3bn for segment profit (JPY2.4bn previously)

Background to earnings forecasts

In the dispensing pharmacy industry, earnings traditionally have been at the mercy of biennial NHI drug price revisions. The first-ever “off-year” revision took place in April 2021, with revisions applied to some 70% of all pharmaceuticals on the NHI drug price list. Going forward, drug price revisions will take place annually (incorporating the off-year revisions), and Medical System Network foresees further deterioration in the business climate for dispensing pharmacies, heightening the need for operational stability. On the other hand, the company noted progress has been made in winning the understanding of wholesalers on previously promoted improvements to drug distribution. Shared Research sees that the company is making progress toward its goal of building a relationship with pharmaceutical wholesalers as business partners.

Revisions to forecasts announced on February 4, 2022 centered on the Dispensing Pharmacy business of the Community Pharmacy Network. At the time of the Q3 results announcement, the company revised up its full-year sales forecast for the Dispensing Pharmacy business by JPY800mn, as the prescription unit price at its directly operated pharmacies and the pharmaceutical transaction volume at its network member pharmacies have trended above the initial plan in this business. In addition, the company revised up its operating profit forecast by JPY300mn to reflect the upward revision to its sales forecast for the Dispensing Pharmacy business and cuts to expenses. It has revised up the forecast for net income by JPY500mn in light of a gain on the sale of investment securities and a lower tax burden resulting from the absorption-type merger with Home-Visit Nursing Care Station Himawari Co., Ltd.

The company sees the changing business climate as an opportunity for the Community Pharmacy Network segment's Pharmaceuticals Network business to continue expanding the number of network members by providing a dispensing pharmacy operating platform. The company aims to increase the number of network members by 1,184 to 7,300 by end-March 2022, but it thinks continuing to steadily increase the number of members after this point will lead to further growth. In the Dispensing Pharmacy business, the company aims to restore sales and continue improving profitability by focusing on filling more prescriptions through strengthening family pharmacy functions, utilizing its LINE official account to enhance communication with customers and enhancing the quality of pharmacists through introduction of the new education system (CP Step). At the Leasing and Facility-related business, the company seeks to stabilize earnings by targeting 90% occupancy for all serviced residences for the elderly.

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–FY03/22) 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

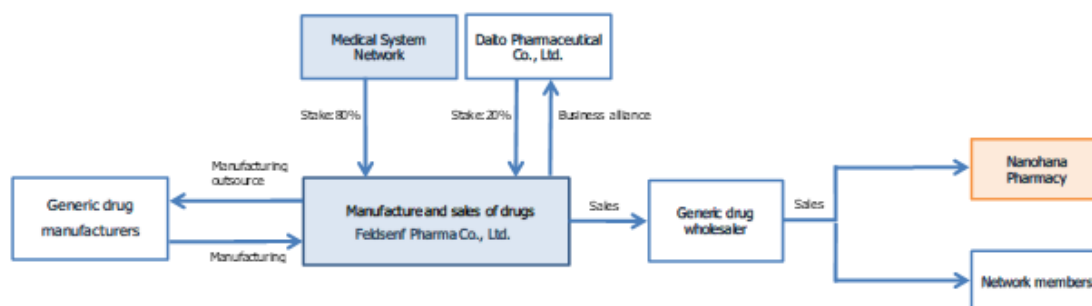
The core strategies of the fifth medium-term plan are as follows. The first four are in response to the NHI drug price and dispensing fee revisions implemented in April 2018. The third strategy is linked to the company's full-scale entry into the generic drug business (manufacture and sales), and the 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 directly operated pharmacies as medical institutions and raise their caliber; promote their family pharmacy functions, allowing them to take initiative in resolving issues surrounding community medical care.
- ▶ Assist government-driven efforts to increase generic drug utilization and help develop efficient drug distribution systems by expanding manufacture and sales of quality generic drugs.
- ▶ Strengthen collaboration among group businesses and take a unified approach in providing community care functions (medical care, long-term care, and disease prevention) that are considered essential to the community-based integrated care system.
- ▶ Improve cash flows, take further steps to achieve efficient management structure, and fortify financial base.

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

Medical System Network has not changed its basic policy outlined above, even after the change in business environment due to the spread of COVID-19 in FY03/20. It provides specific policies for each business in the core Community Pharmacy Network segment. In the Pharmaceuticals Network business, the company will continue to maintain and increase network members. In the Dispensing Pharmacy business, the company aims to strengthen the family pharmacy function of its directly operated Nanohana Pharmacies. In the manufacture and market pharmaceuticals business, the company seeks to increase the product lineup of generic drugs sold as well as the number of network members that sell its products. In May 2021, the company announced a change to its fifth medium-term plan final year (FY03/22) sales and profit forecasts to reflect the impact of the COVID-19 pandemic.

Feldsenf Pharma's generic drugs supply chain



Source: Shared Research based on company data

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

Numerical targets (as of when plan was announced)

The company outlined numerical targets for FY03/22 (the final year of the fifth medium-term plan) as follows: JPY120.0bn in sales, JPY5.0bn in operating profit (consolidated EBITDA of JPY7.5bn), equity ratio of over 30%, and 5,000 network members (when initially announced).

The number of pharmacies looking to become network members continues a steady increase. With more pharmacies having sought to become network members since the April 2018 NHI drug price revision, the company cleared the 5,000-member target in FY03/20, two years earlier than initially planned. In FY03/21, the number network members surpassed 6,000, exceeding a market share of 10% (number of pharmacies basis). In terms of earnings forecasts, the company revised its FY03/20 forecasts to reflect the impact of COVID-19 and associated significant change in the operating environment. The company initially issued its full-year FY03/21 forecast in a range form and revised the forecast on November 6, 2020. As for the numerical targets for FY03/22, the final year of its fifth medium-term plan, the basic policy is unchanged but announced when reporting FY03/21 results that the forecasts need to reflect the continuing impact of COVID-19 pandemic and NHI price revisions.

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

| (JPYmn) | FY03/17 Act. | FY03/18 Act. | FY03/19 Act. (JPYmn) | | FY03/20 Est. | FY03/22 Targets |
|---------------------------------|-----------------|-----------------|-------------------------|---------------------------------|-----------------|--------------------|
| Sales | 88,865 | 93,977 | 98,232 | Sales | 105,241 | 120,000 |
| Pharmaceuticals Network | 3,237 | 3,639 | 3,951 | Community Pharmacy 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 | 1,615 | 5,000 |
| Pharmaceuticals Network | 1,718 | 1,949 | 2,331 | Community Pharmacy 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 | 1,560 | - |
| Recurring profit margin | 2.4% | 3.5% | 1.5% | Recurring profit margin | 1.5% | - |
| Net income | 571 | 1,022 | 462 | Net income | -895 | - |
| Equity ratio | 20.1% | 16.9% | 15.6% | Equity ratio | - | 30% or higher |
| Pharmaceuticals Network members | 1,770 | 2,509 | 3,790 | Pharmaceuticals Network members | 5,000 | 5,000 |
| No. of regional pharmacies | 377 | 399 | 420 | No. of regional pharmacies | - | - |

Source: Shared Research based on company data

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

Note: Segment figures include internal transactions.

Business

Business model

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

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

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

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

Overview of business segments

Medical System Network comprised five business segments until FY03/19. The mainstay segments were Pharmaceuticals Network and Dispensing Pharmacy. These two segments were consolidated into the Community Pharmacy Network segment along with the manufacture and market pharmaceuticals business (previously included in the Other business and operated by Feldsenf Pharma). PharmaShift Co., Ltd, was established on October 1, 2020 to operate the Family Pharmacy Support Service. The new Community Pharmacy Network segment from FY03/21 comprises the Pharmaceuticals Network, Dispensing Pharmacy, manufacture and market pharmaceuticals, and digital shift businesses. The company does not disclose a sales and profit breakdown by business.

As peripheral business in healthcare and care-related businesses, the company maintains its three segments; Leasing and Facility-related, Food Service, and Other businesses. The main business in the Other business segment is home-visit nursing care. Each business segment continues to be operated by respective core subsidiaries.

Affiliated companies (as of May 31, 2021)

| Segment | Company | Location | Ratio of voting rights |
|------------------------------|----------------------------------------------------|-------------------|------------------------|
| Community Pharmacy Network | Hokkaido Institute for Pharmacy Benefit Co., Ltd. | Sapporo, Hokkaido | 100.0% |
| | Nanohana Hokkaido Co., Ltd. | Sapporo, Hokkaido | 100.0% |
| | Clinics Co., Ltd. | Sapporo, Hokkaido | 100.0% |
| | Nanohana Tohoku Co., Ltd. | Hachinohe, Aomori | 100.0% |
| | Nanohana East Japan Co., Ltd. | Minato-ku, Tokyo | 100.0% |
| | Metro Pharmacy 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% |
| Digital Shift | Feldsenf Pharma Co., Ltd. | Sapporo, Hokkaido | 80.0% |
| | PharmaShift Co., Ltd. | Minato-ku, Tokyo | 51.0% |
| Leasing and Facility-related | Paltecno Co., Ltd. | Sapporo, Hokkaido | 100.0% |
| Food Service | Sakura Foods Co., Ltd. | Kasuya, Fukuoka | 100.0% |
| Other | Agrimas Corp. * | Ota-ku, Tokyo | 77.7% |
| | Home-Visit Nursing Care Station Himawari Co., Ltd. | Nerima-ku, Tokyo | 100.0% |

Source: Shared Research based on data from the company website.

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.

*** Home-visit Nursing Care Station Himawari will be consolidated through absorption-type merger from July 1, 2021 (announced in May 2021)

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 new Family Pharmacy Support Service business was also added from FY03/21.

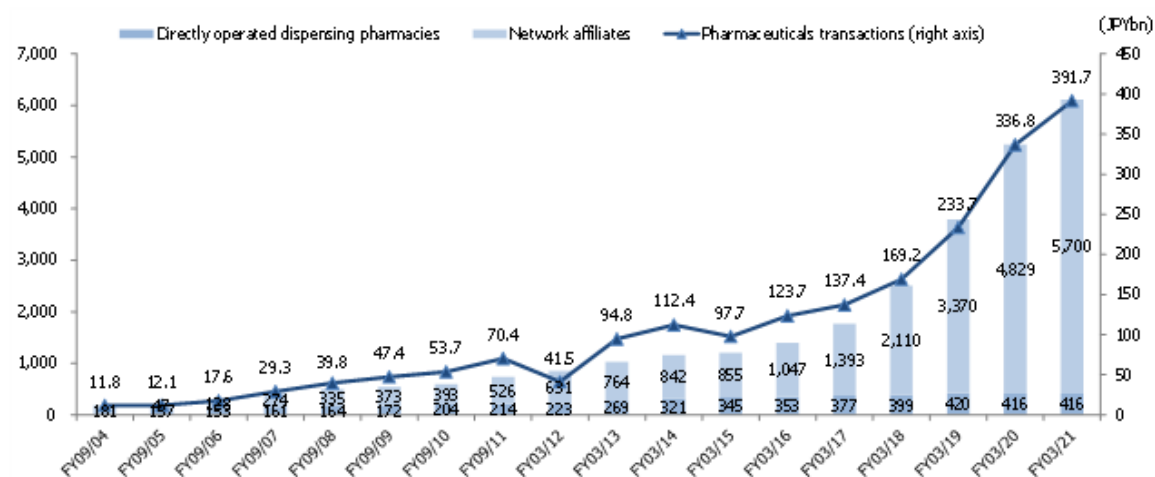
The company cited following two reasons for the reorganization:

- To accommodate expansion of the company's business scope to the entire supply chain accompanied by the rise in pharmaceuticals network members 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

Pharmaceuticals Network business (former Pharmaceuticals Network segment)

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

Network members and pharmaceuticals transactions



Note: Figures for FY09/04 are totals of directly operated dispensing pharmacies and affiliates only.

Source: Shared Research based on company data

Four functions

(1) Pharmaceuticals supply chain management

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

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

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

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

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

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

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

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

(3) Pharmacist training support

An attractive training system can improve staff loyalty and draw talented recruits to dispensing pharmacies. The company holds nationwide training courses for pharmacists including those working at network pharmacies in collaboration with training organization Iyaku Sogo Kenkyukai (ISK). These workshops are run by dispensing pharmacies and online courses are also available. The workshops cover topics such as simulated patient training, POS* training, case studies, and customer relations training. Certification by Japan Pharmacists Education Center (JPEC; a public interest incorporated foundation) requires attendance at, and gaining credits for workshops run by JPEC and registered organizations that provide group and practical training sessions such as Japan Society of Hospital Pharmacists (JSHP) and Japan Pharmaceutical Association (and their regional chapters).

ISK is one of the few private-sector organizations registered as a provider of various certification programs for pharmacists. Medical System Network and ISK help pharmacies run training sessions and apply for accreditation, which enables them to become members of the ISK organization and run JPEC accredited training courses. ISK issues attendance stickers to pharmacists who attend these courses. This is an incentive for network pharmacies, because it helps them recruit pharmacists.

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

(4) Financing support

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

Dispensing Pharmacy business (former Dispensing Pharmacy segment)

Scale

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

The Dispensing Pharmacy business operates the group's directly operated pharmacies. The company provides support services through its pharmaceuticals network to both its directly-operated pharmacies and non-directly operated 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 end-March 2021, the number of directly operated pharmacies and non-directly operated pharmacy members of the Pharmaceuticals Network (affiliates) stood at 6,116, exceeding 10% of the 60,171 pharmacies in Japan (MHLW survey) and ranking first in the domestic market. The total value of drug orders was JPY391.7bn (+16.3%), representing the largest scale in Japan.

Directly operated pharmacies

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

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

Market position of directly operated Nanohana Pharmacy

The number of Nanohana brand pharmacies totaled 416 at end-March 2021. 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 brand pharmacies rank 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 | 292,615 | 1,088 |
| 2 Qol | March | 161,832 | 811 |
| 3 Toho Holdings | March | 96,124 | 777 |
| 4 Sogo Medical Holdings | March | - | 748 |
| 5 Nihon Chouzai | March | 278,951 | 670 |
| 6 Suzuken | March | 96,439 | 592 |
| 7 Kraft | - | 193,700 | 580 |
| 8 Medical System Network | March | 90,706 | 416 |
| 9 Aisei Pharmacy | March | 64,185 | 396 |
| 10 Pharmanise Holdings | May | 40,417 | 312 |

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

Note: Sales figures are aggregate of dispensing pharmacy segment, Aisei Pharmacy Co., Ltd. and Kraft Inc. (Sakura Pharmacy) are unlisted, Sogo Medical Holdings was delisted in April 2020, and companies that are primarily drugstore chains were excluded.

Note: Based on earnings announcement data disclosed as of June 2021.

Initiatives in line with the distribution improvement guidelines

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

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

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

Efforts to streamline Nanohana Pharmacy operations

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

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

Manufacture and market pharmaceuticals business (formerly in the Other business)

Business overview

The manufacture and market pharmaceuticals business was transferred from the Other business to the Community Pharmaceutical Network business in FY03/20. It is operated by consolidated subsidiary Feldsenf Pharma Co., Ltd., which was established in September 2016 to manufacture and market ethical drugs. It does not have manufacturing capabilities or facilities but aims to develop an efficient pharmaceutical distribution system from manufacturing through the filling of prescriptions at the pharmacy by building a collaborative relationship with pharmaceutical manufacturers with capability to provide a stable supply of high-quality, lower-priced generic drugs. In 2018, it formed a business alliance with Daito Pharmaceutical Co., Ltd. (TSE1: 4577), which manufactures and supplies ethical drugs to Feldsenf Pharma.

Feldsenf Pharma started marketing generic drugs from 2018. It mainly supplies directly-operated pharmacies and network members, but eyes expanding its lineup of in-house brand generic drugs to become a supplier to dispensing pharmacies and

medical institutions nationwide.

Business scale, profit trends

In FY03/19, Feldsenf Pharma started out with 17 active pharmaceutical ingredients (API) across 34 items, and expanded to 34 API across 68 products at FY03/21. Management aims to further expand the product lineup of in-house drugs and sales tie-up products. In FY03/21, the company supplied its products to directly-operated pharmacies and to 1,116 network members. It reported sales exceeding JPY1bn and it was profitable at the operating level.

Digital shift business (established in FY03/21)

Family Pharmacy Support Service

The company established a Joint venture, PharmaShift Inc. in September 2020 with OPT, Inc. (unlisted; company name later changed to Re:teigi, Inc.), a core subsidiary of Digital Holdings (TSE1: 2389). Medical System Network holds a 51% equity stake while RePharmacy, Inc. (wholly-owned subsidiary of Re:teigi, Inc.) holds the remaining 49%.

PharmaShift's main business is Family Pharmacy Support Service. Medical System Network created the digital shift business as a new business with establishment of PharmaShift. In the joint venture, PharmaShift is mainly in charge of customer development while RePharmacy focuses on system development.

Family Pharmacy Support Service engages in and pursues the following three points:

- Facilitates smooth communication between patients and pharmacies by leveraging official LINE accounts and aggregating patients' medical information
- Contributes to strengthening functionality and enhancing efficiency of family pharmacies while also supporting non-dispensing businesses such as health and nutrition counseling
- Building an information infrastructure that can be linked with various other businesses such as physicians by aggregating information obtained from having strengthened functionality of family pharmacies

Utilization of official LINE accounts

The plan is to integrate various functions based on the LINE communication app to facilitate communication between patients and pharmacies using the official LINE account. Specifically, Medical System Network looks to incorporate functions such as prescription transmittal, electronic medication records, surveys of pharmacy visits, and follow-ups during medication. In collaboration with OPT, it aims to develop products using the LINE official account based on a common platform for dispensing pharmacies so that it can provide the products not only to directly-operated and network member pharmacies, but to all pharmacies nationwide.

In FY03/21, the Family Pharmacy Support Service utilizing the official LINE account launched from March 15, 2021 and the number of registered friends grew from 10,000 on April 2 to over 30,000 as of May 6. As of end-March 2021, 36 pharmacies had adopted the service, expanding to 168 pharmacies by end-April. According to the company, the number of prescriptions sent to pharmacies that have adopted the service more than double that of those that have not. Safe management of personal information is a high priority, so proactive measures being taken include no need to fill out personal information on the LINE Talk screen, making service available on external website apps, and utilizing highly secure domestic servers.

LINE is a messaging application developed and operated by LINE Inc (unlisted). The LINE messaging application has achieved substantial market penetration in Asian countries such as Japan, Thailand, and Taiwan.

Leasing and Facility-related

Planning and development of medical buildings and medical plazas

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

Leben, which was a subsidiary, but was absorbed in October 2017.

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

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

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

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

An example of a medical building developed by the company is the Leben Building in Sapporo, Hokkaido. Standing near a general hospital in Sapporo, in an area where multiple specialty clinics are also located, the building houses four clinics, including surgery and internal medicine, and a Nanohana Pharmacy. An example of a medical plaza is the Shizunai Aoyagi district, located in Hidaka, Hokkaido, with five clinics, including internal medicine and otolaryngology, and two Nanohana Pharmacies. The company notes the latter is a medical mall with roots in the local community, and has been attracting attention as a model case for supporting regional medical care in cities experiencing depopulation and aging.

Planning and development of long-term care facilities

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

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, especially for the Wisteria Senri-Chuo and Wisteria Minami Ichijo. The company plans to focus on building a community where medical care and long-term care are offered as one, with dispensing pharmacies, hospitals, and long-term care and childcare facilities surrounding the serviced elderly housing facilities.

Food Service

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

Other

The major business in this segment is home-visit nursing care carried out by subsidiary Home-Visit Nursing Station Himawari Co., Ltd., which is slated for an absorption-type merger from July 1, 2021. In addition, the manufacture and market pharmaceuticals business, conducted by subsidiary Feldsenf Pharma Co., Ltd., was consolidated into the newly established Community Pharmacy Network segment from FY03/20.

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

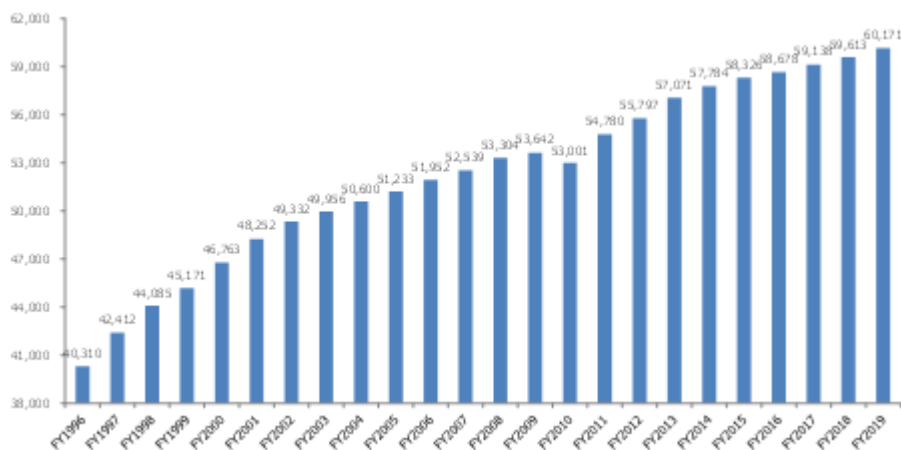
Market and value chain

Continued growth in the dispensing pharmacy market

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

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

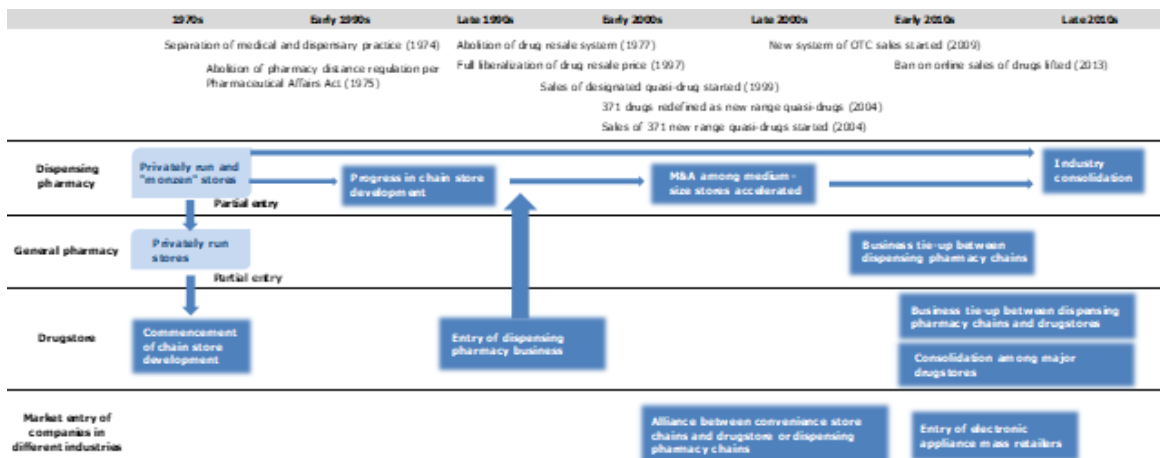
Number of dispensing pharmacies



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

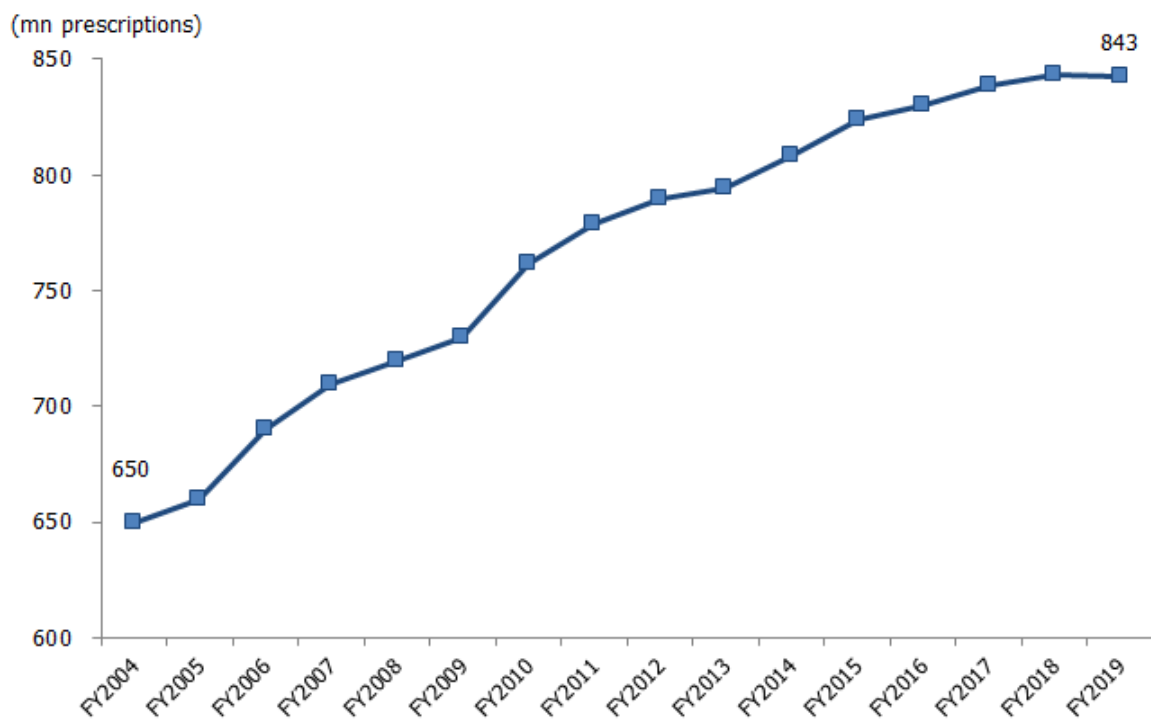
Note: 2010 does not include some of Miyagi or Fukushima Prefectures' data.

Developments surrounding dispensing pharmacies



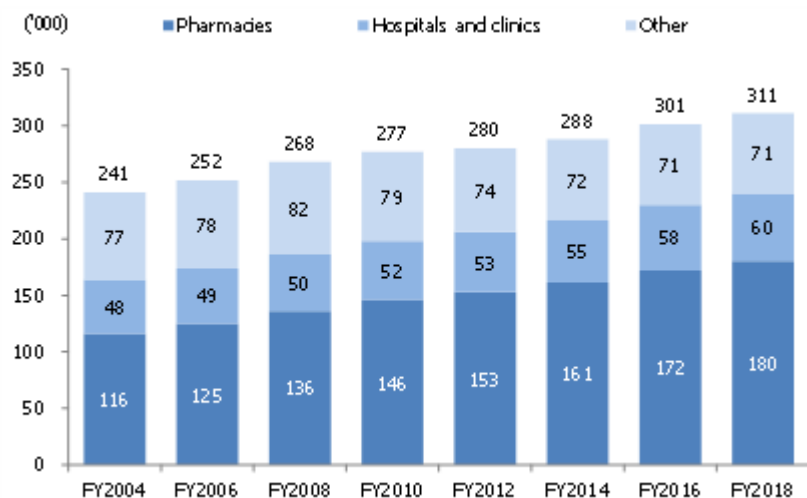
Source: Shared Research based on MHLW's Report on Public Health Administration and Services

Prescription volume



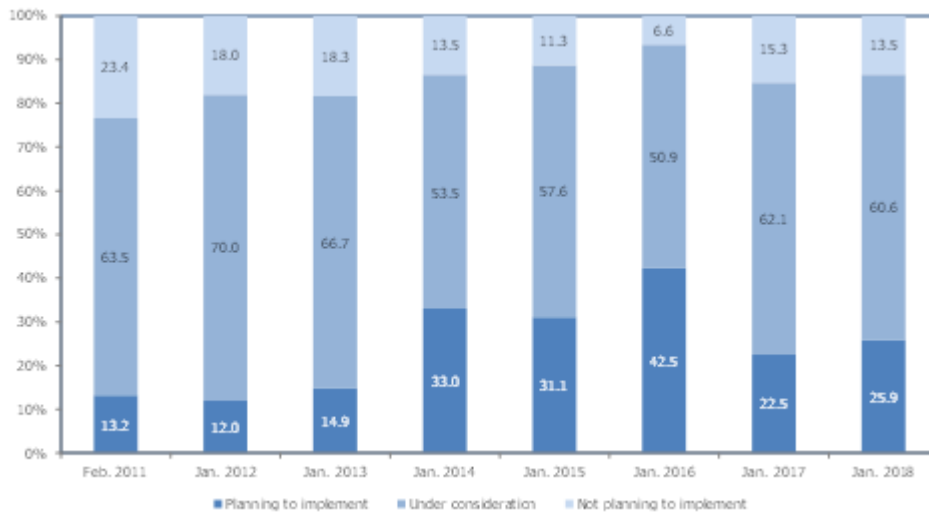
Relative to the increase in the elderly population, the number of dispensing pharmacists has not kept pace with the increase in pharmacies, and securing sufficient staffing is a pressing issue, particularly for small and mid-tier pharmacies.

Pharmacist numbers



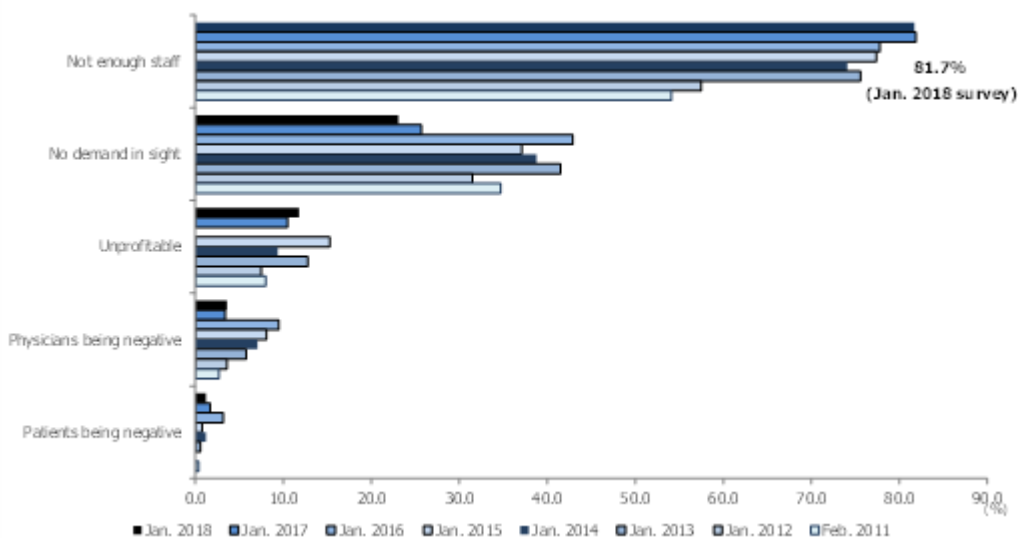
A 2018 Nippon Pharmacy Association (NPhA) survey of member pharmacies showed that the percentage of pharmacies planning to embark on home-based medication management and guidance services, one of the new roles being promoted by MHLW, is not expanding. Most respondents cited labor shortages as the main reason. MHLW is also advocating for 24-hour availability as a means to improve patient convenience, but this service will also likely increase labor costs for dispensing pharmacies.

Survey results on home-based medication management service



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

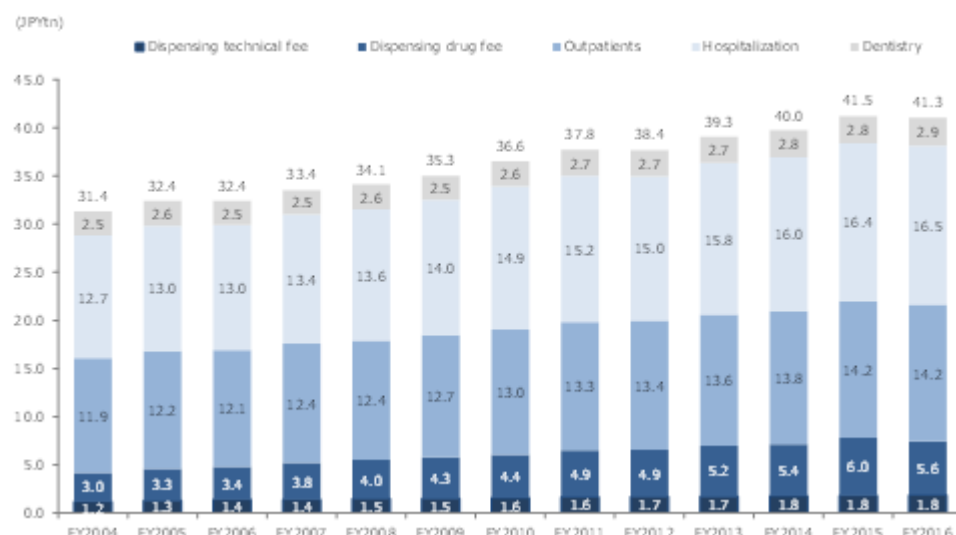
Reasons cited for not providing home-based medication management service



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

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

(Reference) Drug expenditures



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

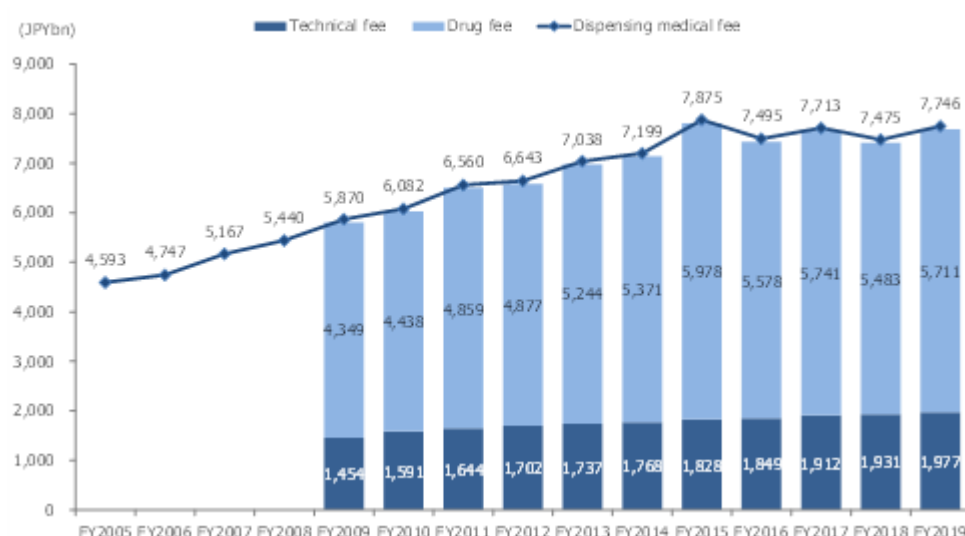
MHLW wants dispensing pharmacies to expand their role from just filling prescriptions to providing comprehensive care to patients as a family pharmacy. This push has made the shortage of pharmacists an even more pressing issue.

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

Environment facing smaller pharmacies: dispensing fee revisions

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

Dispensary charges



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

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

The “Guidelines for the Improvement of Commercial Transaction Practices of Ethical Drugs” (so-called distribution improvement guidelines) were adopted starting April 2018. Issued by MHLW, the guidelines targeting industry members reflect the ministry’s initiative to shift the role of spearheading improvement in prescription drug distribution from the distributors to the government. Items of note on the relationship between drug wholesalers and medical institutions/dispensing pharmacies include the avoidance of excessive discounts. According to these guidelines, offering prices involving excessive discounts that do not reflect the actual value of pharmaceuticals, such as using a benchmark without considering transaction terms, is incompatible with the current NHI drug price system (where individual drug price reflects the value). The guidelines urge wholesalers and medical institutions/dispensing pharmacies also to consider distribution costs and stable provision/sourcing of pharmaceuticals, and to take a comprehensive perspective on each price negotiation, seeing it as an extension of the price negotiations between drug manufacturers and wholesalers.

Key points from the “distribution improvement guidelines”

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

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

FY2020 medical fee revision

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

Net medical fee revision -0.46% = core medical fee +0.55% + drug reimbursement price -1.01%

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

Medical fee revision (%)

| Year of revision | 2002 | 2004 | 2006 | 2008 | 2010 | 2012 | 2014 | 2016 | 2018 | 2020 |
|----------------------------|-------|-------|-------|-------|-------|--------|-------|-------|-------|-------|
| Core medical fees (actual) | -1.30 | ±0.00 | -1.36 | +0.38 | +1.55 | +1.379 | +0.10 | +0.49 | +0.55 | +0.55 |
| Dispensing fee | -1.30 | +0.00 | -0.60 | +0.17 | +0.52 | +0.46 | +0.04 | +0.17 | +0.19 | +0.16 |
| Drug prices (actual) | -1.40 | -1.05 | -1.80 | -1.20 | -1.36 | -1.375 | -1.36 | -1.33 | -1.74 | -1.01 |
| NHI basis | -6.30 | -4.20 | -6.70 | -5.20 | -5.75 | -6.00 | -5.64 | -5.57 | -7.48 | -4.38 |
| Consumption tax addition | - | - | - | - | - | - | +1.36 | - | - | - |
| Total (nominal) | -2.70 | -1.05 | -3.16 | -0.82 | +0.19 | +0.004 | +0.10 | -0.84 | -1.19 | -0.46 |

Source: Shared Research based on company data

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

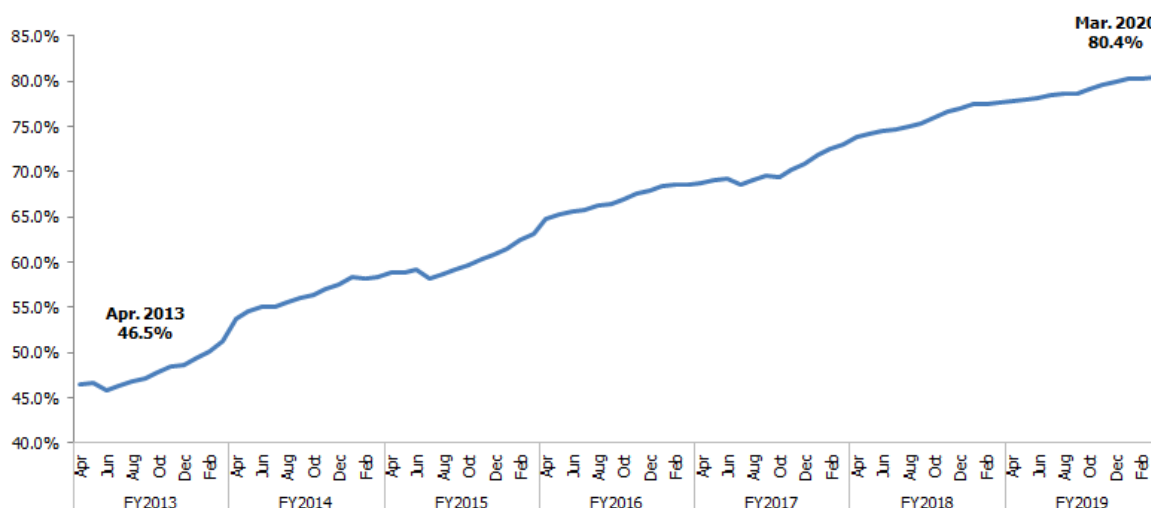
also encourages the proper assessment of large pharmacies operating near medical institutions. On generic drug utilization, MHLW is continuing efforts to improve utilization rates, and the FY2020 medical fee revision includes components that will further stimulate generic drug use.

Mid-year revision of NHI drug price

NHI drug price revisions, previously held once every other year, were shifted to an annual basis effective from 2021 with the first mid-year revision conducted in April 2021. The reasoning behind the shift was that the stance of the Japanese government and MHLW intending to reduce healthcare expenditures by reflecting the drop in market values more quickly onto the official reimbursement pricing.

As of May 2021, about 14,228 drugs were listed as ethical drugs used in healthcare services provided by health insurance for reimbursement under the NHI scheme and 12,180 of them were subject to this mid-year price revision. The first mid-year revision was applied to drugs for which the pricing differential between official reimbursement price and actual market price was 0.625x of the average 8.0% divergence (divergence of 5.0% or higher). A breakdown of the 12,180 drugs for which reimbursement prices were revised shows 1,350 were new drugs (59% of new drugs), 1,490 were long-listed drugs (88% of long-listed drugs), 8,200 were generic drugs (83% of generic drugs), and 1,140 were products in the other categories commercialized before 1967 (31% of other drugs). Most of generic and long-listed drugs were subject to this price revisions. Shared Research anticipates the impact of the NHI price revision will be far-reaching, not limited to generic and brand drug manufacturers but extended to pharmaceutical distribution-related companies and dispensing pharmacies.

Generic drug ratio



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

Industry peers (dispensing pharmacy chains)

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

Comparison of profit margins of industry peers' pharmacy operation segments

| Ticker | Company | FY end | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 |
|-----------------------------|---------|----------|--------|--------|--------|--------|--------|--------|
| 2796 Pharmarise Holdings | | May | 2.6% | 2.0% | 3.5% | 2.3% | 3.4% | - |
| 3034 Qol | | March | 5.8% | 5.1% | 6.4% | 4.7% | 4.7% | 4.4% |
| 3341 Nihon Chouzai | | March | 5.6% | 5.0% | 6.0% | 4.2% | 4.2% | 4.3% |
| 4350 Medical System Network | | March | 4.2% | 2.8% | 3.5% | 3.6% | 3.8% | 5.7% |
| - Sogo Medical Holdings | | March | 5.0% | 6.3% | 6.5% | 5.0% | - | - |
| 7649 Sugi Holdings | | February | 5.6% | 5.3% | 5.4% | 5.3% | 5.5% | 5.6% |
| 9627 Ain Holdings | | April | 9.1% | 8.6% | 9.5% | 7.5% | 7.9% | - |

Source: Shared Research based on each company's data and websites (as of end-May 2021)

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

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

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

Main industry peers

| Ticker | Company | Latest FY results | | | Business description (segment as % of total sales) |
|-----------------------------|---------|-------------------|--------------------------------|------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | Sales (JPYmn) | Operating profit margin (%) | ROE (%) | |
| 2796 Pharmarise Holdings | | 51,030 | 1.9% | 9.6% | 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. |
| 3034 Qol | | 161,832 | 4.6% | 8.2% | Major pharmacy chain. Started as monzen pharmacy. Opened stores with Lawson and Bic Camera. Also developing MR and pharmacist dispatch business. |
| 3341 Nihon Chouzai | | 278,951 | 2.9% | 7.3% | 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. |
| 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. |
| 7649 Sugi Holdings | | 602,510 | 5.6% | 11.0% | Developed drugstore/dispensing pharmacy, Sugi Pharmacy, in its stronghold Tokai area. The holding company also has discount stores. |
| - Sogo Medical Holdings | | - | - | - | Started with hospital room TV and equipment rental business. Entered dispensing pharmacy business, and expanded from local Kyushu to Kinki, Chubu, and East Japan areas. Also engages in medical practice support and hospital revitalization consulting business. |
| 9627 Ain Holdings | | 292,615 | 5.5% | 8.5% | 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. |

Source: Shared Research based on company data

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

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

Financials of industry peers

| (JPYmn) | Medical System Network (4350) | | | Pharmarise Holdings (2796) | | | Qol Holdings (3034) | | |
|-------------------------|-------------------------------|---------|---------|----------------------------|---------|---------|---------------------------|---------|---------|
| | FY03/19 | FY03/20 | FY03/21 | FY05/18 | FY05/19 | FY05/20 | FY03/19 | FY03/20 | FY03/21 |
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Sales | 98,232 | 105,241 | 104,257 | 54,562 | 51,728 | 51,030 | 144,783 | 165,411 | 161,832 |
| Gross profit | 37,271 | 40,214 | 42,412 | 7,950 | 7,342 | 7,391 | 17,863 | 21,094 | 21,102 |
| SG&A expenses | 35,842 | 38,599 | 38,982 | 6,771 | 6,702 | 6,403 | 10,812 | 13,361 | 13,737 |
| Operating profit | 1,428 | 1,615 | 3,429 | 1,179 | 640 | 987 | 7,050 | 7,733 | 7,364 |
| Recurring profit | 1,501 | 1,560 | 3,479 | 1,092 | 590 | 976 | 7,208 | 8,024 | 7,403 |
| Net income | 462 | -895 | 2,198 | -28 | 23 | 526 | 3,970 | 4,067 | 3,365 |
| ROE | 4.3% | -8.9% | 21.3% | -0.5% | 0.4% | 9.6% | 10.5% | 10.3% | 8.2% |
| ROA (RP-based) | 2.3% | 2.3% | 5.3% | 4.5% | 2.4% | 3.9% | 7.9% | 8.1% | 7.3% |
| Operating profit margin | 1.5% | 1.5% | 3.3% | 2.2% | 1.2% | 1.9% | 4.9% | 4.7% | 4.6% |
| Total assets | 68,935 | 66,464 | 64,448 | 24,265 | 24,217 | 25,228 | 94,236 | 102,872 | 100,571 |
| Net assets | 10,761 | 9,418 | 11,187 | 5,624 | 5,619 | 5,895 | 39,017 | 41,001 | 41,834 |
| Equity ratio | 100.0% | 100.0% | 100.0% | 21.8% | 21.9% | 22.4% | 41.1% | 39.4% | 40.9% |
| Operating CF | 2,840 | 4,232 | 5,205 | 1,330 | 895 | 1,572 | 5,773 | 4,468 | 12,912 |
| Investing CF | -5,921 | -2,383 | -1,485 | -527 | -501 | -734 | -8,287 | -8,670 | -3,065 |
| Financing CF | 4,338 | -1,687 | -5,312 | -894 | 354 | -766 | 2,906 | -225 | -6,114 |
| Cash and deposits | 11,520 | 11,722 | 10,118 | 3,643 | 4,393 | 4,464 | 193 | 15,766 | 19,498 |
| Interest-bearing debt | 38,897 | 37,558 | 32,558 | 10,550 | 11,138 | 10,375 | 28,873 | 32,650 | 29,721 |
| Net debt | 27,377 | 25,836 | 22,440 | 6,907 | 6,745 | 5,911 | 28,680 | 16,884 | 10,223 |
| | Nihon Chouzai (3341) | | | Sugi Holdings (7649) | | | Sogo Medical Holdings (-) | | |
| | FY03/19 | FY03/20 | FY03/21 | FY02/19 | FY02/20 | FY02/21 | FY03/19 | FY03/20 | FY03/21 |
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Sales | 245,687 | 222,147 | 278,951 | 488,464 | 541,964 | 602,510 | 144,630 | - | - |
| Gross profit | 41,975 | 46,372 | 49,374 | 142,300 | 162,182 | 181,291 | 22,715 | - | - |
| SG&A expenses | 35,242 | 38,779 | 41,267 | 116,483 | 132,420 | 147,590 | 17,303 | - | - |
| Operating profit | 6,733 | 7,593 | 8,106 | 25,817 | 29,762 | 33,701 | 5,411 | - | - |
| Recurring profit | 6,077 | 7,405 | 8,409 | 27,237 | 31,473 | 35,333 | 5,607 | - | - |
| Net income | 3,792 | 6,697 | 3,538 | 17,940 | 20,782 | 21,120 | 3,246 | - | - |
| ROE | 9.2% | 15.2% | 7.3% | 10.9% | 11.9% | 11.0% | 8.7% | - | - |
| ROA (RP-based) | 3.3% | 4.1% | 4.5% | 10.5% | 10.9% | 10.7% | 6.1% | - | - |
| Operating profit margin | 2.7% | 2.8% | 2.9% | 5.3% | 5.5% | 5.6% | 3.7% | - | - |
| Total assets | 178,677 | 185,551 | 186,262 | 265,481 | 313,757 | 345,933 | 93,560 | - | - |
| Net assets | 41,073 | 47,072 | 49,868 | 166,563 | 182,750 | 200,629 | 38,669 | - | - |
| Equity ratio | 23.0% | 25.4% | 26.8% | 62.7% | 58.2% | 58.0% | 41.0% | - | - |
| Operating CF | 13,572 | 13,192 | 11,213 | 22,894 | 45,353 | 34,027 | 3,852 | - | - |

Medical System Network/ 4350

| | | | | | | | | |
|----------------------------|----------------|----------------|----------------|---------|---------|---------|--------|---|
| Investing CF | -1,770 | -2,731 | -7,767 | -22,362 | -18,422 | -29,254 | -6,624 | - |
| Financing CF | -10,516 | -7,955 | -2,806 | -13,897 | -4,895 | -5,274 | -945 | - |
| Cash and deposits | 29,749 | 32,254 | 32,893 | 34,311 | 56,347 | 55,845 | 10,733 | - |
| Interest-bearing debt | 82,391 | 63,624 | 44,365 | 0 | 0 | 0 | 22,373 | - |
| Net debt | 52,642 | 31,370 | 11,472 | -34,311 | -56,347 | -55,845 | 11,640 | - |
| Ain Holdings (9627) | | | | | | | | |
| | FY04/18 | FY04/19 | FY04/20 | | | | | |
| | Cons. | Cons. | Cons. | | | | | |
| Sales | 268,386 | 275,596 | 292,615 | | | | | |
| Gross profit | 47,993 | 45,363 | 46,861 | | | | | |
| SG&A expenses | 28,371 | 29,295 | 30,793 | | | | | |
| Operating profit | 19,623 | 16,067 | 16,068 | | | | | |
| Recurring profit | 20,130 | 16,637 | 16,822 | | | | | |
| Net income | 10,567 | 9,029 | 9,179 | | | | | |
| ROE | 13.5% | 9.0% | 8.5% | | | | | |
| ROA (RP-based) | 11.8% | 8.9% | 8.8% | | | | | |
| Operating profit margin | 7.3% | 5.8% | 5.5% | | | | | |
| Total assets | 183,435 | 189,021 | 193,451 | | | | | |
| Net assets | 96,733 | 103,922 | 111,003 | | | | | |
| Equity ratio | 52.7% | 54.9% | 57.3% | | | | | |
| Operating CF | 21,657 | 14,788 | 17,747 | | | | | |
| Investing CF | -5,282 | -19,985 | -11,474 | | | | | |
| Financing CF | 17,623 | -10,681 | -7,837 | | | | | |
| Cash and deposits | 63,233 | 47,495 | 45,931 | | | | | |
| Interest-bearing debt | 18,861 | 11,957 | 6,074 | | | | | |
| Net debt | -44,372 | -35,538 | -39,857 | | | | | |

Source: Shared Research based on each company's data

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

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-directly operated pharmacies (i.e., affiliates) access to the company's proprietary system, thus allowing them to maintain management independence, but this has the potential negative effect of impeding growth of the Dispensing Pharmacy business. While the company's peers are expanding through acquisition of smaller pharmacies, the availability of membership to the Pharmaceuticals Network system is a possible lifeline to smaller pharmacies that could encourage them to delay M&A action.

- ▶ Low profit margins for dispensing pharmacies without drugstore function:

The Dispensing Pharmacy business OPM of about 3.0% (based on disclosed data through FY03/19) is 2–5pp below that of other major chains. This is mainly because most of the company's dispensing operations are limited to prescription drugs and are not accompanied by drugstore functions handling items such as OTC drugs, long-term care products, and toiletries. Many of the other major chains have adopted the strategy to boost pharmacy profit margins by integrating drugstore operations with added floor space for food products and cosmetics. The company is looking to expand its product offerings to include various long-term care products like adult diapers as part of a family pharmacy service, but it will take time to transition to this business format.

- ▶ Relatively small assets a disadvantage in acquisitions:

The company is at a disadvantage versus the major players in terms of asset scale when it comes to acquisitions targeting pharmacy chain expansion. Looking at the M&A-based increases in outlet numbers over the past three years, industry leader Ain Holdings acquired more than 100 pharmacies while Medical System Network was flat YoY in FY03/21. 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 JPY64.0bn. 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 (JPYmn) | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 | FY03/18 | FY03/19 | FY03/20 | FY03/21 |
|------------------------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|----------|---------|
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Sales | 25,411 | 54,827 | 66,182 | 75,548 | 87,715 | 88,865 | 93,977 | 98,232 | 105,241 | 104,257 |
| YoY | - | - | 20.7% | 14.2% | 16.1% | 1.3% | 5.8% | 4.5% | 7.1% | -0.9% |
| Cost of sales | 16,451 | 35,415 | 43,445 | 47,072 | 54,913 | 54,700 | 57,369 | 60,961 | 65,027 | 61,845 |
| Gross profit | 8,960 | 19,412 | 22,737 | 28,476 | 32,801 | 34,164 | 36,607 | 37,271 | 40,214 | 42,412 |
| YoY | - | - | 17.1% | 25.2% | 15.2% | 4.2% | 7.2% | 1.8% | 7.9% | 5.5% |
| Gross profit margin | 35.3% | 35.4% | 34.4% | 37.7% | 37.4% | 38.4% | 39.0% | 37.9% | 38.2% | 40.7% |
| SG&A expenses | 7,603 | 17,365 | 20,646 | 25,835 | 29,018 | 32,050 | 33,444 | 35,842 | 38,599 | 38,982 |
| SG&A ratio | 29.9% | 31.7% | 31.2% | 34.2% | 33.1% | 36.1% | 35.6% | 36.5% | 36.7% | 37.4% |
| Operating profit | 1,357 | 2,047 | 2,091 | 2,641 | 3,783 | 2,113 | 3,163 | 1,428 | 1,615 | 3,429 |
| YoY | - | - | 2.2% | 26.3% | 43.2% | -44.1% | 49.7% | -54.9% | 13.1% | 112.3% |
| Operating profit margin | 5.3% | 3.7% | 3.2% | 3.5% | 4.3% | 2.4% | 3.4% | 1.5% | 1.5% | 3.3% |
| Non-operating income | 81 | 150 | 250 | | 457 | 275 | 378 | 405 | 288 | 361 |
| Non-operating expenses | 124 | 284 | 321 | 349 | 380 | 279 | 291 | 333 | 343 | 312 |
| Recurring profit | 1,315 | 1,912 | 2,020 | 2,540 | 3,860 | 2,109 | 3,250 | 1,501 | 1,560 | 3,479 |
| YoY | - | - | 5.6% | 25.8% | 52.0% | -45.4% | 54.1% | -53.8% | 3.9% | 123.0% |
| Recurring profit margin | 5.2% | 3.5% | 3.1% | 3.4% | 4.4% | 2.4% | 3.5% | 1.5% | 1.5% | 3.3% |
| Extraordinary gains | 25 | 59 | 155 | 169 | 88 | 57 | 19 | 49 | 48 | 914 |
| Extraordinary losses | 41 | 65 | 404 | 415 | 470 | 260 | 976 | 128 | 1,586 | 426 |
| Income taxes | 702 | 1,018 | 1,073 | 1,315 | 1,599 | 1,262 | 1,271 | 962 | 918 | 1,769 |
| Implied tax rate | 54.1% | 53.4% | 60.6% | 57.3% | 46.0% | 66.2% | 55.4% | 67.7% | 4,172.7% | 44.6% |
| Net income attributable to non-controlling interests | 78 | 133 | 29 | 92 | 158 | 72 | 0 | -2 | 0 | 0 |
| Net income | 518 | 756 | 668 | 885 | 1,720 | 571 | 1,022 | 462 | -895 | 2,198 |
| YoY | - | - | -11.6% | 32.4% | 94.4% | -66.8% | 79.0% | -54.8% | -293.7% | -345.6% |
| Net margin | 2.0% | 1.4% | 1.0% | 1.2% | 2.0% | 0.6% | 1.1% | 0.5% | -0.9% | 2.1% |

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 fifth medium-term plan from FY03/19

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

The third medium-term plan (FY03/13–FY03/15) began the following year. We believe the company has also applied plan targets to its business strategy from FY03/16 and beyond (the fourth medium-term plan), i.e., to increase the number of network member pharmacies and grow its own dispensing pharmacies. The five key initiatives of the fifth medium-term plan, which started in FY03/19, are as follows. We note that OPM has remained in the 1% range in FY03/19 and FY03/20 amid a severe business environment such as NHI medical fee revisions and price negotiations with wholesalers but recovered to the 3% level in FY03/21 owing to growth of the Pharmaceuticals Network business and improved profitability of the Dispensing Pharmacy business.

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

SG&A expenses

| SG&A expenses (JPYmn) | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 | FY03/18 | FY03/19 | FY03/20 |
|-----------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Salaries and allowances | 2,806 | 6,364 | 7,489 | 9,266 | 10,406 | 12,088 | 12,481 | 13,467 | 14,195 |
| Provision for employee bonuses | 582 | 685 | 724 | 939 | 1,062 | 1,133 | 1,418 | 1,333 | 1,393 |
| Retirement benefit expenses | 88 | 172 | 195 | 264 | 329 | 361 | 466 | 457 | 596 |
| Provision for directors' bonuses | 32 | 64 | 68 | 76 | 55 | 47 | 35 | 33 | 41 |
| Provision for directors' stock benefits | | | | | 33 | 52 | 38 | 33 | 35 |
| Taxes and dues | 853 | 1,913 | 2,350 | 3,870 | 4,479 | 4,374 | 4,420 | 4,692 | 5,691 |
| Depreciation | 270 | 658 | 802 | 945 | 1,029 | 1,052 | 1,491 | 1,624 | 1,811 |
| Amortization of goodwill | 177 | 487 | 669 | 849 | 917 | 1,009 | 1,056 | 1,147 | 1,217 |
| Other | 2,142 | 5,509 | 6,612 | 7,537 | 8,486 | 9,630 | 9,559 | 15,827 | 16,648 |
| Total | 7,603 | 17,365 | 20,646 | 25,835 | 29,018 | 32,050 | 33,444 | 35,842 | 38,599 |

Source: Shared Research based on company data

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

Balance sheet

| Balance sheet (JPYmn) | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 | FY03/18 | FY03/19 | FY03/20 | FY03/21 |
|------------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Assets | | | | | | | | | | |
| Cash and deposits | 2,072 | 2,092 | 3,106 | 2,499 | 2,081 | 2,252 | 10,201 | 11,703 | 11,722 | 10,118 |
| Notes and accounts receivable | 2,597 | 1,514 | 2,802 | 2,484 | 2,614 | 2,223 | 2,332 | 2,420 | 2,313 | 2,646 |
| Inventories | 1,796 | 2,219 | 2,732 | 3,846 | 3,431 | 4,053 | 3,520 | 4,297 | 4,452 | 4,408 |
| Other | 629 | 614 | 664 | 709 | 927 | 958 | 868 | 1,528 | 940 | 994 |
| Allowance for doubtful accounts | -3 | -6 | -6 | -7 | -7 | -10 | -11 | -12 | -12 | -12 |
| Total current assets | 8,902 | 8,271 | 10,941 | 11,023 | 10,783 | 11,098 | 18,736 | 21,055 | 20,578 | 19,313 |
| Total tangible fixed assets | 9,976 | 11,472 | 15,976 | 17,249 | 20,253 | 21,246 | 24,129 | 25,721 | 25,126 | 24,634 |
| Total intangible assets | 5,040 | 8,263 | 12,399 | 13,554 | 13,481 | 13,833 | 15,045 | 16,235 | 14,615 | 13,572 |
| Investment securities | | 54 | 179 | 157 | 524 | 583 | 812 | 726 | 483 | 397 |
| Long-term loans | | | | | | | | | | |
| Other | 2,728 | 2,771 | 3,645 | 3,631 | 3,838 | 4,008 | 4,066 | 5,217 | 5,686 | 6,549 |
| Allowance for doubtful accounts | -43 | -42 | -26 | -29 | -33 | -32 | -31 | -21 | -26 | -20 |
| Investment and other assets | 2,685 | 2,783 | 3,798 | 3,759 | 4,329 | 4,559 | 4,847 | 5,922 | 6,143 | 6,926 |
| Total fixed assets | 17,701 | 22,518 | 32,173 | 34,564 | 38,063 | 39,639 | 44,023 | 47,879 | 45,885 | 45,134 |
| Total assets | 26,603 | 30,789 | 43,114 | 45,587 | 48,847 | 50,737 | 62,759 | 68,935 | 66,464 | 64,448 |
| Liabilities | | | | | | | | | | |
| Notes and accounts payable | 5,158 | 5,616 | 7,798 | 8,598 | 9,525 | 9,144 | 9,416 | 10,198 | 10,021 | 9,258 |
| Short-term debt | 3,856 | 5,119 | 12,922 | 9,214 | 6,910 | 3,863 | 7,463 | 9,158 | 8,905 | 10,210 |
| Income taxes payable | 582 | 459 | 578 | 599 | 1,065 | 413 | 1,135 | 695 | 454 | 1,556 |
| Other | 3,097 | 3,181 | 3,582 | 3,215 | 3,561 | 3,500 | 3,755 | 3,793 | 3,916 | 4,394 |
| Total current liabilities | 12,693 | 14,375 | 24,880 | 21,626 | 21,061 | 16,920 | 21,769 | 23,844 | 23,296 | 25,418 |
| Long-term debt | 7,029 | 8,758 | 10,948 | 15,391 | 14,859 | 20,186 | 26,329 | 29,739 | 28,653 | 22,348 |
| Deferred tax assets | 1 | 1 | 1 | 1 | 1 | 1 | | | | |
| Other | 1,200 | 1,419 | 1,933 | 2,434 | 2,660 | 2,985 | 4,075 | 4,590 | 5,096 | 5,493 |
| Total fixed liabilities | 8,230 | 10,178 | 12,882 | 17,826 | 17,520 | 23,172 | 30,404 | 34,329 | 33,749 | 27,841 |
| Total liabilities | 20,923 | 24,553 | 37,762 | 39,452 | 38,581 | 40,092 | 52,174 | 58,173 | 57,045 | 53,260 |
| Net assets | | | | | | | | | | |
| Capital stock | 1,091 | 1,091 | 1,091 | 1,091 | 1,932 | 1,932 | 2,097 | 2,128 | 2,128 | 2,128 |
| Capital surplus | 924 | 901 | 901 | 901 | 1,742 | 1,742 | 1,160 | 1,185 | 1,183 | 1,182 |
| Retained earnings | 3,281 | 3,836 | 4,300 | 4,980 | 6,467 | 6,735 | 7,459 | 7,616 | 6,414 | 8,305 |
| Treasury stock | 0 | -45 | -1,181 | -1,147 | -328 | -302 | -275 | -233 | -206 | -344 |
| Valuation differences on securities | -5 | 3 | 2 | 11 | 15 | 49 | 143 | 83 | -37 | -24 |
| Foreign currency translation adjustments | | | | | | | | | | |
| Other | -52 | -40 | -31 | -28 | -17 | 23 | 52,316 | 58,239 | 56,945 | 53,154 |
| Non-controlling interests | 436 | 493 | 273 | 338 | 469 | 514 | 2 | 0 | 0 | 23 |
| Total net assets | 5,680 | 6,236 | 5,352 | 6,136 | 10,265 | 10,644 | 10,584 | 10,761 | 9,418 | 11,187 |
| Total liabilities and net assets | 26,603 | 30,789 | 43,114 | 45,588 | 48,846 | 50,736 | 62,759 | 68,935 | 66,464 | 64,448 |
| Working capital | -765 | -1,883 | -2,265 | -2,268 | -3,480 | -2,868 | -3,564 | -3,481 | -3,256 | -2,204 |
| Total interest-bearing debt | 10,885 | 13,877 | 23,870 | 24,605 | 21,769 | 24,049 | 33,792 | 38,897 | 37,558 | 32,558 |
| Net debt | 8,813 | 11,785 | 20,763 | 22,120 | 19,708 | 21,814 | 23,591 | 27,194 | 25,836 | 22,440 |

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. (later became a subsidiary of Hanshin Dispensing Holding Co., Ltd. [merged into I&H Co., Ltd. in November 2019]). In July 2013, the two companies established a joint venture, H&M Co., Ltd. The main purpose of the joint venture was joint sourcing and distribution of pharmaceuticals, purchase of medical devices, and clearance of dead stock. H&M's chief goal is not to win pricing concessions from drug

wholesalers as a result of buying power due to large-volume procurement, but to collaborate with drug wholesalers to set economically rational prices. This is the core objective of the company's Pharmaceuticals Network business.

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

Liabilities: External financing

Liabilities rose during this period as the number of directly operated pharmacies increased in line with a rising network member count. The increase in current assets, which is working capital, was especially pronounced in FY03/14, when in addition to the increase in current assets, tangible fixed assets increased JPY4.5bn (+JPY2.5bn for buildings, +JPY1.9bn for land) and intangible fixed assets increased JPY4.1bn (JPY4.1bn increase in goodwill). Assets also increased in FY03/15 (buildings and structures +JPY237mn, land +JPY640mn, goodwill +JPY961mn). Growing demand for funds was met primarily through external financing. Short-term borrowings increased by about JPY7.0bn to JPY102.7bn in FY03/14, while long-term borrowings increased by about JPY4.5bn to JPY14.2bn in FY03/15 and has continued to gradually rise. Short- and long-term borrowings have been over JPY30.0bn since FY03/18. Profits increased in FY03/21 while interest-bearing debt declined YoY.

Net assets: Capital stock increase in FY03/16

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

Cash flow statement

| Cash flow statement (JPYmn) | FY03/12 | FY03/13 | FY03/14 | FY03/15 | FY03/16 | FY03/17 | FY03/18 | FY03/19 | FY03/20 | FY03/21 |
|---------------------------------------------------------|------------|---------------|---------------|-------------|--------------|-------------|-------------|---------------|--------------|--------------|
| | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. | Cons. |
| Cash flows from operating activities (1) | 1,566 | 3,790 | 3,706 | 3,838 | 6,409 | 3,084 | 6,699 | 2,840 | 4,232 | 5,205 |
| Pre-tax profit | 1,298 | 1,907 | 1,770 | 2,294 | 3,479 | 1,906 | 2,293 | 1,422 | 22 | 3,967 |
| Depreciation | 354 | 841 | 1,077 | 1,209 | 1,362 | 1,594 | 1,491 | 1,624 | 1,811 | 1,859 |
| Amortization of goodwill | 177 | 487 | 669 | 849 | 917 | 1,009 | 1,056 | 1,147 | 1,217 | 1,136 |
| Change in accounts receivable | -325 | 1,739 | 382 | 935 | 191 | 812 | 496 | 500 | 285 | -239 |
| Change in inventories | 8 | -74 | -173 | -689 | 455 | -472 | 759 | -620 | -140 | 72 |
| Change in accounts payable | 102 | -558 | 365 | -295 | 683 | -765 | -569 | 69 | -328 | -864 |
| Cash flows from investing activities (2) | -1,248 | -5,425 | -7,559 | -3,958 | -5,040 | -3,909 | -6,848 | -5,921 | -2,383 | -1,485 |
| Purchase of tangible fixed assets | -805 | -1,625 | -4,180 | -2,360 | -3,674 | -2,170 | -4,050 | -3,094 | -1,351 | -1,375 |
| Purchase of intangible assets | -1 | -13 | -44 | -93 | -273 | -192 | -190 | -82 | -107 | -154 |
| Purchase, sale, and redemption of investment securities | 2 | 1 | 129 | | -267 | -19 | -39 | -16 | 102 | 18 |
| Change in loans (short- and long-term; net) | 18 | -245 | -56 | -106 | -106 | -38 | -95 | -3 | -102 | -233 |
| Free cash flow (1+2) | 318 | -1,635 | -3,853 | -120 | 1,369 | -825 | -149 | -3,081 | 1,849 | 3,720 |
| Cash flows from financing activities | 425 | 1,654 | 4,864 | -483 | -1,792 | 998 | 8,050 | 4,338 | -1,687 | -5,312 |
| Change in short-term borrowings | 1,293 | 685 | 7,255 | -4,334 | -2,314 | -3,241 | 2,598 | 1,471 | -505 | 0 |
| Change in long-term borrowings | -489 | 1,846 | -250 | 4,816 | -896 | 5,292 | 7,292 | 3,701 | -376 | -4,634 |
| Acquisition of treasury stock | 0 | -129 | -1,155 | | 1,005 | 0 | | | | |
| Dividends paid | -162 | -276 | -221 | -190 | -229 | -297 | -297 | -304 | -305 | 0 |

Source: Shared Research based on company data

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

Cash flows from operating activities

Cash flow from operating activities since FY03/12, when the accounting period was changed, has trended around JPY3.7bn–3.8bn, approximately half of which is derived from pre-tax profit, except for FY03/16–FY03/17 when profits fluctuated sharply. FY03/16–FY03/17 earnings were impacted by a number of temporary factors and a changing business environment owing to NHI drug price and dispensing fee revisions. The company notes temporary factors that boosted FY03/16 profits such as JPY242mn in gains from the sale of real estate, JPY100mn in subsidies for opening a serviced elderly housing facility, and a JPY90mn tax benefit from acquisition of subsidiary shares. The decline in FY03/17 profits was exacerbated by factors such as drug price and dispensing fee revisions, a winding down of major hepatitis C drug sales, and the absence of temporary factors that boosted FY03/16 profits. Operating cash flow in FY03/19 declined by half YoY owing to the April 2018 NHI price revision, but turned positive again in FY03/20 and FY03/21 as earnings recovered.

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

Cash flows from investing activities

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

The company aims to make its network system an industry standard by expanding the number of affiliates and to improve the profitability of the Dispensing Pharmacy business, and these remain objectives of the fourth medium-term plan and fifth medium-term plan starting in FY03/19, which targets expansion of its network and improving profitability of the Dispensing Pharmacy business. As the company continues to invest in business expansions, free cash flow has been negative since the start of the third medium-term plan, with the exception of FY03/16 when free cash flow turned positive due to temporary factors that sharply lifted profits, and FY03/20 and FY03/21, when there were few M&A deals.

Cash flows from financing activities

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

In FY03/14, there was a JPY1.2bn cash flow deficit due to a share buyback accompanying the restructuring of an affiliated company. In FY03/16, cash flow saw a JPY2.8bn surplus as the company increased capital and sold treasury shares to improve its financial standing. Total borrowing also increased JPY5.2bn in FY03/19, but JPY3.9bn was invested in M&A, including the acquisition of Nagatomi Pharmacy. There were few M&A deals in FY03/20 and FY03/21 because the company prioritized improving profitability of existing stores.

Historical performance

1H FY03/22 earnings results (out November 5, 2021)

Overview

1H FY03/22 (April–September 2021) earnings results

- Sales: JPY52.2bn (+2.2% YoY)
- Operating profit: JPY1.9bn (+37.4% YoY)
- Recurring profit: JPY2.2bn (+60.0% YoY)
- Net income attributable to owners of the parent: JPY1.4bn (+147.6% YoY)

Company response and business conditions

Sales were up 2.2% YoY, driven by a 2.3% sales increase in the mainstay Community Pharmacy Network segment. Of the four businesses that make up the Community Pharmacy Network segment, Pharmaceuticals Network and Dispensing Pharmacy businesses contributed to segment sales and profit growth. Sales were up both in the Pharmaceuticals Network

and Dispensing Pharmacy businesses, owed to steady growth in new network members in the former, and to a certain degree of recovery in the number of prescriptions filled in the latter. Operating profit rose 37.4% YoY, also driven by growth in the Pharmaceuticals Network and Dispensing Pharmacy businesses. Net income attributable to owners of the parent increased 147.2% as a result of profit from the sale of investment securities and tax effect of the absorption-type merger with Home-Visit Nursing Care Station Himawari Co., Ltd.

Breakdown of 1H FY03/22 (April–September 2021) results by segment

Community Pharmacy Network

- Segment sales: JPY49.7bn (+2.3% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY2.9bn (+21.8% YoY)
- 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. A digital shift business that provides services utilizing the company subsidiary's (PharmaShift) official LINE (instant messaging app) account was added to the segment from FY03/21.

Pharmaceuticals Network

In 1H FY03/22, of the JPY1.1bn YoY increase in overall sales, growth in the Pharmaceuticals Network business accounted for JPY156mn. In Japan, dispensing pharmacies sought to improve operating stability amid harsh business environments in the industry, including the start of annual NHI drug price revisions in April 2021. As a result, there was increased demand among pharmacy operators to join the company's pharmaceuticals network in the hopes of streamlining operations involved in negotiations with wholesalers and ordering. The number of new network members continued to increase steadily, with network members totaling 6,700 (+584 versus end-FY03/21) at end-September 2021, consisting of 419 directly operated pharmacies and 6,281 affiliates. On the profit front, of the JPY507mn increase in company-wide operating profit in 1H, JPY156mn was from the Pharmaceuticals Network business.

Dispensing Pharmacy

In 1H, of the JPY1,124mn increase in overall company sales, growth in the Dispensing Pharmacy business contributed JPY1,059mn. Price per prescription dropped due in part to the NHI drug price revisions, but the number of prescriptions filled recovered to some extent. As a result, in Q2 FY03/22 all-store dispensing fees for the directly managed Nanohana Pharmacy chain grew 3.7% YoY. As of end-September 2021, the group had 419 dispensing pharmacies (up three versus end-FY03/21), one care plan center, and eight cosmetics/drug stores. On the profit front, the Dispensing Pharmacy business contributed JPY331mn to company-wide operating profit growth of JPY507mn.

Manufacture and market pharmaceuticals

This business aims to provide a stable supply of good-quality, low-priced generic drugs. As of end-September 2021, the company was selling 39 different ingredients and 77 products. The company said Feldsenf Pharma, the main subsidiary operating the business, has continued operating in the black.

Digital shift

Subsidiary PharmaShift Co., Ltd. was established on October 1, 2020 to create a "new pharmaceutical platform" for the digital age. In March 2021 the subsidiary launched the "Tsunagaru (connected) Pharmacy" service utilizing its official LINE account. Main services include electronic medication records, prescription transmittal, follow-up medication management, online medication guidance, and payment services. The company receives a monthly service usage fee of JPY10,000 from dispensing pharmacies that have introduced the service. As of end-September 2021, the official LINE account had more than 170,000 friends (users), with 552 stores having introduced the service.

Leasing and Facility-related

- Segment sales: JPY1.5bn (+6.8% YoY)
- Segment profit: JPY32mn (+100.0% YoY)

Operating conditions of serviced elderly housing facilities

In 1H FY03/22, property leasing revenue was generally strong and orders for construction projects increased. However, the spread of COVID-19 limited sales activities for the company's serviced elderly housing facilities, leading to sluggish growth in occupancy. As of end-September 2021, the company reported stable occupancy rates at three of its five properties, while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 78.1% (with 64 out of 82 units occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 70.7% (with 82 out of 116 units occupied).

Food Service

- Segment sales: JPY1.2bn (-6.6% YoY)
- Segment profit: JPY1mn (versus loss of JPY13mn in 1H FY03/21)

Despite a drop in the number of meals supplied due to the pandemic, the segment turned profitable in 1H FY03/22 as the company revised its operations, including changing its suppliers.

Other (mostly home-visit nursing care)

- Segment sales: JPY152mn (+38.2% YoY)
- Segment loss: JPY12mn (versus loss of JPY13mn in 1H FY03/21)

Q1 FY03/22 earnings results (out August 6, 2021)

Overview

Q1 FY03/22 (April–June 2021) earnings results

- Sales: JPY25.9bn (+3.0% YoY)
- Operating profit: JPY667mn (loss of JPY61mn in Q1 FY03/21)
- Recurring profit: JPY935mn (loss of JPY62mn in Q1 FY03/21)
- Net income attributable to owners of the parent: JPY583mn (loss of JPY201mn in Q1 FY03/21)

Company response and business conditions

The Pharmaceuticals Network business recorded a steady increase in new network members in general, and the Dispensing Pharmacy business saw some recovery in the number of prescriptions filled despite a drop in the average prescription price. The increase in Pharmaceuticals Network business network members contributed to profit growth.

Breakdown of Q1 FY03/22 (April–June 2021) results by segment

Community Pharmacy Network

- Segment sales: JPY24.7bn (+3.1% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY1.2bn (+177.0% YoY)
- 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. A digital shift business that utilizes instant messaging app LINE was added to the segment from FY03/21.

Pharmaceuticals Network

The number of new network members continued to increase, driven by the need for improved operating stability amid harsh business environments in the dispensing pharmacy industry. As of end-June 2021, network members numbered 6,367 (+251 versus end-FY03/21), consisting of 417 directly operated pharmacies and 5,950 affiliates. By end-June 2021, the company's market share exceeded 10%.

Dispensing Pharmacy

The number of prescriptions filled during the period recovered to some extent, despite a drop in the average prescription price. As of end-June 2021, the group had 417 dispensing pharmacies, one care plan center, and eight cosmetics/drug stores.

Manufacture and market pharmaceuticals

This business aims to provide a stable supply of good-quality, low-priced generic drugs. As of end-June 2021, the company was selling 37 different ingredients and 74 products.

Digital shift

Subsidiary PharmaShift Co., Ltd. was established on October 1, 2020, to create a “new pharmaceutical platform” for the digital age. In March 2021 the subsidiary launched the “Tsunagaru (connected) Pharmacy” service utilizing its official LINE account. As of end-June 2021, the official LINE account had more than 87,000 friends (users), with 350 stores having introduced the service.

Leasing and Facility-related

- Segment sales: JPY739mn (+2.2% YoY)
- Segment loss: JPY2mn (profit of JPY6mn in Q1 FY03/21)

Reasons for segment loss

In Q1 FY03/22, the spread of COVID-19 limited sales activities for the company's serviced elderly housing facilities, leading to sluggish growth in occupancy. The company also incurred increased expenses for implementing counter-infection measures. As of end-June 2021, the company reported stable occupancy rates at three of its five properties, while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 78.1% (with 64 out of 82 units occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 67.2% (with 78 out of 116 units occupied).

Food Service

- Segment sales: JPY586mn (-4.2% YoY)
- Segment loss: JPY1mn (versus loss of JPY19mn in Q1 FY03/21)

Loss improved

Losses narrowed due to a decline in the number of meals supplied due to the pandemic, withdrawal from unprofitable facilities, and changes in suppliers.

Other (mostly home-visit nursing care)

- Segment sales: JPY74mn (+45.1% YoY)
- Segment loss: JPY7mn (versus loss of JPY11mn in Q1 FY03/21)

Full-year FY03/21 earnings results (out May 7, 2021)

Overview

FY03/21 (April 2020–March 2021) earnings results

- Sales: JPY104.3bn (-0.9% YoY)
 - Operating profit: JPY3.4bn (+112.3% YoY)
 - Recurring profit: JPY3.5bn (+123.0% YoY)
 - Net income*: JPY2.2bn (versus loss of JPY895mn in FY03/20)
- *Net income attributable to owners of the parent

Company response and business conditions

Sales declined 0.9% YoY with the mainstay Community Pharmacy Network business declining 0.4% and the other three businesses falling a combined 11.7%. Among the Community Pharmacy Network business, the Pharmaceuticals Network business recorded a steady increase in new network members, while the Dispensing Pharmacy business saw a 9.4% drop in the number of prescriptions filled owing to fewer medical examinations as a result of the COVID-19 pandemic. This decline in the number of prescriptions filled was the main reason for the drop in sales.

On the profit front, profit margins improved due to an increase in Pharmaceuticals Network business network members, progress promoting the switch to generics in the Dispensing Pharmacy business, streamlined operations, improved productivity, and reduced expenses. Of the JPY1.8bn increase in operating profit, JPY1.4bn was derived from the Dispensing Pharmacy business. The company also turned into the black at the net income level, due to JPY907mn in proceeds from the sale of some shares in a non-equity-method affiliate in December 2020, booked as extraordinary gains.

Breakdown of FY03/21 (April 2020–March 2021) results by segment

Community Pharmacy Network

- Segment sales: JPY99.2bn (-0.4% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY5.7bn (+52.4% YoY)
- 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.

Pharmaceuticals Network

Despite the loss of some major customers due to the emergence of competitors, the number of new network members continued to increase, driven by the need for improved distribution efficiency. As of end-March 2021, network members numbered 6,116 (+871 versus end-FY03/20), consisting of 416 directly operated pharmacies and 5,700 affiliates. By end-March 2021, the company's market share (number of pharmacies basis) exceeded 10%.

Dispensing Pharmacy

Reflecting the decline in medical examinations in the wake of the pandemic, the number of prescriptions filled during the period declined 9.4% despite a 7.7% hike in average prescription prices due to an increase in long-term prescriptions. However, the company notes segment profits increased thanks to efforts to promote the switch to generics as an economic alternative with stable supply, as well as to streamline operations, optimize personnel deployment, and reduce overtime. As of end-March 2021, the group had 416 dispensing pharmacies, one care plan center, and eight cosmetics/drug stores.

Manufacture and market pharmaceuticals

This business aims to provide a stable supply of good-quality, low-priced generic drugs. As of end-March 2021, the company was selling 34 different ingredients and 68 products. Sales exceeded JPY1bn and the business turned profitable.

Digital shift

Subsidiary PharmaShift Co., Ltd. was established on October 1, 2020, to create a "new pharmaceutical platform" for the digital age. In March 2021 the subsidiary launched the "Your Family Pharmacy" service utilizing its official LINE account. The number of registered friends increased from 10,000 as of April 2, 2021 to over 50,000 by May 28, 2021. Furthermore, the number of pharmacies adopting the service reached 168 as of April 2021.

Leasing and Facility-related

- Segment sales: JPY2.9bn (-14.2% YoY)
- Segment profit: JPY32mn (-28.7% YoY)

Reasons for declines in sales and profit

In FY03/21, the spread of COVID-19 limited sales activities for the company's serviced elderly housing facilities, leading to sluggish growth in occupancy. There were also pandemic-related postponements of certain construction projects. As of end-March 2021, the company reported stable occupancy rates at three out of its five properties, while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 78.1% (with 64 out of 82 units occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 67.2% (with 78 out of 116 units occupied).

Food Service

- Segment sales: JPY2.5bn (-11.6% YoY)
- Segment loss: JPY21mn (versus loss of JPY43mn in FY03/20)

Loss improved

While there was a decline in the number of meals supplied due to the pandemic, losses narrowed owing to the company's withdrawal from unprofitable facilities.

Other (mostly home-visit nursing care)

- Segment sales: JPY229mn (+38.6% YoY)
- Segment loss: JPY31mn (versus loss of JPY71mn in FY03/20)

Q3 FY03/21 earnings results (out February 5, 2021)

Overview

Consolidated results for cumulative Q3 FY03/21 (April–December 2020)

- Sales: JPY78.2bn (-1.0% YoY)
 - Operating profit: JPY2.8bn (+125.8% YoY)
 - Recurring profit: JPY2.8bn (+129.3% YoY)
 - Net income*: JPY2.0bn (+517.5% YoY)
- *Net income attributable to owners of the parent

Business conditions and company initiatives: The Pharmaceuticals Network business recorded a steady increase in new network members. The Dispensing Pharmacy business saw a drop in the number of prescriptions filled owing to an increase in long-term prescriptions as the COVID-19 pandemic led to fewer medical examinations. The Community Pharmacy Network segment as a whole reported a 0.4% YoY fall in sales. Among other three businesses, sales also decreased YoY at the Leasing and Facility-related business and the Food Service business, and consolidated sales were down 1.0% YoY as a consequence.

At the profit level, operating profit improved by 125.8% YoY. Within the Community Pharmacy Network segment, the Dispensing Pharmacy business registered profit growth on measures to promote the switch to generics, streamline operations, improve productivity, and reduce expenses. The Pharmaceuticals Network business also put up a solid performance, contributing to profit growth. Although the Leasing and Facility-related business experienced lower profit, the Food Service business and Other (home-visit nursing care) business both managed to rein in losses. All of the above combined to produce a sharp increase in companywide operating profit. YoY growth in net income attributable to owners of the parent expanded as the company booked extraordinary gains in connection with the sale of some shares in an equity-method affiliate in December 2020.

Breakdown of results by segment

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.

- Segment sales: JPY74.4bn (-0.4% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY4.3bn (+56.6% YoY)

Pharmaceuticals Network: The number of new network members continued to increase, driven by the need for improved distribution efficiency. As of end-December 2020, network members numbered 5,745 (up 500 versus end-FY03/20), consisting of 413 directly operated pharmacies and 5,332 affiliates. As of end-January 2021, the number was 5,845; the company grew network member numbers by 100 in one month, despite increased competition.

Dispensing Pharmacy: Reflecting the decline in medical examinations in the wake of the pandemic, the volume of long-term prescriptions increased while the number of prescriptions filled during the period was down. As the result of the decline in the number of prescriptions filled, growth in the drug charge per prescription (9.9%) exceeded growth in the technical fee per prescription (4.1%). Consequently, on a companywide basis, the prescription unit price (comprised of the drug charge per prescription and technical fee per prescription) grew 8.6% YoY. Shared Research believes that profitability in the Dispensing Pharmacy business is improving, as following September 2020 revisions to the Pharmaceutical and Medical Device Act, the company has sought to streamline negotiations for procurement prices. In addition, it has worked to promote the switch to generics as an economic alternative with stable supply, streamline operations, optimize personnel deployment, and reduce overtime. As of end-December 2020, the group had 413 dispensing pharmacies, one care plan center, and nine cosmetics/drug stores.

Manufacture and market pharmaceuticals business: This business aims to provide a stable supply of good-quality, low-priced generic drugs. As of end-December 2020, the company was selling 33 different ingredients and 66 products.

Digital Shift: Spearheaded by subsidiary PharmaShift Co., Ltd., the Digital Shift business was established to promote digital transformation of dispensing pharmacies. When reporting earnings for cumulative Q3 FY03/21, the company disclosed results from a PharmaShift trial of the Family Pharmacy Support Service (utilizing an official LINE account) at 10 directly operated pharmacies. According to Medical System Network, results were even better than anticipated, with one in three pharmacy customers and roughly half of those using LINE agreeing to “friend registration.” The company also has organized a Digital Pharmacy Consortium comprising seven companies who will now progressively implement the Family Pharmacy Support Service across their pharmacy networks, with an initial goal of rolling out the service at 2,000 pharmacies by end-December 2021. With the aforementioned September 2020 revisions to the Pharmaceutical and Medical Device Act, pharmacists are now obliged to follow up with customers during drug use periods. For dispensing pharmacies, building closer relationships with patients is a pressing issue to be addressed.

Leasing and Facility-related

Results for cumulative Q3 FY03/21 (April–December 2020)

- Segment sales: JPY2.2bn (-17.5% YoY)
- Segment profit: JPY34mn (-49.3% YoY)

The decline in sales and profit reflected pandemic-related postponements of certain construction projects; on the plus side, the company saw solid growth in leasing revenues and occupancy numbers at its serviced elderly housing facilities. As of end-December 2020, the company reported stable occupancy rates at three out of its five properties; as for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 76.8% (with 63 out of 82 units being occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 66.4% (with 77 out of 116 units being occupied). According to the company, Wisteria Senri-Chuo turned profitable in 1H and remained in the black in Q3 (October–December 2020). Wisteria Minami Ichijo remained in the red in Q3 as growth in occupancy stalled against the backdrop of the pandemic. Medical System Network plans to carry out sales activities targeting an occupancy rate of over 90% at all facilities. The company continues its marketing efforts aimed at getting its occupancy rate up to 90% by end-FY03/21 while taking all due precautions to prevent COVID-19 infections.

Food Service

Results for cumulative Q3 FY03/21 (April–December 2020)

- Segment sales: JPY1.9bn (-11.9% YoY)
- Segment loss: JPY2mn (versus loss of JPY38mn in cumulative Q3 FY03/20)

Loss shrank: Sales fell as the COVID-19 pandemic led to a decline in the number of meals supplied and the company withdrew from unprofitable facilities. At the same time, though, the exit from unprofitable facilities caused losses to narrow, as did price negotiations and improvement in costs for food ingredients procurement.

Other

The main business is home-visit nursing care.

Results for cumulative Q3 FY03/21 (April–December 2020)

- Segment sales: JP171mn (+40.2% YoY)
- Segment loss: JPY17mn (versus loss of JPY56mn in cumulative Q3 FY03/20)

News and topics

Revisions to earnings forecast

2021-10-28

Medical System Network Co., Ltd. announced revisions to its earnings forecast.

Revisions to 1H FY03/22 consolidated earnings forecast (announced on October 28, 2021)

Sales: JPY52.2bn (previous forecast: JPY51.9bn)

Operating profit: JPY1.9bn (JPY1.4bn)

Recurring profit: JPY2.2bn (JPY1.8bn)

Net income attributable to owners of the parent: JPY1.4bn (JPY750mn)

EPS: JPY47.41 (JPY24.87)

Reasons for revision

The company now forecasts 1H FY02/22 consolidated sales of JPY52.2bn (up 0.6% from its previous forecast), largely because the price per prescription and number of prescriptions filled were higher than expected at the Dispensing Pharmacy business. It also forecasts operating profit of JPY1.9bn (up 32.9%), due to higher sales, reduction in travel and other such expenses, and the deferral of some expenses expected in 1H to 2H; recurring profit of JPY2.2bn (up 27.4%); and net income of JPY1.4bn (up 90.7%), owing to a gain on the sale of investment securities held and the tax effect of the absorption-style merger of consolidated subsidiary Home-Visit Nursing Care Station Himawari Co., Ltd., in July 2021. The company made no change to the full-year consolidated earnings forecast announced on May 7, 2021.

Termination of the capital alliance with EPS Holdings, Inc. and the business alliance with EP-Sogo Co., Ltd.

2021-06-18

On June 18, 2021, Medical System Network Co., Ltd. announced the termination of the capital alliance with EPS Holdings, Inc. and the business alliance with EP-Sogo Co., Ltd.

The company announced that at a meeting held on the same day, its Board of Directors resolved to terminate the capital alliance with EPS Holdings (TSE 1: 4282) and the business alliance with EP-Sogo (unlisted).

The company entered into a business alliance with Sogo Rinsho Holdings Co., Ltd. (current EP-Sogo) in 2015, and since then has maintained a capital alliance (which was later transferred to EP-Sogo's parent company, EPS Holdings). The company resolved to terminate the capital and business alliances mainly because it has already achieved results from the business alliance with EP-Sogo and it will accept a tender offer for its shares in EPS Holdings made public in May 2021. Despite the termination of the capital and business alliances, the company intends to maintain good, cooperative relationships with EPS Holdings and EP-Sogo.

The dates of termination of the capital and business alliances are both set for July 15, 2021. The company expects to book an extraordinary gain of JPY112mn arising from the sale of shares in EPS Holdings, but said that the termination of the business alliance will have a negligible impact on its consolidated earnings.

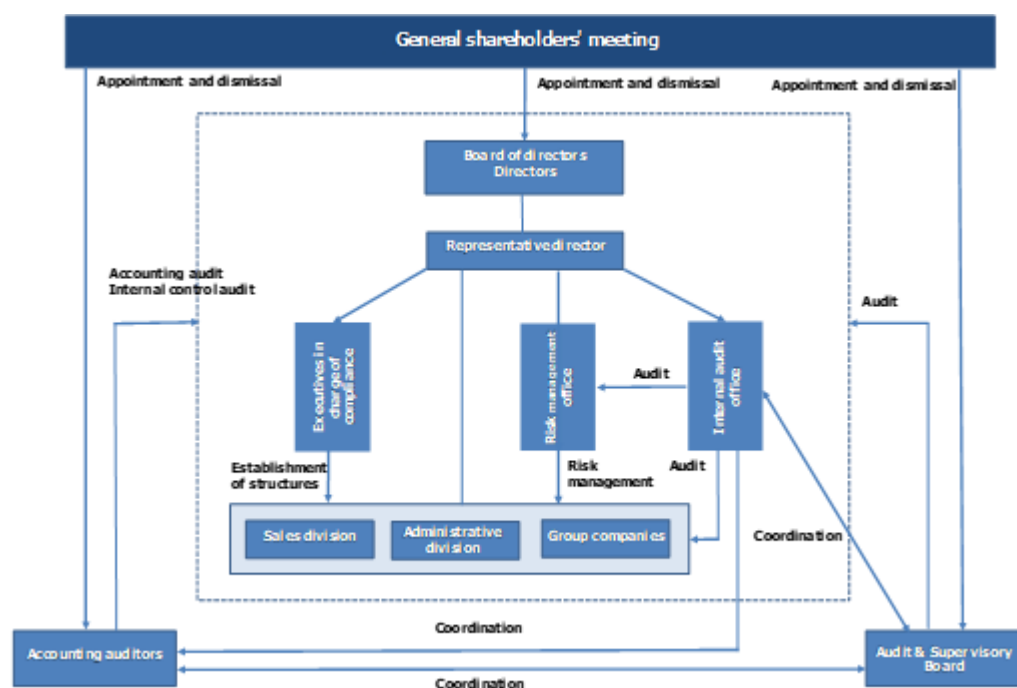
Other information

History

| Data | Description |
|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Sep 1999 | Established Medical System Network (capital stock :JPY 10mn) 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 JPY 200mn, Medical System Network held 51% equity stake, but dissolved alliance and absorbed MM net in 2013) |
| Oct | Pharmaholdings acquired 100% of Summedic 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 Hansin Dispensing Pharmacy (Switched to alliance with parent Hansin Pharmacy Holdings when the holding company was established in December 2012) |
| May 2013 | Formed business alliance with FamilyMart |
| Jul | Pharmaholdings and Hansin 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 |
| Apr | Acquired A-System Co., Ltd. in a absorption-type merger |
| Feb 2020 | Dissolved H&M Co., Ltd, terminating business tie-up with I&H Co., Ltd. |
| Oct | Established PharmaShift Co., Ltd., a joint venture with Opt, Inc. (now Re:teigi, Inc.) |

Source: Shared Research based on company data (as of March 2021)

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 of Feldsenf Pharma Co., Ltd. |
| Jun 2020 | President and representative director (current) of Feldsenf Pharma Co., Ltd. |

Source: Shared Research based on company data (as of June 2020)

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 12 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 |
|-----------------------------------------------------------|-------------|--------------------|
| QUINTET PRIVATE BANK (EUROPE) S.A. 107704 | 2,863,900 | 9.36% |
| S&S G.K. | 2,769,100 | 9.05% |
| Yasuyuki Okinaka | 2,506,000 | 8.19% |
| Jiro Akino | 2,220,200 | 7.26% |
| The Master Trust Bank of Japan, Ltd. (Trust Account) | 1,396,400 | 4.56% |
| Custody Bank of Japan, Ltd. (Trust Account) | 996,200 | 3.25% |
| EPS Holdings, Inc. | 950,000 | 3.10% |
| Inao Tajiri | 712,800 | 2.33% |
| Medical System Network Employees Stockholding Association | 666,300 | 2.17% |
| Tsuyoshi Nakamura | 494,600 | 1.61% |
| SUM | 15,575,500 | 50.93% |

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

Employees

| Segment | No. of employees | No. of temporary employees | Total |
|------------------------------|------------------|----------------------------|-------|
| Pharmaceuticals Network | 2,866 | 486 | 3,352 |
| Pharmacists | 1,376 | 61 | 1,437 |
| Leasing and Facility-related | 120 | 15 | 135 |
| Food Service | 184 | 278 | 462 |
| Other | 27 | 12 | 39 |
| Corporate (administration) | 129 | 8 | 137 |
| Total | 3,326 | 799 | 4,017 |

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

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

Profile

Company Name

Medical System Network Co., Ltd.

Phone

(011) 612-1069

Established

1999-09-16

Website

<https://www.msnw.co.jp/>

IR Contact

Corporate management Department

IR Phone

-

Head Office

24-3 Kitajuku-Nishi, Chuoku, Sapporo, Hokkaido

Listed On

First Section of the Tokyo Stock Exchange

Exchange Listing

2002-03-18

Fiscal Year-End

Mar

IR Web

<https://www.msnw.co.jp/eng/>

IR Email

-

About Shared Research Inc.

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>.

Contact Details

Company name

Shared Research Inc.

Phone

+81 (0)3 5834-8787

Address

3-31-12 Sendagi Bunkyo-ku Tokyo, Japan

Email

info@sharedresearch.jp

Website

<https://sharedresearch.jp>

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.