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Medical System Network

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Executive summary

Business overview

Medical System Network (TSE Standard: 4350) primarily focuses on managing dispensing pharmacies and offering pharmacy support services. Alongside operating its Nanohana Pharmacy chain, the company delivers diverse support services to member medical institutions belonging to its pharmaceutical network, including both directly operated and affiliated pharmacies. These services encompass pharmaceutical procurement and pharmacist training. As its core service, the company specializes in comprehensive pharmaceutical supply chain management, covering aspects such as wholesale price determination, drug ordering, and payment settlement. As of end-March 2023, the network had 8,912 members (+1,511 from end-March 2022), consisting of 428 directly operated pharmacies and 8,484 affiliated pharmacies.

The company has four business segments: Community Pharmacy Network (accounting for 95.3% of total sales in FY03/23), Leasing and Facility-related (2.4%), Meal Catering (2.1%), and Other (0.3%). Almost all segment profit (before adjustment) is generated by the Community Pharmacy Network segment, a new segment disclosed from FY03/20 that integrated former businesses and consists of four business divisions. In addition to the Community Pharmacy business, which operates dispensing pharmacies, there are three businesses that support the operation of dispensing pharmacies: the Pharmaceutical Network business, the Manufacture and Market Pharmaceuticals business, and the Digital Shift businesses added from FY3/21. The company discloses the operating status of each business within this segment, but does not provide a sales and profit breakdown by business. The Leasing and Facility-related segment develops locations for pharmacies, rents out buildings, and operates serviced housing facilities for the elderly. The Meal Catering segment is a contracted food service business providing meals to hospitals and welfare facilities, and the Other segment is a home-visit nursing service that supports at-home care.

The Community Pharmacy business within the Community Pharmacy Network segment mainly operates the Nanohana Pharmacy chain, which is directly managed by the group. The majority of dispensing pharmacies in Japan are medium-sized regional pharmacy chains or small family-run pharmacies. The dispensing pharmacies operated by Medical System Network 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 61,791 dispensing pharmacies in Japan in FY2021. Dispensing pharmacies directly operated by Medical System Network accounted for 0.7% of this market. Each of the major dispensing pharmacy chains, including Medical System Network, has a maximum share of around 2% in terms of pharmacy numbers, but companies are looking to grow their shares not only via new pharmacy openings but also through acquisition of smaller operators. Since FY03/21, Medical System Network's pharmaceutical network members (including both directly operated pharmacies and affiliates) have collectively accounted for over 10% of the domestic market.

The Pharmaceutical Network business within the Community Pharmacy Network segment provides operational support to the company's directly operated dispensing pharmacies and general affiliates. By acting as an intermediary in pharmaceutical transactions between pharmacies, hospitals, and drug wholesalers, Medical System Network contributes to efficiency gains in the drug distribution process and provides comprehensive management support services to dispensing pharmacies. In the Manufacture and Market Pharmaceuticals business, consolidated subsidiary Feldsenf Pharma Co., Ltd. manufactures and markets generic pharmaceuticals. In the Digital Shift Business, consolidated subsidiary PharmaShift Co., Ltd. aims to build a new pharmaceutical platform by supporting pharmacies' digital transformation, and is conducting family pharmacy support services using tools such as LINE.

Trends and outlook

In FY03/23, the company reported sales of JPY109.6bn (+2.7% YoY), EBITDA of JPY6.1bn (-8.7% YoY), operating profit of JPY3.2bn (-17.9% YoY), recurring profit of JPY3.4bn (-22.2% YoY), and net income attributable to owners of the parent of JPY1.6bn (-32.7% YoY). Sales in the mainstay Community Pharmacy Network segment stood at JPY104.4bn (+2.9% YoY). Within this segment, the Community Pharmacy business saw a decline in the price per prescription; still, an increase in the number of pharmacies through new store openings and acquisitions lifted overall segment sales. The Pharmaceutical Network business also steadily added new network affiliates. Operating profit fell 17.9% YoY, mainly due to the impact of the NHI drug price and dispensing fee revisions and higher labor expenses accompanying the company's efforts to step up interpersonal services.

The company's announced an upward revision to its full-year earnings forecast for FY03/24 at the time of the 1H results announcement (dated November 7, 2023). The revised forecast calls for sales of JPY113.8bn (+3.9% YoY), EBITDA of JPY6.6bn (+7.8% YoY), operating profit of JPY3.5bn (+10.7% YoY), recurring profit of JPY3.5bn (+2.8% YoY), and net income attributable to owners of the parent of JPY1.7bn (+2.5% YoY). The company raised its full-year forecast to reflect the better-than-expected 1H results. It maintained its initial outlook for 2H in light of the impact of shipment adjustments in the Manufacture and Market Pharmaceutical business.

Within the Community Pharmacy Network segment, the company will seek to further strengthen interpersonal services in the Community Pharmacy business by fostering a medical mindset and facilitating high-quality pharmacotherapy, while also gaining prescriptions primarily through use of the official LINE account Tsunagaru Pharmacy. In the Pharmaceutical Network business, it will work to win new network members, provide comprehensive management support to dispensing pharmacies, and further improve the efficiency of pharmaceutical distribution. In the Leasing and Facility-related segment, the company aims to expedite achieving occupancy rates of 90% at all five serviced elderly housing facilities.

When reporting FY03/22 results, Medical System Network also released its sixth medium-term plan spanning FY03/23 through FY03/26. While under the fifth medium-term plan the company sought to expand both market share and the scale of operations, under the new plan it aims to transition to a new stage in which the company's networks form a foundation platform that functions as a new pharmacy infrastructure with group pharmacies at the core but also including affiliates. Medical System Network plans to utilize this platform to pursue growth in various businesses.

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	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23	FY03/24
(JPYmn)	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Est.**
Sales	**66,182**	**75,548**	**87,715**	**88,865**	**93,977**	**98,232**	**105,241**	**104,257**	**106,685**	**109,551**	**113,800**
YoY	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%	-0.9%	2.3%	2.7%	3.9%
Gross profit	22,737	28,476	32,801	34,164	36,607	37,271	40,214	42,412	44,429	45,921	
YoY	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%	5.5%	4.8%	3.4%	
Gross profit margin	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%	40.7%	41.6%	41.9%	
Operating profit	**2,091**	**2,641**	**3,783**	**2,113**	**3,163**	**1,428**	**1,615**	**3,429**	**3,852**	**3,163**	**3,500**
YoY	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%	112.3%	12.3%	-17.9%	10.7%
Operating profit margin	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%	3.3%	3.6%	2.9%	3.1%
Recurring profit	**2,020**	**2,540**	**3,860**	**2,109**	**3,250**	**1,501**	**1,560**	**3,479**	**4,313**	**3,355**	**3,450**
YoY	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%	123.0%	24.0%	-22.2%	2.8%
Recurring profit margin	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%	3.3%	4.0%	3.1%	3.0%
Net income	**668**	**885**	**1,720**	**571**	**1,022**	**462**	**-895**	**2,198**	**2,394**	**1,610**	**1,650**
YoY	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%	-	-	8.9%	-32.7%	2.5%
Net margin	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%	-	2.1%	2.2%	1.5%	1.4%
Per-share data											
Shares issued at year-end (000 shares)	25,970	25,970	29,890	29,890	30,523	30,643	30,643	30,643	30,643	30,643	-
EPS	27.7	37.1	60.1	19.3	34.5	15.3	-29.5	72.5	79.4	53.4	54.7
EPS (fully diluted)	-	-	-	-	34.3	15.0	-	-	-	-	-
Dividend per share	8.0	8.0	9.5	10.0	10.0	10.0	10.0	10.0	12.0	12.0	12.0
Book value per share	214.7	243.3	334.9	345.3	351.4	354.8	310.4	370.2	439.7	478.9	-
Balance sheet (JPYmn)											
Cash and cash equivalents	3,106	2,499	2,081	2,252	10,201	11,703	11,722	10,118	8,201	8,141	
Total current assets	**10,941**	**11,023**	**10,783**	**11,098**	**18,736**	**21,055**	**20,578**	**19,313**	**18,701**	**20,265**	
Tangible fixed assets	15,976	17,249	20,253	21,246	24,129	25,721	25,126	24,634	24,624	27,060	
Investments and other assets	3,798	3,759	4,329	4,559	4,847	5,922	6,143	6,926	6,848	7,090	
Intangible assets	12,399	13,554	13,481	13,833	15,045	16,235	14,615	13,572	12,767	11,807	
Total assets	**43,114**	**45,587**	**48,847**	**50,737**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**	
Accounts payable	7,798	8,598	9,525	9,144	9,416	10,198	10,021	9,258	9,680	9,937	
Short-term debt	12,922	9,214	6,910	3,863	7,463	9,158	8,905	10,210	5,935	6,377	
Total current liabilities	**24,880**	**21,626**	**21,061**	**16,920**	**21,769**	**23,844**	**23,296**	**25,418**	**20,435**	**21,349**	
Long-term debt	10,948	15,391	14,859	20,186	26,329	29,739	28,653	22,348	23,631	24,139	
Total fixed liabilities	**12,882**	**17,826**	**17,520**	**23,172**	**30,404**	**34,329**	**33,749**	**27,841**	**29,219**	**30,385**	
Total liabilities	**37,762**	**39,452**	**38,581**	**40,092**	**52,174**	**58,173**	**57,045**	**53,260**	**49,654**	**51,735**	
Total net assets	**5,352**	**6,136**	**10,265**	**10,644**	**10,584**	**10,761**	**9,418**	**11,187**	**13,286**	**14,488**	
Total interest-bearing debt	23,870	24,605	21,769	24,049	33,792	38,897	37,558	32,558	29,566	30,516	
Cash flow statement (JPYmn)											
Cash flows from operating activities	3,706	3,838	6,409	3,084	6,699	2,840	4,232	5,205	4,010	4,973	
Cash flows from investing activities	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383	-1,485	-2,511	-2,114	
Cash flows from financing activities	4,864	-483	-1,792	998	8,050	4,338	-1,687	-5,312	-3,415	-2,918	
Financial ratios											
ROA (RP-based)	5.5%	5.7%	8.2%	4.2%	5.7%	2.3%	2.3%	5.3%	6.8%	5.2%	
ROE	12.2%	16.2%	21.9%	5.7%	9.8%	4.3%	-8.9%	21.3%	19.6%	11.6%	
Equity ratio	11.9%	12.7%	20.3%	20.1%	16.9%	15.6%	14.2%	17.3%	21.1%	21.8%	

Source: Shared Research based on company data

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

Recent updates

Acquisition of treasury shares

2024-02-16

Medical System Network Co., Ltd. announced a decision regarding the acquisition of treasury shares.

Method of acquisition

The company will entrust the purchase at the closing price of JPY585 on February 16, 2024 (including the final special quote), through the off-auction own share repurchase trading (ToSTNeT-3) of the Tokyo Stock Exchange at 8:45 AM on February 19, 2024 (No changes will be made to other trading systems or trading hours). The purchase order will be limited to the trading time.

Share buyback details

- Class of shares to be acquired: Common shares
- Total number of shares to be acquired: 950,000 shares (upper limit; 3.10% of issued shares excluding treasury shares)
- Total value of shares to be acquired: JPY556mn (upper limit)
- Announcement of acquisition results: After the close of trading at 8:45 AM

Establishment of subsidiary

2024-02-16

Medical System Network Co., Ltd. announced that it had resolved at its Board of Directors meeting held on February 16, 2024, to establish a subsidiary.

The name of the new company will be MediLogiNet Co., Ltd. (location: Minato Ward, Tokyo), and its business will involve the logistics of pharmaceuticals and other products, with a capital of JPY10mn, entirely funded by the company. The establishment is scheduled for April 2024, with business operations commencing in October 2024.

The purpose of the establishment is to enhance services for network affiliates within the company's Pharmaceutical Network business. The new subsidiary will handle the logistics for pharmaceuticals, with a primary focus on generic drugs produced and marketed by Feldsenf Pharma Co., Ltd., a consolidated subsidiary. The impact of this matter on the company's consolidated financial results for FY03/24 is anticipated to be minimal.

Trends and outlook

Quarterly trends and results

Cumulative	FY03/22				FY03/23				FY03/24			FY03/24	
(JPYmn)	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3	% of Est.	FY Est.
Sales	25,914	52,169	79,868	106,685	26,299	53,340	81,878	109,551	27,656	56,461	86,175	75.7%	113,800
YoY	3.0%	2.2%	2.2%	2.3%	1.5%	2.2%	2.5%	2.7%	5.2%	5.9%	5.2%		3.9%
Gross profit	10,738	21,861	33,443	44,429	11,062	22,315	34,287	45,921	11,433	23,453	35,882		
YoY	10.7%	6.6%	5.6%	4.8%	3.0%	2.1%	2.5%	3.4%	3.4%	5.1%	4.7%		
Gross profit margin	41.4%	41.9%	41.9%	41.6%	42.1%	41.8%	41.9%	41.9%	41.3%	41.5%	41.6%		
SG&A expenses	10,071	19,999	30,379	40,576	10,713	21,215	31,942	42,758	10,981	21,740	32,813		
YoY	3.1%	4.4%	5.1%	4.1%	6.4%	6.1%	5.1%	5.4%	2.5%	2.5%	2.7%		
SG&A ratio	38.9%	38.3%	38.0%	38.0%	40.7%	39.8%	39.0%	39.0%	39.7%	38.5%	38.1%		
Operating profit	667	1,862	3,063	3,852	348	1,099	2,344	3,163	451	1,712	3,069	87.7%	3,500
YoY	-	37.4%	10.5%	12.3%	-47.8%	-41.0%	-23.5%	-17.9%	29.6%	55.8%	30.9%		10.7%
Operating profit margin	2.6%	3.6%	3.8%	3.6%	1.3%	2.1%	2.9%	2.9%	1.6%	3.0%	3.6%		3.1%
Recurring profit	935	2,235	3,485	4,313	392	1,242	2,499	3,355	410	1,692	3,044	88.2%	3,450
YoY	-	60.0%	25.8%	24.0%	-58.1%	-44.4%	-28.3%	-22.2%	4.6%	36.2%	21.8%		2.8%
Recurring profit margin	3.6%	4.3%	4.4%	4.0%	1.5%	2.3%	3.1%	3.1%	1.5%	3.0%	3.5%		3.0%
Net income	583	1,431	2,144	2,394	91	502	1,195	1,610	148	861	1,693	102.6%	1,650
YoY	-	147.6%	6.5%	8.9%	-84.4%	-64.9%	-44.3%	-32.7%	62.6%	71.5%	41.7%		2.5%
Net margin	2.2%	2.7%	2.7%	2.2%	0.3%	0.9%	1.5%	1.5%	0.5%	1.5%	2.0%		1.4%
Quarterly	FY03/22				FY03/23				FY03/24				
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3		
Sales	25,914	26,255	27,699	26,817	26,299	27,041	28,538	27,673	27,656	28,805	29,714		
YoY	3.0%	1.4%	2.1%	2.8%	1.5%	3.0%	3.0%	3.2%	5.2%	6.5%	4.1%		
Gross profit	10,738	11,123	11,582	10,986	11,062	11,253	11,972	11,634	11,433	12,020	12,429		
YoY	10.7%	3.0%	3.8%	2.2%	3.0%	1.2%	3.4%	5.9%	3.4%	6.8%	3.8%		
Gross profit margin	41.4%	42.4%	41.8%	41.0%	42.1%	41.6%	42.0%	42.0%	41.3%	41.7%	41.8%		
SG&A expenses	10,071	9,928	10,380	10,197	10,713	10,502	10,727	10,816	10,981	10,759	11,073		
YoY	3.1%	5.8%	6.5%	1.1%	6.4%	5.8%	3.3%	6.1%	2.5%	2.4%	3.2%		
SG&A ratio	38.9%	37.8%	37.5%	38.0%	40.7%	38.8%	37.6%	39.1%	39.7%	37.4%	37.3%		
Operating profit	667	1,195	1,201	789	348	751	1,245	819	451	1,261	1,357		
YoY	-	-15.6%	-15.3%	20.3%	-47.8%	-37.2%	3.7%	3.8%	29.6%	67.9%	9.0%		
Operating profit margin	2.6%	4.6%	4.3%	2.9%	1.3%	2.8%	4.4%	3.0%	1.6%	4.4%	4.6%		
Recurring profit	935	1,300	1,250	828	392	850	1,257	856	410	1,282	1,352		
YoY	-	-10.9%	-9.0%	16.8%	-58.1%	-34.6%	0.6%	3.4%	4.6%	50.8%	7.6%		
Recurring profit margin	3.6%	5.0%	4.5%	3.1%	1.5%	3.1%	4.4%	3.1%	1.5%	4.5%	4.6%		
Net income	583	848	713	250	91	411	693	415	148	713	832		
YoY	-	8.9%	-50.3%	35.1%	-84.4%	-51.5%	-2.8%	66.0%	62.6%	73.5%	20.1%		
Net margin	2.2%	3.2%	2.6%	0.9%	0.3%	1.5%	2.4%	1.5%	0.5%	2.5%	2.8%		

Source: Shared Research based on company data

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

Quarterly results

By segment (cumulative)	FY03/22				FY03/23				FY03/24		
(JPYmn)	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3
Sales	**25,914**	**52,169**	**79,868**	**106,685**	**26,299**	**53,340**	**81,878**	**109,551**	**27,656**	**56,461**	**86,175**
YoY	3.0%	2.2%	2.2%	2.3%	1.5%	2.2%	2.5%	2.7%	5.2%	5.9%	5.2%
Community Pharmacy Network	24,657	49,663	75,986	101,457	25,045	50,792	78,078	104,399	26,356	53,765	82,105
YoY	3.1%	2.3%	2.2%	2.3%	1.6%	2.3%	2.8%	2.9%	5.2%	5.9%	5.2%
% of total	94.6%	94.6%	94.5%	94.5%	94.5%	94.5%	94.7%	94.5%	94.7%	94.7%	94.7%
Leasing and Facility-related	739	1,536	2,461	3,326	794	1,673	2,448	3,494	800	1,687	2,560
YoY	2.2%	6.8%	12.2%	13.1%	7.4%	8.9%	-0.5%	5.1%	0.8%	0.8%	4.6%
% of total	2.8%	2.9%	3.1%	3.1%	3.0%	3.1%	3.0%	3.2%	2.9%	3.0%	3.0%
Meal Catering	586	1,166	1,752	2,322	573	1,135	1,701	2,289	590	1,189	1,781
YoY	-4.2%	-6.6%	-6.5%	-6.1%	-2.2%	-2.7%	-2.9%	-1.4%	3.0%	4.8%	4.7%
% of total	2.2%	2.2%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
Other	74	152	232	305	77	151	228	304	78	155	237
YoY	45.1%	38.2%	35.7%	33.2%	4.1%	-0.7%	-1.7%	-0.3%	1.3%	2.6%	3.9%
% of total	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Segment sales adjustments	-143	-350	-563	-727	-190	-412	-579	-937	-168	-336	-510
Operating profit	**667**	**1,862**	**3,063**	**3,852**	**348**	**1,099**	**2,344**	**3,163**	**451**	**1,712**	**3,069**
YoY	-	37.4%	10.5%	12.3%	-47.8%	-41.0%	-23.5%	-17.9%	29.6%	55.8%	30.9%
Community Pharmacy Network	1,202	2,885	4,663	6,117	1,014	2,384	4,299	5,887	1,077	2,947	4,965
YoY	177.0%	21.8%	7.7%	7.3%	-15.6%	-17.4%	-7.8%	-3.8%	6.2%	23.6%	15.5%
Operating profit margin	4.9%	5.8%	6.1%	6.0%	4.0%	4.7%	5.5%	5.6%	4.1%	5.5%	6.0%
Leasing and Facility-related	-2	32	53	39	-43	-65	-97	-92	22	69	129
YoY	-	100.0%	55.9%	21.9%	-	-	-	-	-	-	-
Operating profit margin	-	2.1%	2.2%	1.2%	-	-	-	-	2.8%	4.1%	5.0%
Meal Catering	-1	1	7	1	-11	-33	-55	-65	-14	-23	-24
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	0.1%	0.4%	0.0%	-	-	-	-	-	-	-
Other	-7	-12	-10	-12	-2	-10	-14	-22	-8	-20	-30
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	-	-	-	-	-	-	-	-	-
Segment profit adjustments	-523	-1,043	-1,650	-2,293	-608	-1,175	-1,787	-2,542	-626	-1,261	-1,970
	FY03/22				FY03/23				FY03/24		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	**25,914**	**26,255**	**27,699**	**26,817**	**26,299**	**27,041**	**28,538**	**27,673**	**27,656**	**28,805**	**29,714**
YoY	3.0%	1.4%	2.1%	2.8%	1.5%	3.0%	3.0%	3.2%	5.2%	6.5%	4.1%
Community Pharmacy Network	24,657	25,006	26,323	25,471	25,045	25,747	27,286	26,321	26,356	27,409	28,340
YoY	3.1%	1.6%	1.9%	2.5%	1.6%	3.0%	3.7%	3.3%	5.2%	6.5%	3.9%
% of total	94.6%	94.5%	94.3%	94.4%	94.5%	94.4%	95.1%	93.9%	94.7%	94.6%	94.8%
Leasing and Facility-related	739	797	925	865	794	879	775	1,046	800	887	873
YoY	2.2%	11.5%	22.4%	16.0%	7.4%	10.3%	-16.2%	20.9%	0.8%	0.9%	12.6%

% of total	2.8%	3.0%	3.3%	3.2%	3.0%	3.2%	2.7%	3.7%	2.9%	3.1%	2.9%
Meal Catering	586	580	586	570	573	562	566	588	590	599	592
YoY	-4.2%	-8.8%	-6.4%	-5.0%	-2.2%	-3.1%	-3.4%	3.2%	3.0%	6.6%	4.6%
% of total	2.2%	2.2%	2.1%	2.1%	2.2%	2.1%	2.0%	2.1%	2.1%	2.1%	2.0%
Other	74	78	80	73	77	74	77	76	78	77	82
YoY	45.1%	32.2%	31.1%	25.9%	4.1%	-5.1%	-3.8%	4.1%	1.3%	4.1%	6.5%
% of total	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Segment sales adjustments	-143	-207	-213	-164	-190	-222	-167	-358	-168	-168	-174
Operating profit	**667**	**1,195**	**1,201**	**789**	**348**	**751**	**1,245**	**819**	**451**	**1,261**	**1,357**
YoY	-	-15.6%	-15.3%	20.3%	-47.8%	-37.2%	3.7%	3.8%	29.6%	67.9%	9.0%
Community Pharmacy Network	1,202	1,683	1,778	1,454	1,014	1,370	1,915	1,588	1,077	1,870	2,018
YoY	177.0%	-13.0%	-9.3%	5.8%	-15.6%	-18.6%	7.7%	9.2%	6.2%	36.5%	5.4%
Operating profit margin	4.9%	6.7%	6.8%	5.7%	4.0%	5.3%	7.0%	6.0%	4.1%	6.8%	7.1%
Leasing and Facility-related	-2	34	21	-14	-43	-22	-32	5	22	47	60
YoY	-	240.0%	16.7%	-	-	-	-	-	-	-	-
Operating profit margin	-	4.3%	2.3%	-	-	-	-	-	2.8%	5.3%	6.9%
Meal Catering	1	2	6	-6	-11	-22	-22	-10	-14	-9	-1
YoY	-	-66.7%	-45.5%	-	-	-	-	-	-	-	-
Operating profit margin	-	0.3%	1.0%	-	-	-	-	-	-	-	-
Other	-7	-5	2	-2	-2	-8	-4	-8	-8	-12	-10
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	2.5%	-	-	-	-	-	-	-	-
Segment profit adjustments	-523	-520	-607	-643	-608	-567	-612	-755	-626	-635	-709

Source: Shared Research based on company data

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

Number of prescriptions filled and price per prescription (Community Pharmacy business, all-store basis)

	FY03/21				FY03/22				FY03/23				FY03/24		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Price per prescription	10,931	10,682	10,630	10,655	10,177	10,254	10,308	10,410	10,041	10,061	10,173	10,235	9,871	10,033	10,070
YoY	13.4%	9.3%	8.6%	7.6%	-6.9%	-4.0%	-3.0%	-2.3%	-1.3%	-1.9%	-1.3%	-1.7%	-1.7%	-0.3%	-1.0%
Drug fee	8,564	8,322	8,262	8,279	7,742	7,819	7,882	7,984	7,620	7,634	7,733	7,789	7,526	7,687	7,709
Technical fee	2,367	2,360	2,368	2,376	2,435	2,435	2,426	2,426	2,421	2,427	2,440	2,446	2,345	2,346	2,361
Number of prescriptions filled ('000)	1,964	4,043	6,212	8,289	2,185	4,367	6,625	8,746	2,230	4,517	6,828	9,088	2,379	4,777	7,266
YoY	-13.4%	-10.8%	-9.8%	-8.7%	11.3%	8.0%	6.6%	5.5%	2.1%	3.4%	3.1%	3.9%	6.7%	5.8%	6.4%
Dispensing fees	21,476	43,188	66,039	88,320	22,238	44,784	68,296	91,056	22,399	45,448	69,472	93,029	23,484	47,935	73,168
YoY	-1.7%	-2.4%	-2.0%	-1.8%	3.5%	3.7%	3.4%	3.1%	0.7%	1.5%	1.7%	2.2%	4.8%	5.5%	5.3%

Source: Shared Research based on company materials

Number of network members by region

Area	Directly operated pharmacies	Affiliates	Total
Hokkaido	122	235	357
Tohoku	25	658	683
Kanto and Koshinetsu	105	2,824	2,929
Tokai and Hokuriku	44	1,562	1,606
Kinki	52	1,502	1,554
Chugoku and Shikoku	21	938	959
Kyushu and Okinawa	67	1,348	1,415
Total	**436**	**9,067**	**9,503**

Source: Shared Research based on company data (as of February 6, 2024)

Cumulative Q3 FY03/24 results (out February 6, 2024)

Overview

Cumulative Q3 FY03/24 (April—December 2023) earnings results

- Sales: JPY86.2bn (+5.2% YoY)
- Operating profit: JPY3.1bn (+30.9% YoY)
- Recurring profit: JPY3.0bn (+21.8% YoY)
- Net income attributable to owners of the parent: JPY1.7bn (+41.7% YoY)

Operating results and business conditions

Sales rose 5.2% YoY due to an increase in the number of prescriptions filled through the mainstay Community Pharmacy business within the Community Pharmacy Network segment. The prescription unit price fell in the same business owing to the impact of off-year National Health Insurance (NHI) drug price revisions and the end of the transitional measures for community support system premiums, but the number of prescriptions filled increased, as patients felt more at ease with seeking medical consultations following the downgrading of COVID-19 to a Class 5 infectious disease. The utilization of digital technologies, including the use of the LINE instant messaging app for transmitting prescriptions, and enhanced patient follow-up during medication periods also boosted prescription volume.

Gross profit reached JPY35.9bn (+4.7% YoY) with a GPM of 41.6% (-0.3% YoY). The marginal decline in GPM primarily stemmed from a 3.3% reduction in technical fees per prescription in the Community Pharmacy business, following the conclusion of transitional measures for community support system premiums. SG&A expenses totaled JPY32.8bn (+2.7% YoY). While the company focused on enhancing productivity and curbed various expenses, SG&A expenses were kept in check partly due to slow workforce expansion. Operating profit rose 30.9% YoY, and EBITDA reached JPY5.4bn (+19.5% YoY). Note that starting from Q1, the costs of the business development division, which were previously allocated to the Leasing and Facility-related Segment, have been transferred to the Community Pharmacy Network Segment due to the company's decision to focus on pharmacy development.

In cumulative Q3, the rate of progress toward the company's full-year earnings forecast was 75.7% for sales, 87.7% for operating profit, 88.2% for recurring profit, and 102.6% for net income.

Segment results

Cumulative Q3 FY03/24 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY82.1bn (+5.2% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY5.0bn (+15.5% 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.

Cumulative Q3 sales increased 5.2% YoY, primarily driven by the Community Pharmacy business, which generates the bulk of sales in this segment. Segment profit increased by 15.5% YoY, with the profit margin rising to 6.0% (+0.5pp YoY). This improvement in profitability was primarily attributed to an increase in the total value of pharmaceutical orders placed by network affiliates as a result of higher prescription volumes and a corresponding rise in commission income.

Community Pharmacy

In cumulative Q3, dispensing fee income generated by directly operated pharmacies (on a company-wide basis) reached JPY73.2bn (+5.3% YoY) due to the rise in the number of prescriptions. The prescription unit price fell to JPY10,070 (-1.0% YoY), due to the impact of off-year NHI drug price revisions and the conclusion of transitional measures for community support system premiums. However, the number of prescriptions filled increased to 7,266,000 (+6.4% YoY), as patients felt more at ease with seeking medical consultations following the downgrading of COVID-19 to a Class 5 infectious disease. The outbreak of several respiratory infections and the utilization of digital technologies (transmission of prescriptions using the LINE messaging app), also drove up the prescription volume.

As of end-December 2023, the company had 436 community pharmacies, one in-home care plan support center, and 10 cosmetics/drug stores. During cumulative Q3, the company opened nine community pharmacies (including four inside medical malls) and one drugstore. It also acquired three community pharmacies through M&A while closing or transferring four.

Pharmaceuticals Network

In cumulative Q3, the total value of pharmaceutical orders placed by network affiliates climbed 18.8% YoY to JPY465.0bn, backed by an increase in the value of pharmaceutical procurement carried out by existing affiliates. The number of new network affiliates fell short of expectations due to pharmacy closures and withdrawals resulting from M&A. As of end-December 2023, pharmaceutical network affiliates totaled 9,503 (+591 from end-FY03/23), comprising 436 directly operated pharmacies and 9,067 affiliates.

Manufacture and Market Pharmaceuticals

The company offered 101 products (48 ingredients) as of end-December 2023. Although the company continued to refrain from accepting orders for some items due to shipment adjustments, cumulative Q3 sales for Feldsenf Pharma, a core subsidiary in the segment, reached JPY2.2bn (+13.2% YoY). The number of new partner pharmacies steadily grew, with the total number of partner pharmacies reaching 4,414 (+847 YoY) as of end-Q3.

Digital Shift

The company established subsidiary PharmaShift Co., Ltd. on October 1, 2020, to create a "new pharmaceutical platform" for the digital age. In March 2021, the subsidiary launched the "Tsunagaru Pharmacy" service utilizing its official LINE account. As of end-December 2023, the number of pharmacies using the service was 4,445 (+1,054 from end-FY03/23) and the number of registered users was 949,000.

Leasing and Facility-related

- Segment sales: JPY2.6bn (+4.6% YoY)
- Segment profit: JPY129mn (versus a loss of JPY97mn in cumulative Q3 FY03/23)

Operating conditions of serviced elderly housing facilities

Cumulative Q3 sales grew 4.6% YoY, driven by robust management fee income from properties under management and an increase in construction orders. As of end-December 2023, the overall occupancy rate at the five Wisteria serviced residences for the elderly stood at 83.3% (+1.5pp YoY). While three of the five properties maintained stable occupancy rates, Wisteria Senri-Chuo had 51 out of 82 units occupied (an occupancy rate of 62.2%), and Wisteria Minami-Ichijo had 88 out of 116 units occupied (an occupancy rate of 75.9%).

The segment continued to be profitable in Q3, sustaining its profitability from Q2. This ongoing profitability was attributable in part to the transfer of costs incurred through the business development division to the Community Pharmacy Network segment and in part to FY03/23 adjustments made to staff allocation and advertising spending associated with the Wisteria serviced residence for the elderly.

Meal Catering

- Segment sales: JPY1.8bn (+4.7% YoY)
- Segment loss: JPY24mn (versus loss of JPY55mn in cumulative Q3 FY03/23)

Higher sales and operating loss

While sales grew owing to a revision of the contract unit price, the gross profit margin declined due to rising purchase prices. The segment remained in the red as a result.

Other (mostly home-visit nursing care)

- Segment sales: JPY237mn (+3.9% YoY)
- Segment loss: JPY30mn (versus a loss of JPY14mn in cumulative Q3 FY03/23)

Company forecast for FY03/24

Recent performance and FY03/24 company forecast

	FY03/22			FY03/23			FY03/24		
(JPYmn)	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	2H Est.	FY Est.
Sales	**52,169**	**54,516**	**106,685**	**53,340**	**56,211**	**109,551**	**56,461**	**57,339**	**113,800**
YoY	2.2%	2.5%	2.3%	2.2%	3.1%	2.7%	5.9%	2.0%	3.9%
Cost of sales	30,307	31,949	62,256	31,024	32,606	63,630	31,024		
Gross profit	**21,861**	**22,568**	**44,429**	**22,315**	**23,606**	**45,921**	**23,453**		
Gross profit margin	41.9%	41.4%	41.6%	41.8%	42.0%	41.9%	41.5%		
SG&A expenses	19,999	20,577	40,576	21,215	21,543	42,758	21,740		
SG&A ratio	38.3%	37.7%	38.0%	39.8%	38.3%	39.0%	38.5%		
Operating profit	**1,862**	**1,990**	**3,852**	**1,099**	**2,064**	**3,163**	**1,712**	**1,788**	**3,500**
YoY	37.4%	-4.1%	12.3%	-41.0%	3.7%	-17.9%	55.8%	-13.4%	10.7%
Operating profit margin	3.6%	3.7%	3.6%	2.1%	3.7%	2.9%	3.0%	3.1%	3.1%
Recurring profit	**2,235**	**2,078**	**4,313**	**1,242**	**2,113**	**3,355**	**1,692**	**1,758**	**3,450**
YoY	60.0%	-0.2%	24.0%	-44.4%	1.7%	-22.2%	36.2%	-16.8%	2.8%
Recurring profit margin	4.3%	3.8%	4.0%	2.3%	3.8%	3.1%	3.0%	3.1%	3.0%
Net income	**1,431**	**963**	**2,394**	**502**	**1,108**	**1,610**	**861**	**789**	**1,650**
YoY	147.6%	-40.6%	8.9%	-64.9%	15.1%	-32.7%	71.5%	-28.8%	2.5%
Net margin	2.7%	1.8%	2.2%	0.9%	2.0%	1.5%	1.5%	1.4%	1.4%

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

The company raised its full-year earnings forecast for FY03/24 when it announced its 1H results on November 7, 2023. The company maintained this revised forecast with the announcement of the Q3 results in February 6, 2024. Note that the company changed its listing market from the Prime Market to the Standard Market on October 20, 2023.

- Sales: JPY113.8bn (+3.9% YoY)
- EBITDA: JPY6.6bn (+7.8% YoY)
- Operating profit: JPY3.5bn (+10.7% YoY)
- Recurring profit: JPY3.5bn (+2.8% YoY)
- Net income attributable to owners of the parent: JPY1.7bn (+2.5% YoY)
- EPS: JPY54.67 (versus JPY53.38 in FY03/23)

Performance outlook

The primary factors behind the upward revision of the earnings forecast at end-1H were: 1) higher-than-expected prescription volumes in the Community Pharmacy business, and 2) the total value of pharmaceutical orders placed by network affiliates, which exceeded initial projections thanks to growth in new network affiliates. On the profit side, efforts to improve productivity across the company and contain various expenses were successful.

Medical System Network plans to continue enhancing productivity and controlling expenses in 2H. However, the company anticipates impact from shipment adjustments in the Manufacture and Market Pharmaceuticals business. In addition, uncertainties remain in terms of the trends in prescription volumes at directly operated pharmacies and the business environment surrounding network affiliation. Therefore, when revising the full-year earnings forecast, the company only reflected the better-than-expected performance in 1H and maintained its initial outlook for 2H. Although the number of prescriptions continued to grow steadily through end-Q3, the company has maintained its full-year earnings forecast, taking into account factors such as the impact of drug price and dispensing fee revisions and the initial costs associated with new store openings.

Based on the revised earnings forecast, the company has also raised its annual dividend forecast to JPY12 per share.

Forecast by key segment (unchanged since release of Q2 earnings)

- Community Pharmacy Network segment: sales of JPY108.4bn (+3.8% YoY), segment profit of JPY6.0bn (+2.3% YoY). (Note: from FY03/24, pharmacy development expenses, which were previously booked under Leasing and Facility-related segment, is booked under the Community Pharmacy business. The impact of this change on segment profit is estimated at JPY142mn.)

  The company also set numerical targets for the three subdivisions that support the Community Pharmacy business:
  1) Pharmaceutical Network business: 10,400 network affiliates (+1,488 YoY)
  2) Manufacture and Market Pharmaceuticals business: 5,000 partner pharmacies (+1,263 YoY)
  3) Digital Shift business: 5,300 pharmacies adopting the company's service (+1,909 stores YoY) and 1mn registered users (+360,000 YoY).

- Other three segments (total for Leasing and Facility-related, Meal Catering, and home-visit nursing care): sales of JPY6.1bn (+0.5% YoY), segment profit of JPY115mn (loss of JPY180mn in FY03/23)

- Adjustments: -JPY712mn for sales, -JPY2.6bn for segment profit

Medical fee revision for FY2024

In December 2023, Japan's Ministry of Health, Labour and Welfare announced the medical fee revision for FY2024. The overall revision rate was -0.12%, reflecting a 0.88% increase in medical fees, offset by a 1.00% decrease in drug prices and other fees. To ease the impact on medical institutions and pharmacies, the implementation dates for these revisions have been staggered, with the drug price revision taking effect on April 1 and the medical fee revision taking effect on June 1.

The basic policy for the revision takes into account inflation, wage increases, management situations, the need for securing personnel, and the impact on patient and insurance burdens. Through the revision, the MHLW aims to address challenges surrounding healthcare by establishing a social security system for all generations; strengthening coordination between medical, nursing care, and disability welfare services; and responding to emerging infectious diseases. Furthermore, the MHLW seeks to ensure the quality of healthcare through medical digital transformation (DX) and innovation, secure stability and sustainability for the social security system, and align its measures with Japan's economy and fiscal policy.

Medium-term plan (out May 6, 2022)

The sixth medium-term plan

When reporting FY03/22 results, Medical System Network also released its sixth medium-term plan kicking off in FY03/23. While under the fifth medium-term plan the company sought to expand both market share and the scale of operations, under the new plan it aims to transition to a new stage in which the company's networks form a foundation platform that functions as a new pharmacy infrastructure with group pharmacies at the core but also including affiliates. Medical System Network plans to utilize this platform to pursue growth in various businesses. Quantitative targets for the final year of the plan calls for sales of JPY140.0bn (CAGR of 7.0% over the span of the sixth medium-term plan), operating profit of JPY6.5bn (14.0%), 12,000 network members in the Pharmaceuticals Network business, and 550 community pharmacies (directly operated pharmacies).

Review of the fifth 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. Starting from the fifth medium-term plan, the company changed the plan's term from three years to four years, which would be in line with the cycle of medical treatment fee revisions.

Core strategies of the fifth medium-term plan

The core strategies of the fifth medium-term plan were as follows. The first four were in response to the NHI drug price and dispensing fee revisions implemented in April 2018. The third strategy was linked to the company's full-scale entry into the generic drug business (manufacture and sales), and the company expected earnings contribution from its consolidated subsidiary Feldsenf Pharma, which has 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 aimed to focus on boosting occupancy rates for these units. Also, having made continued investments into these new facilities, the company saw 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 planned 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.

Although the business environment surrounding Medical System Network changed during the fifth medium-term plan because of the spread of COVID-19, the company did not change its basic policy outlined above, even from FY03/20 when the effects of the pandemic were felt strongly. It did, however, revise the sales and profit targets for the plan's final year (FY03/22) to reflect the pandemic's impact.

Final year of the fifth medium-term plan (FY03/22)

The company was unable to fulfill the quantitative targets of its fifth medium-term plan due to the spread of COVID-19. Consolidated sales in FY03/22 (plan's final year) stood at JPY106.7bn versus the JPY120.0bn target, consolidated operating profit was JPY3.9bn versus the JPY5.0bn target, and consolidated EBITDA came to JPY6.7bn versus the JPY7.5bn target. The equity ratio was 21.1% versus the target of at least 30%.

Meanwhile, network members in the Pharmaceuticals Network business continued a steady increase, surpassing the 6,000 mark in FY03/21, well above the plan's target of 5,000. By number of pharmacies, the company captured over 10% of the domestic dispensing pharmacy market. The network member count continued to expand in the final year of FY03/22, reaching a total of 7,401. In addition to business growth in the Pharmaceuticals Network business, profitability improvements at directly managed pharmacies in the Community Pharmacy business contributed to earnings, and the recurring profit margin in the final year reached 4.0%, largely in line with the 4.1% target.

Positioning of the sixth medium-term plan and basic policy

Up until the fifth medium-term plan, the company mainly sought to expand market share and scale of operations under its pharmaceuticals network. As a result of focusing on scale expansion, sales grew 1.9x over the past decade from JPY54.8bn in FY03/13 to JPY106.7bn in FY03/22, with recurring profit increasing 2.3x from JPY1.9bn to JPY4.3bn over the same period.

Medical System Network primarily operates in two areas: pharmaceuticals network (the Pharmaceuticals Network business under the current Community Pharmacy Network segment) and dispensing pharmacies (Community Pharmacy business). Now that its pharmaceuticals network has expanded to account for 10% of the domestic dispensing pharmacy market by number of pharmacies, the company thinks these two businesses have strengthened their correlation, and are evolving into a "platform" for community pharmacies. It maintains that the sixth medium-term plan positions this platform as a foundation based on which the company will seek to expand into new growth areas and further bolster overall scale. In this way, the company plans to transition into a new growth stage and build a new growth model.

The company says the platform, comprising network members with directly operated pharmacies at its core, will function as an infrastructure for community pharmacies. Put differently, the platform can be described as a base formed by the Community Pharmacy business (directly operated pharmacies) overlaid with the Pharmaceuticals Network business, which involves all network members. One of the growth strategies under the sixth medium-term plan seeks to establish multiple layers of new growth businesses over this platform to achieve multifaceted operations. While improving the pharmacy infrastructure, the company will step up efforts to provide quality healthcare, goods, and services, and streamline pharmaceuticals distribution to ensure sustainability of local healthcare and the distribution market.

Another growth strategy under the sixth medium-term plan calls for continued expansion of the platform's base. The company's directly operated pharmacies managed under the Nanohaha Pharmacy brand underwent eliminations, new openings, and acquisitions, and reached a total of 425 locations as of end-FY03/22. Over the four years of the sixth medium-term plan, Medical System Network plans to increase this number to 550 through acquisitions and new openings. At the same time, it will continue to expand network membership, roughly doubling the current member count to 12,000 (including directly operated pharmacies) over the same period. If the company manages to achieve this number, it would capture about 20% of the domestic dispensing pharmacy market (by number of pharmacies). Because boosting network membership leads to an increase in pharmaceuticals transactions, Shared Research understands that an upscaled network will grant the company an even greater presence in pharmaceuticals distribution.

Numerical targets for the sixth medium-term plan

(JPYmn)	Fifth medium-term plan results	Sixth medium-term plan targets
	FY03/22	FY03/26
Consolidated revenue	106,685	140,000
Consolidated operating profit	3,852	6,500
Operating profit margin	3.6%	4.6%
Consolidated EBITDA	6,708	10,000
No. of network members	7,401	12,000
No. of community pharmacies	425	550
Equity ratio	21.1%	30.0%

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 strategies and measures by business category

Medical System Network places its community pharmacies—in other words, the directly operated pharmacy business—at the core of the aforementioned platform. In the first two years of the sixth medium-term plan, the company will seek to establish how individual dispensing pharmacies should play a role in the community-based integrated care systems. The plan is to elevate their functions from a simple "monzen" pharmacy (conveniently located near hospitals) to a family pharmacy, and to a community pharmacy, enhancing the quality of their services by shifting the focal point from objects to people. For example, enhanced services cover centralized and continuous management of medication information, home healthcare support, 24-hour support, and collaboration with various internal and external specialists in the areas of medical care, long-term care, food, and daily care.

The objective for the latter two years of the medium-term plan is to equip the company's pharmacies with the means to function as the central body or a hub supporting local healthcare and community at large. The company will seek to achieve optimization for the area rather than within the boundaries of its own operations. For instance, it will work to share knowledge, human resources, and pharmaceuticals across the community, maximize and jointly use local resources, and expand the network of hub pharmacies. The company's goal is to have the platform provide values and functions needed in the community while also maintaining profitability as a business.

Community Pharmacy

The sixth medium-term plan's principal theme for this business is "be 'the town's beacon of light' supporting local communities and bolster area coverage." Priority measures comprise improving quality and efficiency of store operations to prepare for enhanced interpersonal work (the initiative includes pharmacist training), providing medical care that supports community-based integrated care systems, and strengthening store development capabilities. The company is laying the groundwork to open 25 new pharmacies per year, and says that costs will temporarily precede earnings when it begins spending upfront on these store openings.

Pharmaceuticals Network

The plan's principal theme for this business is "target of 12,000 network members × (distribution improvement + service expansion)." Priority measures include boosting network member count to 12,000 by FY03/26 (the final year of plan), capturing 20% industry share, improving distribution and establishing supply chain management, and contributing to community-based medical care by building an area network.

Manufacture and Market Pharmaceuticals

The plan's principal theme for this business is "stable supply of safe and secure pharmaceuticals to the company's network." Group company Feldsenf Pharma is the main driver of this business. Priority measures include creating a system to ensure quality and safety, building a system to ensure stable supply, and expanding the product lineup and sales channels. The company targets sales of JPY10.0bn in this business in the plan's final year.

Digital Shift

The plan's principal theme for this business is "establishment of pharmacy business infrastructure and expansion to multiple business lines." Priority measures include expanding market share (raising the number of pharmacies using the LINE app-based Tsunagaru Pharmacy service to 20,000 by the plan's final year), upgrading services with highly value-added functions (such as the ability to network with medical institutions and long-term care facilities), and launching new businesses.

Nursing care, long-term care, and nutrition

The plan's principal theme for this business is "deepen cooperation between medical and long-term care." Separate priority measures have been set for nursing care, long-term care, and nutrition. In nursing care, the plan calls for expansion of collaborative opportunities with dispensing pharmacies and development of service locations. In long-term care, the company will roll out home-visit services at its Wisteria series serviced elderly housing facilities. In nutrition, it will pursue expansion in scale and earnings.

Earnings structure to achieve targets; financial outlook

Historically speaking, the company's earnings growth was propelled by expansion of the Pharmaceuticals Network business and profitability improvement in the Community Pharmacy business. However, with the sixth medium-term plan, Medical System Network made a major turn toward proactively opening more pharmacies to further develop the platform structure. Since this means that the company will be making front-loaded spending in the Community Pharmacy business, it expects profit from this business to decline over the span of the medium-term plan. Accordingly it has positioned the three pharmacy support businesses (Pharmaceuticals Network, Manufacture and Market Pharmaceuticals, and Digital Shift) to take on the role of absorbing the earnings drop in the Community Pharmacy business.

In the final year of the plan (FY03/26), the company targets sales of JPY140.0bn, an increase by roughly JPY35.0bn from FY03/22, which it plans to generate in the Community Pharmacy business (+JPY20.0bn) and the pharmacy support businesses (+JPY15.0bn). Meanwhile, the target for operating profit in the final year is JPY6.5bn, up roughly JPY2.7bn from FY03/22. Since the company anticipates operating profit in the Community Pharmacy business to fall due to the burden of upfront opening costs, the three pharmacy support businesses are expected to underpin profit growth, lifting the operating profit margin by 1.0pp as well, by the final year.

In terms of cumulative cash flows over the four years of the medium-term plan, the company expects JPY20.0bn in net cash inflow from operating activities and JPY18.0bn in net cash outflow from investing activities (business development and acquisitions focusing on investment efficiency). The free cash flow of JPY2.0bn will be used mainly to reduce debt (JPY2.0bn in net cash outflow from financing activities). By reducing interest-bearing debts that account for about 60% of total liabilities in FY03/22, the company will seek to achieve equity ratio of 30% by the final year of plan.

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 (Community Pharmacy business*). The dispensing pharmacy support services (Pharmaceuticals Network business**) are highly profitable.
*The former Dispensing Pharmacy segment; currently the Community Pharmacy business under the Community Pharmacy Network segment
**The former Pharmaceuticals Network segment; currently the Pharmaceuticals Network business under the Community Pharmacy Network segment

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), on the condition that they join the company's network. Shared Research understands that the then Dispensing Pharmacy business generated about 30% of operating profit (unadjusted for internal transactions) in FY03/19 while the then 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 and periodically revised by MHLW, which is the governing authority.

Overview of business segments

Medical System Network comprised five business segments until FY03/19, which were consolidated into four business segments in FY03/20. Previously, the mainstay segments were Pharmaceuticals Network and Dispensing Pharmacy, but these two segments were consolidated into the Community Pharmacy Network segment along with the Manufacture and Market Pharmaceuticals business (mainly operated by Feldsenf Pharma) previously included in the former Other business segment. Then in FY03/21 the company added the Family Pharmacy Support Service (operated by PharmaShift Co., Ltd., established on October 1, 2020). As of end-FY03/23, the Community Pharmacy Network segment comprises the four businesses outlined below. 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, Meal Catering, and Other businesses) even after the FY03/23 segment reshuffle. Following the transfer out of the Manufacture and Market Pharmaceuticals business, the main business in the Other business segment is home-visit nursing care. Each business segment continues to be operated by respective core subsidiaries.

Status of affiliated companies

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%
	Nanohana Tohoku Co., Ltd.	Hachinohe, Aomori	100.0%
	Nanohana East Japan Co., Ltd.	Minato-ku, Tokyo	100.0%
	Nanohana Central Co., Ltd.	Nagoya, Aichi	100.0%
	Nanohana West Japan Co., Ltd.	Toyonaka, Osaka	100.0%
	Total Medical Service Co., Ltd.	Kasuya, Fukuoka	100.0%
	Nagatomi Pharmacy Co., Ltd.	Oita, Oita	100.0%
	Feldsenf Pharma Co., Ltd.	Sapporo, Hokkaido	80.0%
Digital Shift	PharmaShift Co., Ltd.	Minato-ku, Tokyo	51.0%
Leasing and Facility-related	Paltecno Co., Ltd.	Sapporo, Hokkaido	100.0%
Meal Catering	Sakura Foods Co., Ltd.	Kasuya, Fukuoka	100.0%
Other	Agrimas Corp. *	Ota-ku, Tokyo	77.7%

Source: Shared Research based on data from the company website.
*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.
***As of September 30, 2022

Community Pharmacy Network

The Community Pharmacy Network business is a new segment created in FY03/20 from consolidating the former Pharmaceuticals Network and Dispensing Pharmacy segments and part of the Other segment (only the Manufacture and Market Pharmaceuticals business). The new Family Pharmacy Support Service business operated by PharmaShift Co., Ltd. was also added from FY03/21. As of FY03/23, the Community Pharmacy Network business comprises four businesses: Community Pharmacy, Pharmaceutical Network, Manufacture and Market Pharmaceuticals, and Digital Shift.

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

Community Pharmacy business (former Dispensing Pharmacy segment)

Business overview

One of the company's core businesses is the Community Pharmacy business (operation of dispensing pharmacies), which corresponds to the former Dispensing Pharmacy business. While the company does not disclose sales and profits for this business, FY03/19 results for the former Dispensing Pharmacy business were sales (to external customers) of JPY90.7bn (92.3% of total sales) and segment profit of JPY1.1bn (33.2%, pre-adjustment basis). Since the company has continued to promote renewal of directly operated pharmacies since then, Shared Research believes that this business accounts for the majority of the company's total sales, and that its operating profit, combined with that from the below-mentioned Pharmaceutical Network business, accounts for the bulk of the company's profits.

The company's directly operated dispensing pharmacies are found in most areas nationwide, although the home base of Hokkaido has the highest concentration followed by the Kanto and Koshinetsu area (for recent regional patterns see the figure Number of network member by region in the Trends and Outlook section). 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. At present, the group's dispensing pharmacies are operated through seven regional consolidated subsidiaries. In terms of operational support, directly operated stores also receive services provided by the below-mentioned Pharmaceutical Network business, as do general affiliates. Another subsidiary, Hokkaido Institute for Pharmacy Benefit Co., Ltd., publishes specialized books for pharmacists and other healthcare professionals and analyzes pharmaceuticals-related data.

Dispensing fees at Community Pharmacy business (companywide basis)

(JPYmn)	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23
Dispensing fees	82,834	89,919	88,320	91,056	93,029
Rate of change	2.5%	8.6%	-1.8%	3.1%	2.2%

Source: Shared Research based on company materials

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 company's directly operated pharmacies, mostly of the Nanohana brand, totaled 428 at end-March 2023. 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. The figure for Medical System Network represents sales of the Community Pharmacy Network segment including the network business. The company has far fewer own-brand outlets than the top-ranking pharmacy chains, but in terms of all network members including affiliates in the company's pharmaceuticals network, the total exceeds the counts of major chains. Medical System Network also ranks among the top five by sales.

Number of dispensing pharmacies

	FY end	Sales (JPYmn)	No. of pharmacies
1 Ain Holdings	April	283,111	1,099
2 Kraft	-	176,200	917
3 Qol	March	155,370	892
4 Toho Holdings	March	92,346	767
5 Sogo Medical Holdings	March	-	740
6 Nihon Chouzai	March	280,164	718
7 Suzuken	March	87,742	577
8 Medical System Network	March	104,366	428
9 Aisei Pharmacy	March	73,700	398
10 Pharmarise Holdings	May	42,038	350

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 May 2023.

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. The company has incorporated these initiatives into its sixth medium-term plan.

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, as shown below. Going forward, the company plans to nationally roll out pharmacies that have achieved these types of operational efficiency, as well as adapting these measures for implentation at affiliates.

- 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.

Pharmaceutical Network business (former Pharmaceuticals Network segment)

Business overview

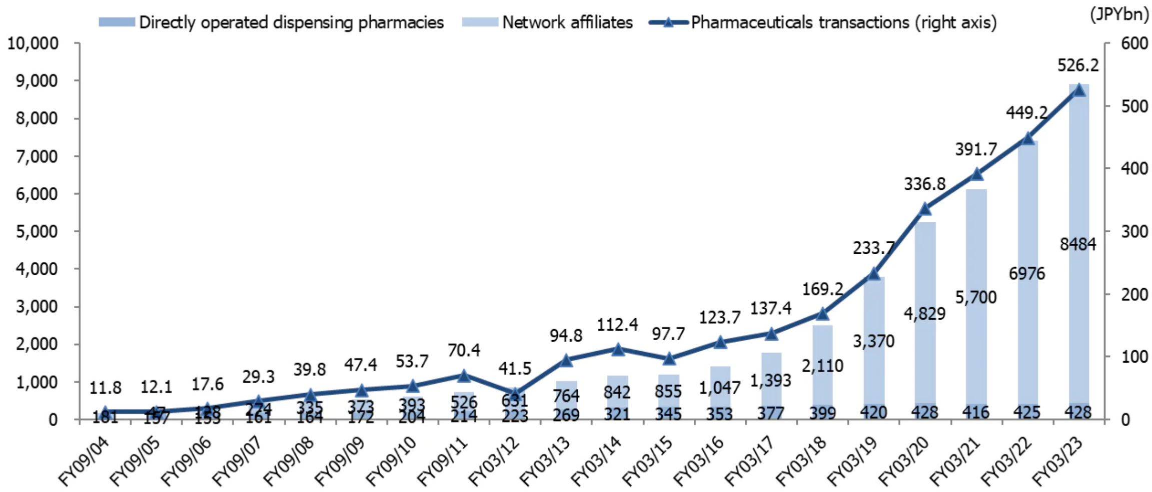
This business provides services that support multiple tasks essential to the operation of dispensing pharmacies, such as pharmaceutical price negotiations, distribution including purchasing, and profit management. These services are first developed for, and provided to, directly operated dispensing pharmacies, but are also provided to general pharmacies for a fee. General dispensing pharmacies must join the company's network to receive this service.

While the company does not disclose sales and profits for this business, FY03/19 results for the former Pharmaceuticals Network segment were sales of JPY4.0bn (1.6% of total sales), of which sales to external customers were JPY1.6bn and inter-segment sales or transfers were JPY2.4bn, and segment profit of JPY2.3bn (72.5%, pre-adjustment basis). The company has since expanded its range of support services and revised membership fees, but Shared Research believes that this business continues to make a significant contribution to segment profit.

General dispensing pharmacies can receive support services by joining the network operated by the company and becoming general network affiliates. The company's network thus consists of directly operated pharmacies and general network affiliates. As shown below, both directly operated pharmacies and general network affiliates continue to increase in number. Growth in the number of general network affiliates has been especially strong, which Shared Research attributes to increasingly tough measures taken by the government each year to curb increases in the nation's medical expenditure. The Ministry of Health, Labour and Welfare now regularly revises drug prices and dispensing fees, and requirements for earning higher dispensing fees, which are an important source of income for dispensing pharmacies, are becoming ever more stringent. This translates to an increasingly tough operating environment for independent dispensing pharmacies not affiliated with any of the major chains.

As of the end of FY03/23, the number of pharmaceutical network member stores (the total of directly operated stores and general network affiliates) was 8,912, for average annual growth of 25% over the past 10 years. According to the Ministry of Health, Labor and Welfare, there were 61,791 dispensing pharmacies in Japan in FY2021, and the share of the company's network member stores exceeded 14%, making it the No. 1 group in Japan. As the number of member stores in the company's network has expanded, the group's pharmaceutical order value similarly has grown to JPY526.2bn (+17.1% YoY) in FY03/23, among the largest in Japan and a significant scale even for a pharmaceutical wholesaler.

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

The core Pharmaceuticals Network business offers comprehensive support for operating dispensing pharmacies, not only distribution support contributing to the sourcing of drugs, but also 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.

(1) Pharmaceuticals supply chain management

Medical System Network determines appropriate transaction prices with drug wholesalers on behalf of its network members. Typically, dispensing pharmacies have to negotiate prices separately with each wholesaler. In contrast, after receiving authorization from its member affiliates, the company determines unit prices per product with wholesalers around the country on their behalf. 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 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.

Since FY03/21, the company's network members—directly operated dispensing pharmacies (the Nanohana Pharmacy chain under the Community Pharmacy business) and affiliates (non-group pharmacies) in its pharmaceuticals network, combined—have accounted for over 10% of the domestic dispensing pharmacy market. Shared Research understands that the company's presence in terms of strength in drug price negotiations is growing.

*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).

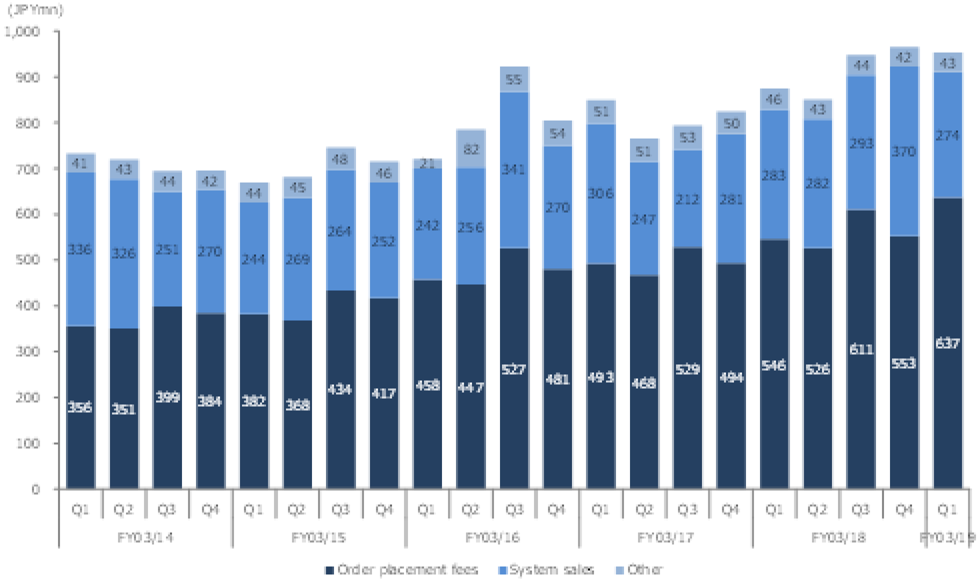
ISK is one of the few private-sector organizations registered as a provider of various certification programs for pharmacists. Medical System Network and ISK help pharmacies run training sessions and apply for accreditation, which enables them to become members of the ISK organization and run JPEC accredited 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.

(Reference) Former Pharmaceuticals Network segment sales



Source: Shared Research based on company data
Notes: Undisclosed from Q2 FY03/19
The former Pharmaceuticals Network segment was integrated into the new Community Pharmacy Network segment from FY03/20

Manufacture and Market Pharmaceuticals business (formerly part of the Other business)

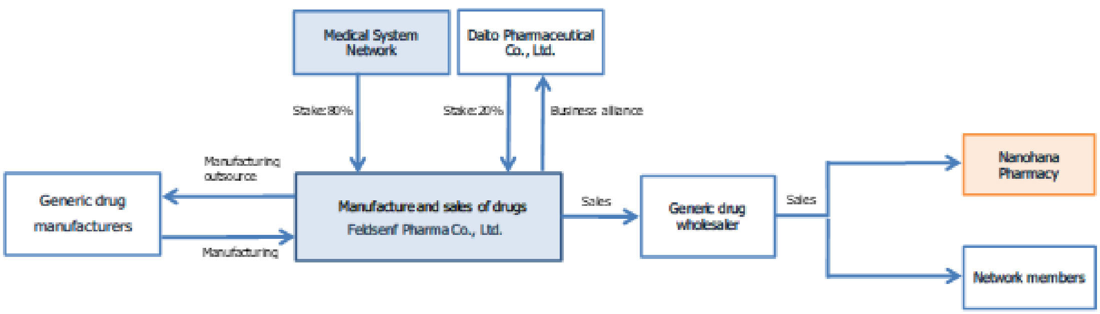
Business overview

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.

Feldsenf Pharma 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. (TSE Prime: 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 affiliates of Medical System Network; in FY03/22, it supplied drugs to 1,698 affiliates. Feldsenf Pharma also has eyes set on expanding its lineup of in-house brand generic drugs in the future to become a supplier first to the company's dispensing pharmacies, then to its affiliates, and then to non-affiliated dispensing pharmacies and medical institutions nationwide.

Feldsenf Pharma's generic drugs supply chain



Source: Shared Research based on company data

Business scale, profit trends

In FY03/19, Feldsenf Pharma started out with 17 active pharmaceutical ingredients (API) across 34 items, and expanded to 45 API across 93 products as of FY03/23. Medical System Network aims to further expand Feldsenf Pharma's product lineup of in-house drugs and sales tie-up products. In addition to first expanding supply of Feldensf Pharma products to its directly operated dispensing pharmacies, the company also has stepped up sales to affiliates members of its network. Sales grew to JPY2.6bn in FY03/23, and the business switched to profits at the operating level in FY03/22, according to the company.

Feldsenf Pharma sales

(JPYbn)	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23
Sales		0.4	1.1	1.8	2.6
Number of items handled	17 ingredients, 34 items	23 ingredients, 51 items	34 ingredients, 68 items	41 ingredients, 82 items	45 ingredients, 93 items

Source: Shared Research based on company data

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; trade name changed to Re:teigi, Inc. following organizational change), a core subsidiary of Digital Holdings (TSE Prime: 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.

The Family Pharmacy Support Service utilizing the official LINE account launched from March 15, 2021. In FY03/23, the number of registered friends (users) roughly doubled YoY to 649,000. The number of directly operated and affiliated pharmacies using the service continues to increase. For dispensing pharmacies, the service offers functions such as centralized management of medication (which could lead to additional medical fee points), medication follow-ups, and online medication guidance, all available on the LINE app. The service apparently is being used more and more for sending prescriptions and providing online medication guidance. Dispensing pharmacies pay a fee for using the service, and the number of pharmacies ordering the service has expanded to 3,787, with the number of pharmacies actually introducing the service rising to 3,391.

According to the company, the number of prescriptions sent to pharmacies that have adopted the service more than doubled 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. The company is encouraging its network members to adopt the service, and plans to establish the system as a standard service of its network at an early stage.

LINE is a messaging application developed and operated by LINE Corporation (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 local dispensing pharmacies, hospitals, and long-term care and childcare facilities surrounding the serviced elderly housing facilities.

The business of serviced housing for the elderly has a large effect on earnings, and occupancy rates have a particularly significant impact. In FY03/23, the number of new residents entering the facilities slowed due to effects from the pandemic, and utility costs increased due to rising energy costs. Thus, although segment sales grew 5.1% YoY to JPY3.5bn, the segment loss was JPY92mn (profit of JPY39mn in FY03/22).

Meal Catering

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, Kumamoto, Miyazaki, and Kagoshima prefectures).

In FY03/23, the number of meals supplied decreased owing to effects from the pandemic, and procurement prices increased. Sales were JPY2.3bn (-1.4% YoY) and the segment loss was JPY65mn (profit of JPY1mn in FY03/22).

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 working in the company's Nanohana Pharmacy chain.

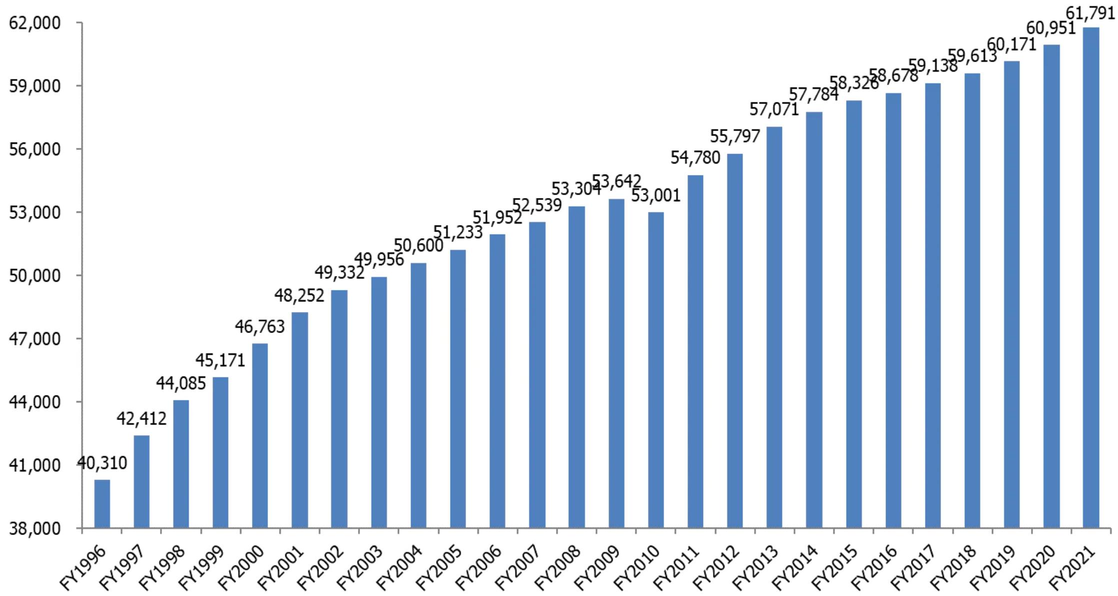
Market and value chain

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% in FY2016 and reached 76.1% in February 2023.

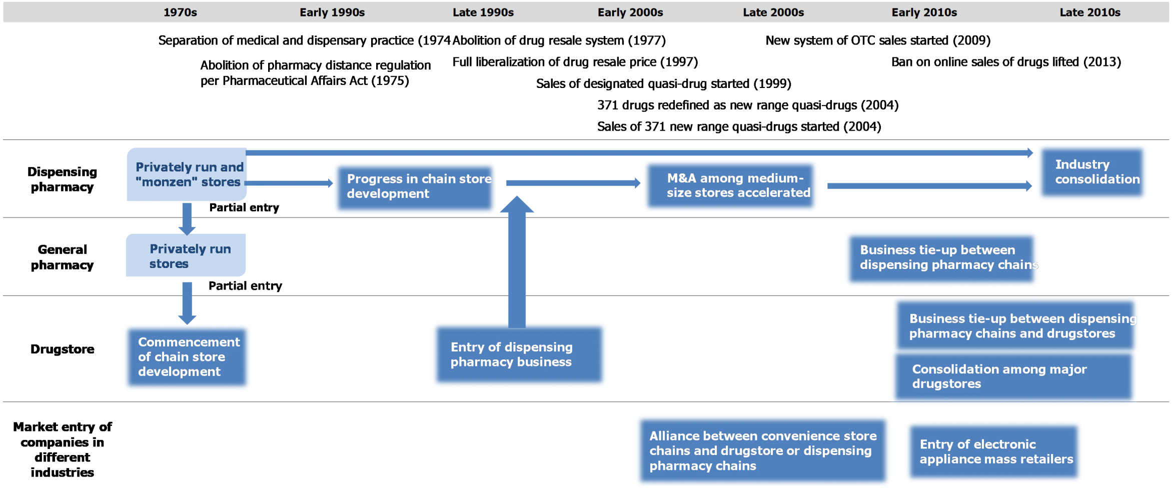
The number of dispensing pharmacies steadily increased as separation of prescribing/dispensing advanced and pharmacies that previously marketed OTC drugs became dispensing pharmacies. There was also a pronounced increase in independent pharmacies operating near large hospitals—so-called "monzen" (Japanese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

Number of dispensing pharmacies



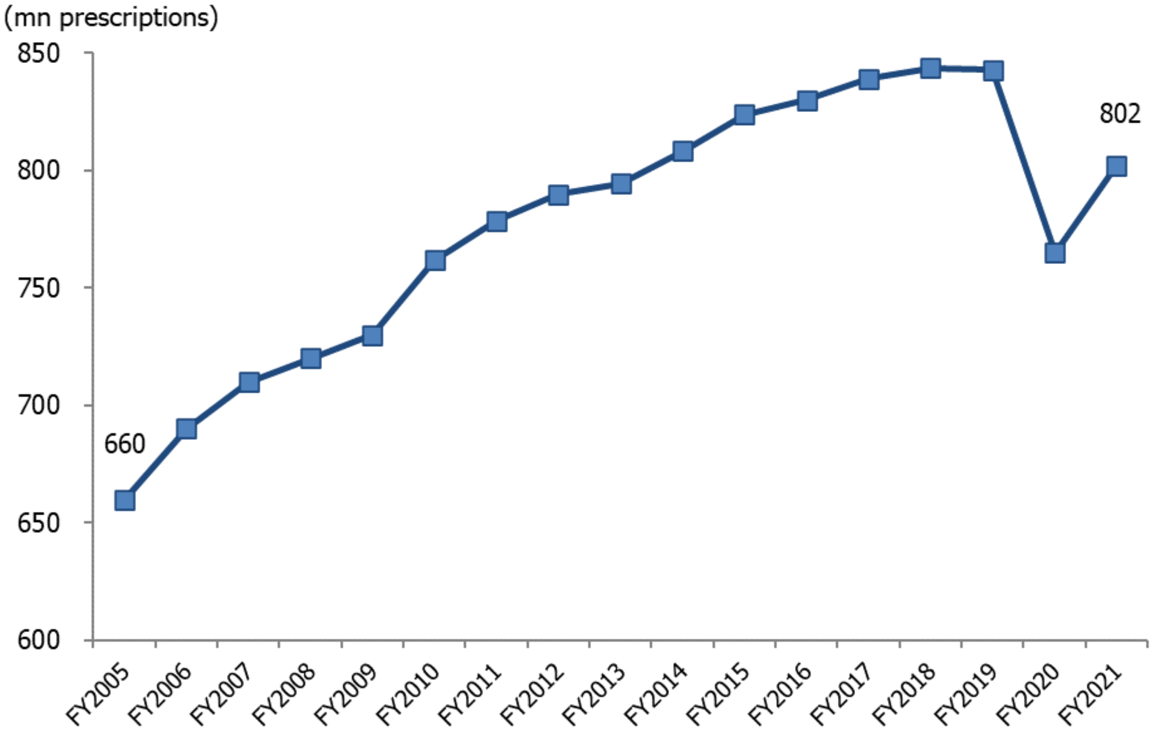
Source: Shared Research based on MHLW's Report on Public Health Administration and Services
Note: 2010 does not include some of Miyagi or Fukushima Prefectures' data.

Developments surrounding dispensing pharmacies



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

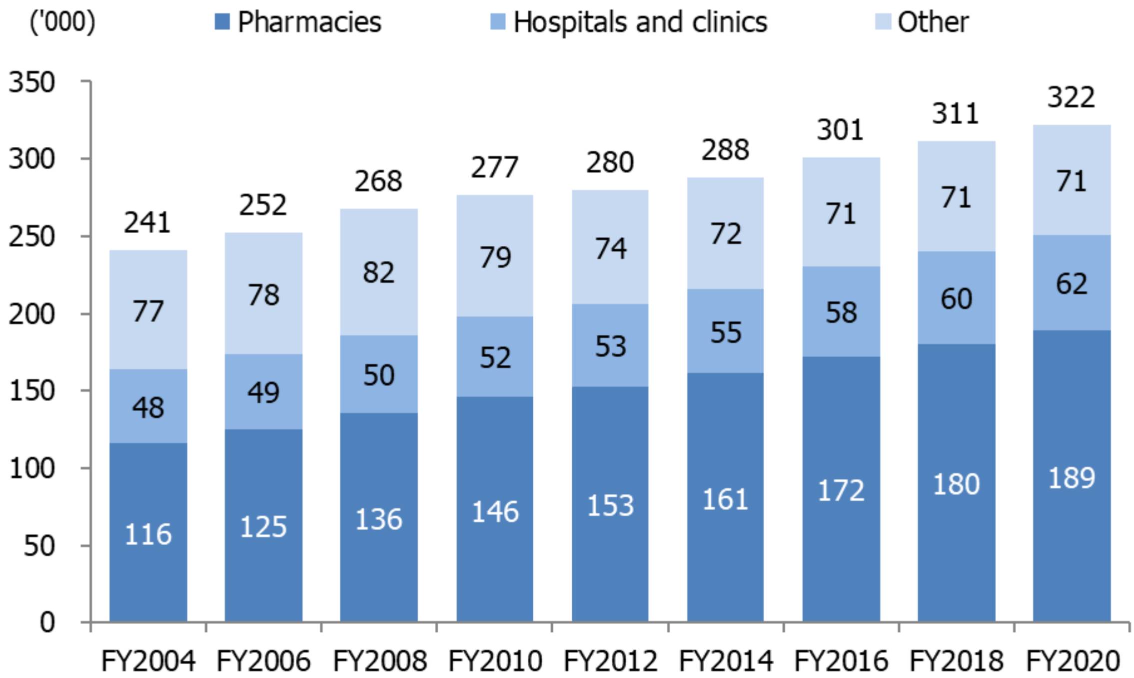
Prescription volume



Source: Shared Research based on MHLW's Trends in Prescription Medicine Costs
Note: Shared Research understands that the volume in FY2020 reflects an increase in long-term prescriptions due to the COVID-19 pandemic.

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

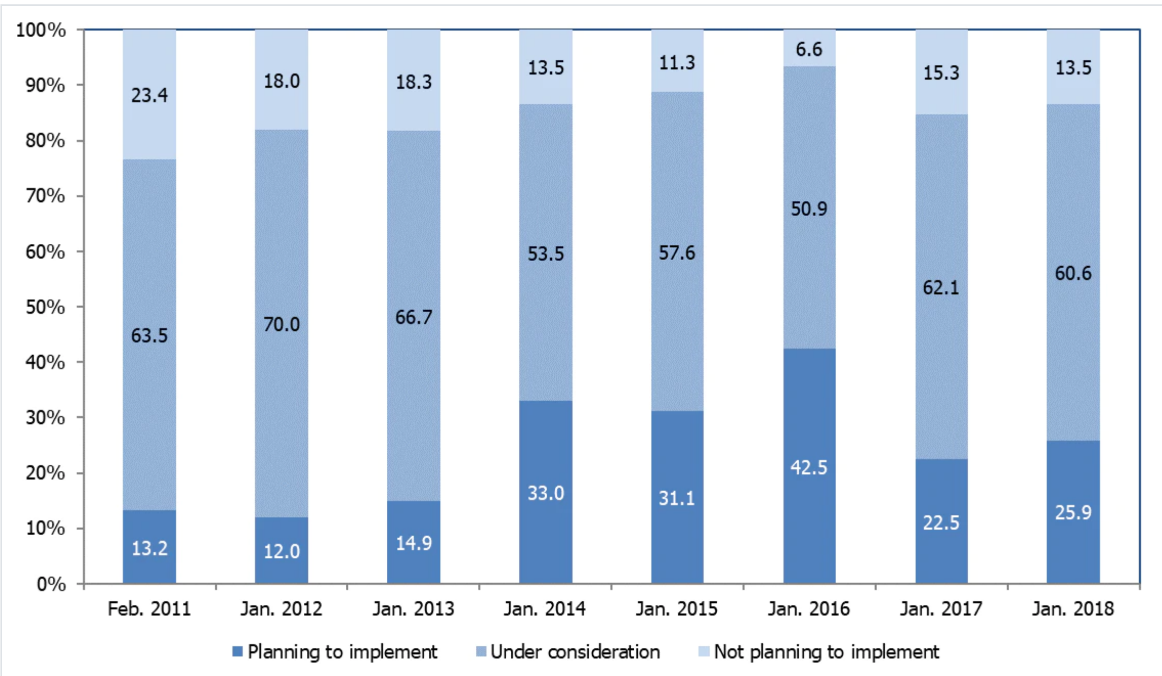
Pharmacist numbers



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

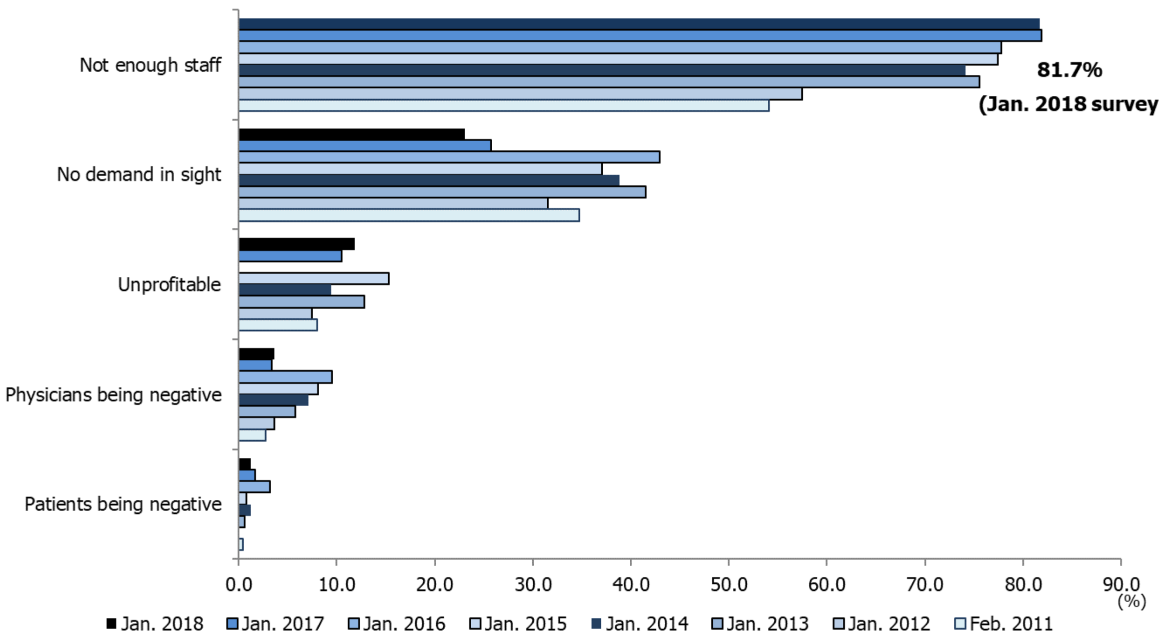
A 2018 Nippon Pharmacy Association (NPhA) survey of member pharmacies showed that the percentage of pharmacies planning to embark on home-based medication management and guidance services, one of the new roles being promoted by MHLW, is not expanding. Most respondents cited labor shortages as the main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

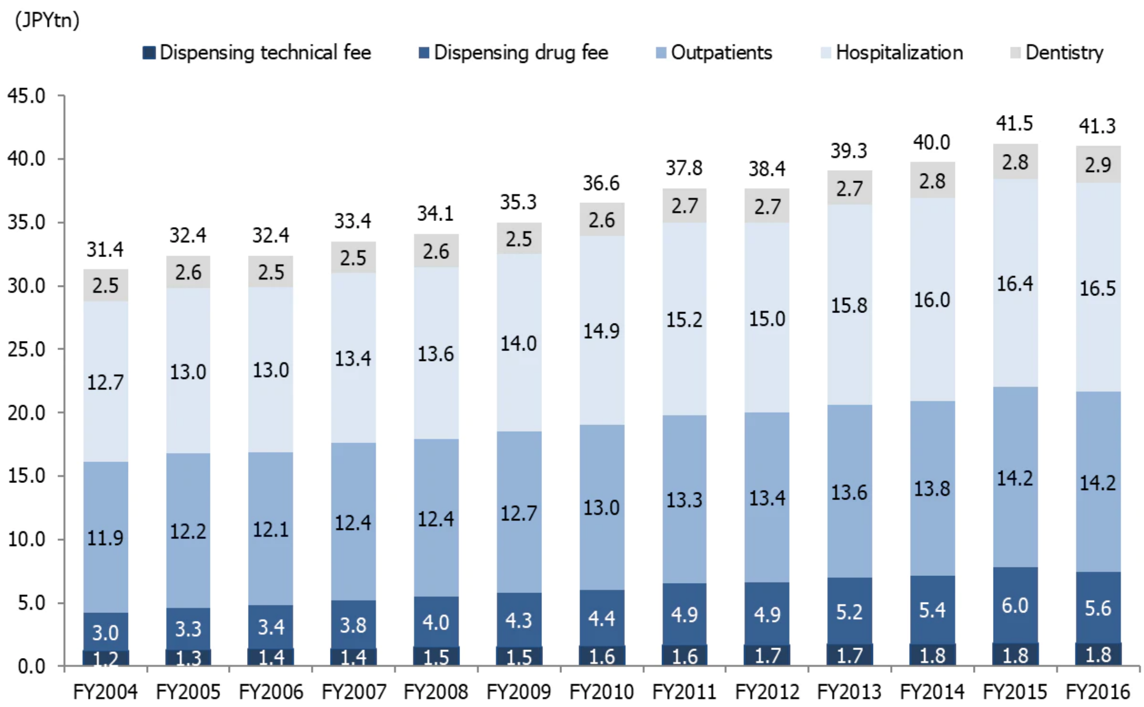
Reasons cited for not providing home-based medication management service



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. In order to practice appropriate healthcare spending as the Japanese population ages, the MHLW is encouraging pharmacies to reduce unnecessary drug use and take on a more patient-centered approach rather than focusing 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 be able to expand their role from just filling prescriptions to providing comprehensive care to patients living in the community as family pharmacies and regional pharmacies. With the functions required of insurance pharmacies expanding in this way, actual responsibility for the associated work lies with the pharmacists working at these pharmacies. This has only served to exacerbate the shortage of the pharmacists needed to perform these important functions.

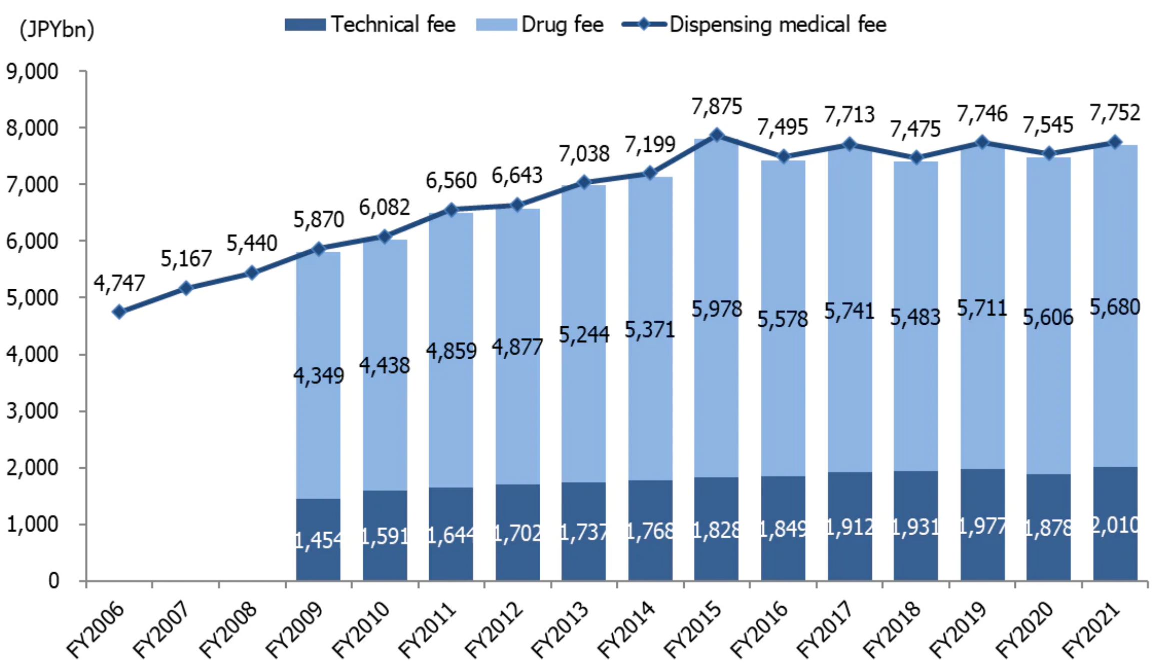
Role of dispensing pharmacies in community-based integrated care system: transforming to family, regional pharmacies

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. Since then, dispensing fees have been further lowered in stages. In addition, faced with concerns of rising medical costs, the government opted to expand the functions of dispensing 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.

However, this trend often works against smaller pharmacies (such as those near large hospitals) that do not belong to major chains, in the sense of increased costs and a shortage of human resources. At a time of virtually flat dispensing fee expenditures, survival for community pharmacies hinges on strengthening family pharmacy functions and services that directly generate 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.

FY2022 medical fee revision

The FY2022 medical fee revision called for a 0.43% increase in medical fee (0.23% increase in core medical fee) and 1.35% reduction in NHI drug prices (official price of medicines).

Net medical fee revision -0.94% = medical fee +0.43% + drug reimbursement price -1.35% +medical materials price -0.02%

The increase in the core medical fee includes +0.26% for medical fees, +0.29% for dental fees, and +0.08% for dispensing fees. In contrast, the reduction in the NHI drug prices includes -1.35% 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.

FY2023 medical fee revisions

The Ministry of Health, Labor and Welfare released information concerning temporary revisions to the medical fee reimbursement system starting from April 1, 2023. Under these temporary revisions, the following three special measures apply. Shared Research understands that the duration of these measures is limited to six or twelve months from April 2023, and that the measures ultimately will lead to higher costs for dispensing pharmacies.

(1) Grace period pertaining to in-principle obligatory introduction of online eligibility verification

A grace period applies when medical institutions and pharmacies covered by insurance are unable to comply with this requirement due to unavoidable circumstances such as system maintenance, network shortcomings, renovation work, and plans to cease/suspend trading. In principle, the grace period extends to the end of September 2023.

(2) Special measures awarding bonus points for introduction and increased uptake of online eligibility verification

Medical care providers already can earn points for performing online eligibility verification at the time of initial consultation and dispensing, but under this new measure awarding bonus points for improving medical information and system infrastructure, the above points have been revised, and points also are awarded at the time of follow-up consultations. The government also has reviewed the calculation method for these bonus points, adding one to two points. This measure is in place from April to December 2023.

(3) Special measures for medical fees to ensure more stable supply of pharmaceuticals

In light of the unstable supply of medicines and from the perspective of prescribing appropriate drugs to patients and promoting cooperation among local pharmacies, one to three additional bonus points are being temporarily awarded for such acts as prescribing generic drugs, promoting greater use of generic drugs, and providing community support systems. This measure is in place from April to December 2023.

Medical fee revision (%)

Year of revision	2002	2004	2006	2008	2010	2012	2014	2016	2018	2020	2022
Core medical fees (actual)	-1.30	±0.00	-1.36	+0.38	+1.55	+1.379	+0.10	+0.49	+0.55	+0.55	+0.43
Dispensing fee	-1.30	+0.00	-0.60	+0.17	+0.52	+0.46	+0.04	+0.17	+0.19	+0.16	+0.08
Drug prices (actual)	-1.40	-1.05	-1.80	-1.20	-1.36	-1.375	-1.36	-1.33	-1.74	-1.01	-1.35
NHI basis	-6.30	-4.20	-6.70	-5.20	-5.75	-6.00	-5.64	-5.57	-7.48	-4.38	-1.44
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	-0.94

Source: Shared Research based on company data

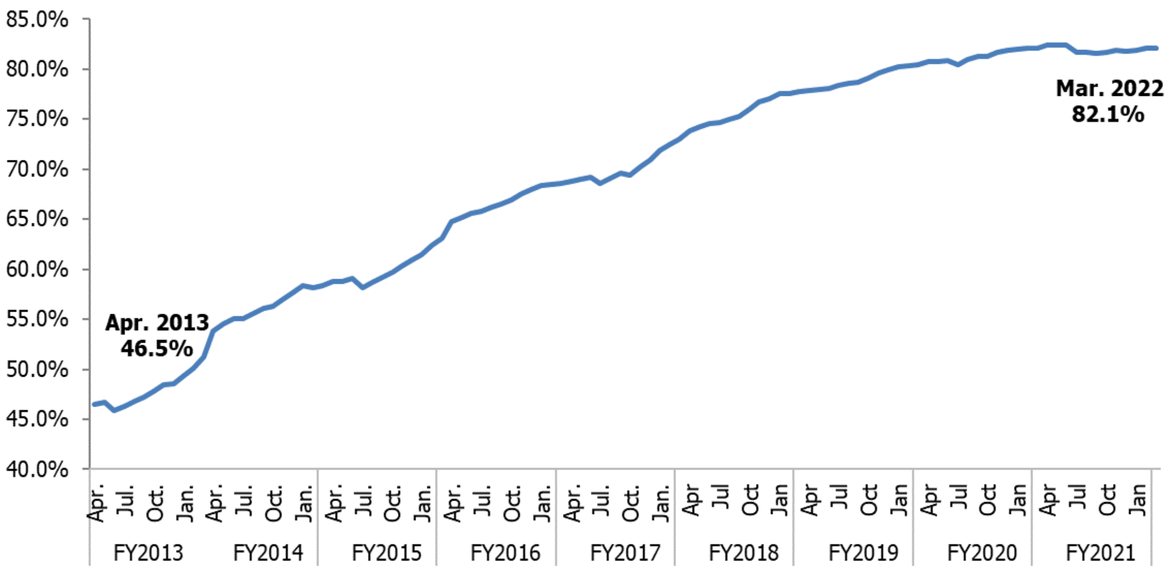
The key point regarding dispensing fees raised around the time of the FY2018 revision is a reassessment of the role of dispensing pharmacies with an emphasis on patient-centered service. Specifically, it promotes evaluation of family pharmacies and pharmacists, patient-centric businesses and at-home 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 12,180drugs 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 (TSE Prime: 9627) had the highest OPM in 2021. 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. The uptrend in the profit margin of Medical System Network's dispensing pharmacy business since FY2019 mainly reflects a change in segmentation.

Comparison of profit margins of industry peers' pharmacy operation segments

Ticker	Company	FY end	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
2796	Pharmarise Holdings	May	2.6%	2.0%	3.5%	2.3%	3.4%	3.4%	4.2%	-
3034	Qol Holdings	March	5.8%	5.1%	6.4%	4.7%	4.7%	6.5%	7.7%	7.4%
3341	Nihon Chouzai	March	5.6%	5.0%	6.0%	4.2%	4.2%	4.3%	4.3%	5.2%
4350	Medical System Network	March	4.2%	2.8%	3.5%	3.6%	3.8%	5.7%	6.0%	5.6%
-	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%	5.1%	4.7%
9627	Ain Holdings	April	9.1%	8.6%	9.5%	7.5%	7.9%	8.0%	8.9%	-

Source: Shared Research based on each company's data and websites (as of end-May 2023)

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: Sales (JPYmn)	Operating profit margin (%)	ROE (%)	Business description
2796	Pharmarise Holdings	51,608	2.9%	7.2%	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	170,036	5.6%	12.2%	Major pharmacy chain. Started as monzen pharmacy. Opened stores with Lawson and Bic Camera. Also developing MR and pharmacist dispatch business.
3341	Nihon Chouzai	313,318	2.4%	9.2%	Second-ranked dispensing pharmacy chain. Nationwide expansion centered on monzen pharmacies in Kanto-Koshinetsu area. Established generic drug manufacturing subsidiary, also developing in-house drugs. Referral & placement of medical staff such as pharmacists.
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	667,647	4.7%	8.8%	Developed drugstore/dispensing pharmacy, Sugi Pharmacy, in its stronghold Tokai area. The holding company also has discount stores.
9627	Ain Holdings	316,247	4.8%	6.0%	Top-ranked dispensing pharmacy chain. Originated in Hokkaido, expanded into metropolitan areas, with nationwide coverage of mainly monzen pharmacies. Concluded capital and business tie-up with Seven & i Holdings.

Source: Shared Research based on company data

Medical System Network (specifically, its Community Pharmacy Network business) ranks among the top ten dispensing pharmacy chains by sales. They all have negative cash flow from investment activities, which Shared Research attributes to their strategies of achieving growth by absorbing smaller local dispensing pharmacies (these smaller pharmacies account for 90% of the market). Shared Research believes that Medical System Network has options for unifying dispensing pharmacies' management styles into a single group: either to integrate pharmacies into the Nanohana Pharmacy group through capital investment (similar to major chains), or allow the smaller pharmacies to continue operating independently and bring them into the company group as affiliates (i.e., network users). By joining the company's network, independently managed dispensing pharmacies can enjoy the same management services as major chains without losing their management rights.

Financials of industry peers

(JPYmn)	Medical System Network(4350)			Pharmarise Holdings (2796)			Qol Holdings (3034)		
	FY03/21	FY03/22	FY03/23	FY05/20	FY05/21	FY05/22	FY03/21	FY03/22	FY03/23
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	104,257	106,685	109,551	51,030	52,324	51,608	161,832	166,199	170,036
Gross profit	42,412	44,429	45,921	7,437	8,067	8,117	21,102	23,163	23,504
SG&A expenses	38,982	40,576	42,758	6,403	6,821	6,596	13,737	13,308	14,009
Operating profit	3,429	3,852	3,163	1,034	1,246	1,520	7,364	9,855	9,495
Recurring profit	3,479	4,313	3,355	1,023	1,288	1,517	7,403	10,094	10,098
Net income	2,198	2,394	1,610	577	426	447	3,365	5,489	5,656
ROE	21.3%	21.1%	21.8%	10.5%	7.3%	7.2%	8.2%	12.9%	12.2%
ROA (RP-based)	5.4%	6.9%	5.1%	4.1%	5.2%	6.3%	7.3%	10.3%	10.2%
Operating profit margin	3.3%	3.6%	2.9%	2.0%	2.4%	2.9%	4.6%	5.9%	5.6%
Total assets	64,448	62,941	66,223	25,206	24,724	23,746	100,571	95,984	101,905
Net assets	11,187	13,286	14,488	5,946	6,331	6,699	41,834	43,881	48,856
Equity ratio	100.0%	102.4%	97.3%	22.6%	24.3%	26.9%	40.9%	45.7%	47.9%
Operating CF	5,205	4,010	4,973	1,572	1,945	713	12,912	10,112	11,662
Investing CF	-1,485	-2,511	-2,114	-734	-1,076	-292	-3,065	-3,087	-7,013
Financing CF	-5,312	-3,415	-2,918	-766	-728	-1,034	-6,114	-10,006	-2,569
Cash and deposits	10,118	8,201	8,141	4,464	4,604	3,991	19,498	16,516	18,596
Interest-bearing debt	32,558	29,566	30,516	10,375	10,251	9,575	29,721	23,282	22,750
Net debt	22,440	21,365	22,375	5,911	5,647	5,584	10,223	6,766	4,154

	Nihon Chouzai (3341)			Sugi Holdings (7649)			Ain Holdings (9627)		
	FY03/21	FY03/22	FY03/23	FY02/21	FY02/22	FY02/23	FY04/20	FY04/21	FY04/22
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	278,951	299,392	313,318	602,850	625,477	667,647	292,615	297,305	316,247
Gross profit	49,374	52,422	53,643	181,631	191,490	202,524	46,861	46,155	49,971
SG&A expenses	41,267	45,833	46,057	147,590	159,353	170,865	30,793	35,222	34,832
Operating profit	8,106	6,589	7,586	34,041	32,137	31,658	16,068	10,932	15,139
Recurring profit	8,409	6,767	7,682	35,333	33,082	32,391	16,822	12,649	16,041
Net income	3,538	3,705	4,458	21,120	19,389	19,007	9,179	6,697	7,092
ROE	7.3%	7.2%	9.2%	11.0%	9.4%	8.8%	8.5%	5.9%	6.0%
ROA (RP-based)	4.5%	3.7%	4.2%	10.7%	9.7%	9.4%	8.8%	6.4%	7.7%
Operating profit margin	2.9%	2.2%	2.4%	5.6%	5.1%	4.7%	5.5%	3.7%	4.8%
Total assets	186,262	178,753	185,297	345,933	334,758	351,895	193,451	203,662	212,461
Net assets	49,868	52,876	56,483	200,629	213,890	216,538	111,003	115,837	119,010
Equity ratio	26.8%	29.6%	30.5%	58.0%	63.9%	61.5%	57.3%	56.8%	56.0%
Operating CF	11,213	19,411	7,532	34,027	7,174	38,279	17,747	14,928	26,156
Investing CF	-7,767	-9,313	-10,018	-29,254	-23,892	-23,256	-11,474	-9,493	-13,943
Financing CF	-2,806	-17,448	713	-5,274	-5,295	-14,209	-7,837	3,643	-7,753
Cash and deposits	32,893	25,543	23,770	55,845	33,831	34,622	45,931	55,009	59,470
Interest-bearing debt	44,365	42,806	45,736	0	0	0	6,074	12,004	8,467
Net debt	11,472	17,263	21,966	-55,845	-33,831	-34,622	-39,857	-43,005	-51,003

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 businesses pursuing M&A-driven pharmacy chain expansion and those offering 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 virtually flat YoY in FY03/23. 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	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23
(JPYmn)	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	**66,182**	**75,548**	**87,715**	**88,865**	**93,977**	**98,232**	**105,241**	**104,257**	**106,685**	**109,551**
YoY	20.7%	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%	-0.9%	2.3%	2.7%
Cost of sales	43,445	47,072	54,913	54,700	57,369	60,961	65,027	61,845	62,256	63,630
Gross profit	**22,737**	**28,476**	**32,801**	**34,164**	**36,607**	**37,271**	**40,214**	**42,412**	**44,429**	**45,921**
YoY	17.1%	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%	5.5%	4.8%	3.4%
Gross profit margin	34.4%	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%	40.7%	41.6%	41.9%
SG&A expenses	20,646	25,835	29,018	32,050	33,444	35,842	38,599	38,982	40,576	42,758
SG&A ratio	31.2%	34.2%	33.1%	36.1%	35.6%	36.5%	36.7%	37.4%	38.0%	39.0%
Operating profit	**2,091**	**2,641**	**3,783**	**2,113**	**3,163**	**1,428**	**1,615**	**3,429**	**3,852**	**3,163**
YoY	2.2%	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%	112.3%	12.3%	-17.9%
Operating profit margin	3.2%	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%	3.3%	3.6%	2.9%
Non-operating income	250		457	275	378	405	288	361	758	550
Non-operating expenses	321	349	380	279	291	333	343	312	296	358
Recurring profit	**2,020**	**2,540**	**3,860**	**2,109**	**3,250**	**1,501**	**1,560**	**3,479**	**4,313**	**3,355**
YoY	5.6%	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%	123.0%	24.0%	-22.2%
Recurring profit margin	3.1%	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%	3.3%	4.0%	3.1%
Extraordinary gains	155	169	88	57	19	49	48	914	146	7
Extraordinary losses	404	415	470	260	976	128	1,586	426	447	343
Income taxes	1,073	1,315	1,599	1,262	1,271	962	918	1,769	1,624	1,389
Implied tax rate	60.6%	57.3%	46.0%	66.2%	55.4%	67.7%	4,172.7%	44.6%	40.5%	46.0%
Net income attributable to non-controlling interests	29	92	158	72	0	-2	0	0	0	0
Net income	**668**	**885**	**1,720**	**571**	**1,022**	**462**	**-895**	**2,198**	**2,394**	**1,610**
YoY	-11.6%	32.4%	94.4%	-66.8%	79.0%	-54.8%	-293.7%	-345.6%	8.9%	-32.7%
Net margin	1.0%	1.2%	2.0%	0.6%	1.1%	0.5%	-0.9%	2.1%	2.2%	1.5%

Source: Shared Research based on company data

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

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 (currently, Community Pharmacy business). In FY03/22, the operating profit margin improved thanks to a boost in the number of network members and further profitability improvement in the Community Pharmacy business (name changed from Dispensing Pharmacy business). In FY03/23, however, the operating profit margin was below 3% due to increases in personnel, utilities, and other costs.

SG&A expenses

SG&A expenses	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22
(JPYmn)	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Salaries and allowances	7,489	9,266	10,406	12,088	12,481	13,467	14,195	14,435	15,301
Provision for employee bonuses	724	939	1,062	1,133	1,418	1,333	1,393	1,486	1,526
Retirement benefit expenses	195	264	329	361	466	457	596	566	576
Provision for directors' bonuses	68	76	55	47	35	33	41	42	39
Provision for directors' stock benefits			33	52	38	33	35	29	32
Taxes and dues	2,350	3,870	4,479	4,374	4,420	4,692	5,691	5,818	6,068
Depreciation	802	945	1,029	1,052	1,491	1,624	1,811	1,859	1,727
Amortization of goodwill	669	849	917	1,009	1,056	1,147	1,217	1,136	1,128
Other	6,612	7,537	8,486	9,630	9,559	15,827	16,648	16,606	14,179
Total	20,646	25,835	29,018	32,050	33,444	35,842	38,599	38,982	40,576

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	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23
(JPYmn)	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Assets										
Cash and deposits	3,106	2,499	2,081	2,252	10,201	11,703	11,722	10,118	8,201	8,141
Notes and accounts receivable	2,802	2,484	2,614	2,223	2,332	2,420	2,313	2,646	2,891	3,437
Inventories	2,732	3,846	3,431	4,053	3,520	4,297	4,452	4,408	4,780	5,179
Other	664	709	927	958	868	1,528	940	994	1,435	2,017
Allowance for doubtful accounts	-6	-7	-7	-10	-11	-12	-12	-12	-3	-11
Total current assets	**10,941**	**11,023**	**10,783**	**11,098**	**18,736**	**21,055**	**20,578**	**19,313**	**18,701**	**20,265**
Total tangible fixed assets	**15,976**	**17,249**	**20,253**	**21,246**	**24,129**	**25,721**	**25,126**	**24,634**	**24,624**	**27,060**
Total intangible assets	**12,399**	**13,554**	**13,481**	**13,833**	**15,045**	**16,235**	**14,615**	**13,572**	**12,767**	**11,807**
Investment securities	179	157	524	583	812	726	483	397	155	159
Long-term loans receivable										
Other	3,645	3,631	3,838	4,008	4,066	5,217	5,686	6,549	6,712	6,950
Allowance for doubtful accounts	-26	-29	-33	-32	-31	-21	-26	-20	-19	-19
Investment and other assets	**3,798**	**3,759**	**4,329**	**4,559**	**4,847**	**5,922**	**6,143**	**6,926**	**6,848**	**7,090**
Total fixed assets	**32,173**	**34,564**	**38,063**	**39,639**	**44,023**	**47,879**	**45,885**	**45,134**	**44,239**	**45,958**
Total assets	**43,114**	**45,587**	**48,847**	**50,737**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**
Liabilities										
Notes and accounts payable	7,798	8,598	9,525	9,144	9,416	10,198	10,021	9,258	9,680	9,937
Short-term debt	12,922	9,214	6,910	3,863	7,463	9,158	8,905	10,210	5,935	6,377
Income taxes payable	578	599	1,065	413	1,135	695	454	1,556	617	600
Other	3,582	3,215	3,561	3,500	3,755	3,793	3,916	4,394	4,203	4,435
Total current liabilities	**24,880**	**21,626**	**21,061**	**16,920**	**21,769**	**23,844**	**23,296**	**25,418**	**20,435**	**21,349**
Long-term debt	10,948	15,391	14,859	20,186	26,329	29,739	28,653	22,348	23,631	24,139
Deferred tax liabilities	1	1	1	1						
Other	1,933	2,434	2,660	2,985	4,075	4,590	5,096	5,493	5,588	6,246
Total fixed liabilities	**12,882**	**17,826**	**17,520**	**23,172**	**30,404**	**34,329**	**33,749**	**27,841**	**29,219**	**30,385**
Total liabilities	**37,762**	**39,452**	**38,581**	**40,092**	**52,174**	**58,173**	**57,045**	**53,260**	**49,654**	**51,735**
Net assets										
Capital stock	1,091	1,091	1,932	1,932	2,097	2,128	2,128	2,128	2,128	2,128
Capital surplus	901	901	1,742	1,742	1,160	1,185	1,183	1,182	1,182	1,182
Retained earnings	4,300	4,980	6,467	6,735	7,459	7,616	6,414	8,305	10,393	11,606
Treasury stock	-1,181	-1,147	-328	-302	-275	-233	-206	-344	-326	-326
Valuation differences on securities	2	11	15	49	143	83	-37	-24	-7	-2
Other	-31	-28	-17	23	52,316	58,239	56,945	53,154	49,547	51,596
Non-controlling interests	273	338	469	514	2	0	0	23	17	37
Total net assets	**5,352**	**6,136**	**10,265**	**10,644**	**10,584**	**10,761**	**9,418**	**11,187**	**13,286**	**14,488**
Total liabilities and net assets	**43,114**	**45,588**	**48,846**	**50,736**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**
Working capital	-2,265	-2,268	-3,480	-2,868	-3,564	-3,481	-3,256	-2,204	-2,009	-1,321
Total interest-bearing debt	23,870	24,605	21,769	24,049	33,792	38,897	37,558	32,558	29,566	30,516
Net debt	20,763	22,120	19,708	21,814	23,591	27,194	25,836	22,440	21,365	22,375

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. In FY03/22, the company continued to reduce assets through absorption of Home-visit Nursing Care Station Himawari Co., Ltd. among other means. In FY03/23, tangible fixed assets increased due to store development centered on medical malls.

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 and FY03/22, and although interest-bearing debt declined YoY in both years, it was more or less flat in FY03/23.

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, and of its sixth medium-term plan unveiled together with the announcement of FY03/22 results. In FY03/23, net assets increased due to an increase in retained earnings.

Cash flow statement

Cash flow statement	FY03/14	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23
(JPYmn)	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Cash flows from operating activities (1)	3,706	3,838	6,409	3,084	6,699	2,840	4,232	5,205	4,010	4,973
Pre-tax profit	1,770	2,294	3,479	1,906	2,293	1,422	22	3,967	4,012	3,019
Depreciation	1,077	1,209	1,362	1,594	1,491	1,624	1,811	1,859	1,727	1,825
Amortization of goodwill	669	849	917	1,009	1,056	1,147	1,217	1,136	1,128	1,132
Change in trade receivables	382	935	191	812	496	500	285	-239	-214	-505
Change in inventories	-173	-689	455	-472	759	-620	-140	72	-406	-377
Change in trade payables	365	-295	683	-765	-569	69	-328	-864	400	211
Cash flows from investing activities (2)	-7,559	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383	-1,485	-2,511	-2,114
Purchase of tangible fixed assets	-4,180	-2,360	-3,674	-2,170	-4,050	-3,094	-1,351	-1,375	-1,934	-1,373
Purchase of intangible assets	-44	-93	-273	-192	-190	-82	-107	-154	-194	-234
Purchase, sale, and redemption of investment securities	129		-267	-19	-39	-16	102	18	379	
Change in shares resulting in change in scope of consolidation		-1,626	-304	-1,725	-2,576	-2,898	-583	-8	-209	-54
Change in loans (short- and long-term; net)	-56	-106	-106	-38	-95	-3	-102	-233	7	
Free cash flow (1+2)	**-3,853**	**-120**	**1,369**	**-825**	**-149**	**-3,081**	**1,849**	**3,720**	**1,499**	**2,859**
Cash flows from financing activities	4,864	-483	-1,792	998	8,050	4,338	-1,687	-5,312	-3,415	-2,918
Change in short-term borrowings	7,255	-4,334	-2,314	-3,241	2,598	1,471	-505	0	-2,901	
Change in long-term borrowings	-250	4,816	-896	5,292	7,292	3,701	-376	-4,634	33	-2,269
Acquisition of treasury stock	-1,155		1,005	0						
Dividends paid	-221	-190	-229	-297	-297	-304	-305	-304	-304	-395

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 increased YoY in FY03/20 and FY03/21 as earnings recovered. In FY03/22, operating cash flow fell YoY again due to an increase in inventories and income taxes paid accompanying earnings recovery. In FY03/23, operating cash flow increased due to a decline in corporate tax payments.

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 has aimed to make its network system an industry standard by expanding the number of affiliates and to improve profitability of the directly operated pharmacy business. Accordingly, in the third to fifth medium-term plans, it focused on profitability improvements in these mainstay businesses. Since the company's businesses call for front-loaded spending by nature, free cash flow has been negative up to FY03/19, with the exception of FY03/16 when free cash flow turned positive due to temporary factors that sharply lifted profits. From FY03/20 onward, free cash flow has remained positive owing to selective engagement in M&A and pretax profits.

Cash flows from financing activities

Financing will be indispensable as the company looks to continue expanding its business. In addition to using internal funds, the company raises funds through short- and long-term borrowing. We list the relatively large-scale financings of the past 10 years below. Most were 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. Under better financial standing, the company reduced its interest-bearing debts, particularly short-term borrowings, in FY03/22. In FY03/22, interest-bearing debt was roughly flat YoY.

Historical performance

1H FY03/24 results (out November 7, 2023)

Overview

1H FY03/24 (April—September 2023) earnings results

- Sales: JPY56.4bn (+5.9% YoY)
- Operating profit: JPY1.7bn (+55.8% YoY)
- Recurring profit: JPY1.7bn (+36.2% YoY)
- Net income attributable to owners of the parent: JPY861mn (+71.5% YoY)

Operating results and business conditions

1H sales amounted to JPY56.4bn (+5.9% YoY), surpassing the company's initial 1H forecast of JPY54.7bn by JPY1.8bn. This was primarily due to higher-than-expected sales in the Community Pharmacy Network segment, which exceeded the forecast by JPY1.8bn. Although the Community Pharmacy business experienced a decline in the price per prescription due to off-year NHI drug price revisions and the end of transitional measures for community support system premiums, the number of prescriptions filled increased. This can be attributed to patients feeling more comfortable seeking medical consultations, following the downgrading of COVID-19 to a Class V infectious disease. Additionally, the Pharmaceutical Network business experienced steady growth in the number of new network affiliates, as well as an expansion in the total value of pharmaceutical orders placed by these affiliates.

Gross profit was JPY23.5bn (+5.1% YoY), with a GPM of 41.5% (-0.3pp YoY). Although the increase in the number of prescriptions in the Community Pharmacy business resulted in higher sales and gross profit, the GPM declined due to a decrease in technical fees charged per prescription, following the termination of transitional measures for community support system premiums. Despite increased sales, SG&A expenses remained at JPY21.7bn (+2.5% YoY), as the company managed to contain personnel costs at its directly operated pharmacies. As a result, operating profit rose 55.8% YoY. The OPM improved 0.9pp YoY to 3.0%, and EBITDA reached JPY3.2bn (+28.0% YoY). The improved OPM was mainly due to company-wide efforts to improve productivity and contain various expenses. (Note: Starting from Q1, the costs of the business development division, which were previously allocated to the Leasing and Facility-related Segment, have been transferred to the Community Pharmacy Network Segment due to the decision to focus on pharmacy development.)

Progress against the company's initial 1H forecast was 103.3% for sales, 214.0% for operating profit, 225.6% for recurring profit, and 344.4% for net income. Based on the significantly better-than-expected 1H results, the company has upwardly revised its full-year earnings forecast (See "Company forecast for FY03/24" below).

Segment results

1H FY03/24 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY53.8bn (+5.9% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY2.9bn (+23.6% 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.

Community Pharmacy

Dispensing revenue totaled JPY47.9bn (+5.5% YoY) in 1H. The price per prescription dropped 0.3% YoY to JPY10,033, due to the impact of off-year NHI drug price revisions and the end of the transitional measures for community support system premiums. However, the number of prescriptions filled increased 5.8% YoY to 4,777, as patients felt more at ease with seeking medical consultations following the downgrading of COVID-19 to a Class V infectious disease. The outbreak of several respiratory infections, and the use of digital technologies, such as the transmission of prescriptions via LINE, also boosted prescription volumes. The growth in prescription volumes was a primary factor contributing to the higher-than-expected operating profit in 1H. In an effort to improve the efficiency of its pharmaceutical ordering operations and address drug shortages, Medical System Network has rolled out its proprietary new inventory management system, LINCLE, to all directly operated pharmacies. It is also testing the system with some network affiliates.

During 1H, the company opened eight community pharmacies, including four inside medical malls. As of end-September 2023, the company had 434 community pharmacies, one in-home care plan support center, and 10 cosmetics/drug stores.

Pharmaceuticals Network

The number of new network affiliates fell short of expectations, but still grew steadily. The total value of pharmaceutical orders placed by network affiliates also expanded, driving the higher profits in the Community Pharmacy Network segment. According to the company, the lower-than-expected number of new network affiliates was due to some pharmacies postponing joining the network in view of the industry trends concerning drug price negotiations. To enhance the functionality of its pharmacy network, the company launched a service in September 2023 that allows network affiliates to share pharmaceutical inventory information with each other. The aim of this service is to effectively distribute pharmaceutical inventory among network affiliates in the same region. Medical System Network completed a patent application for this service in August 2023.

As of end-September 2023, pharmaceutical network affiliates totaled 9,374 (+462 from end-FY03/23), comprising 434 directly operated pharmacies and 8,940 affiliates. The value of pharmaceutical orders placed by network affiliates totaled JPY303.5bn (+21.7% YoY).

Manufacture and Market Pharmaceuticals

In this business, the company group aims to provide a stable supply of good-quality, low-priced generic drugs. The company offered 98 products (47 ingredients) as of end-September 2023. While the company stopped accepting orders for some products due to the impact of shipment adjustments, the total number of partner pharmacies (including group pharmacies, general network affiliates, and other customers) grew to 3,894 (+663 YoY). Sales of Feldsenf Pharma, the core subsidiary of the segment, reached JPY1.4bn (+5.4% YoY, including sales to the company's directly operated pharmacies).

Digital Shift

The company established subsidiary PharmaShift Co., Ltd. on October 1, 2020, to create a "new pharmaceutical platform" for the digital age. In March 2021, the subsidiary launched the "Tsunagaru Pharmacy" service utilizing its official LINE account. As of end-September 2023, the number of pharmacies using the service was 4,195 (+804 from end-FY03/23). PharmaShift, the core subsidiary in this segment, dissolved its joint venture with Re:teigi and became a wholly owned subsidiary of the company as of November 30, 2023.

Leasing and Facility-related

- Segment sales: JPY1.7bn (+0.8% YoY)
- Segment profit: JPY69mn (versus loss of JPY65mn in 1H FY03/23)

Operating conditions of serviced elderly housing facilities

Segment sales grew 0.8% YoY, driven by a steady increase in management fee income from managed properties. The segment remained profitable in Q2 for the second consecutive quarter. This was attributed to the transfer of the pharmacy development costs of the business development division to the Community Pharmacy Network segment (the actual amount transferred was JPY78mn) and the review of staff allocation and advertising expenses for the Wisteria serviced residence for the elderly. As of end-September 2023, the company reported stable occupancy rates at three of its five properties (the total occupancy rate at the five serviced residences for the elderly stood at 82.1%), while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 67.1% (with 55 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).

Meal Catering

- Segment sales: JPY1.2bn (+4.8% YoY)
- Segment loss: JPY23mn (versus loss of JPY33mn in 1H FY03/23)

Lower sales and operating loss

While sales grew owing to a revision of the contract unit price, the gross profit margin declined due to rising purchase prices. The segment remained in the red as a result.

Other (mostly home-visit nursing care)

- Segment sales: JPY155mn (+2.8% YoY)
- Segment loss: JPY20mn (versus a loss of JPY10mn in 1H FY03/23)

Q1 FY03/24 results (out August 8, 2023)

Overview

Q1 FY03/24 (April—June 2023) earnings results

- Sales: JPY27.7bn (+5.2% YoY)
- Operating profit: JPY451mn (+29.6% YoY)
- Recurring profit: JPY410mn (+4.6% YoY)
- Net income attributable to owners of the parent: JPY148mn (+62.6% YoY)

Q1 sales and operating profit

Sales rose 5.2% YoY. Sales in the mainstay Community Pharmacy Network segment amounted to JPY26.4bn (+5.2% YoY), accounting for 95.3% of the total sales (before segment adjustments). Although the price per prescription fell in the Community Pharmacy business owing to the impact of off-year NHI drug price revisions and the end of the transitional measures for community support system premiums, the number of prescriptions filled exceeded the company's expectations, as patients felt more at ease with seeking medical consultations following the downgrading of COVID-19 to a Class 5 infectious disease. Further, in the Pharmaceutical Network business, the number of new network affiliates grew steadily.

Gross profit came in at JPY11.4bn (+3.4% YoY), with a GPM of 41.3% (-0.8pp YoY). This was primarily due to a lower profit margin in the Community Pharmacy business due to the impact of the drug price revisions and a drop in technical fees per prescription. However, by containing SG&A expenses to JPY10.9bn (+2.5% YoY), the company achieved operating profit growth of 29.6% YoY. EBITDA was 13.3% higher YoY at JPY1.2bn.

Segment results

Q1 FY03/24 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY26.4bn (+5.2% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY1.1bn (+6.2% YoY)
- Starting from Q1, the costs of the business development division, which were previously allocated to the Leasing and Facility-related segment, have been transferred to the Community Pharmacy Network segment due to the decision to focus on pharmacy development. The amount transferred was JPY46mn.
- This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (operated by Feldsenf Pharma) previously included in Other. A digital shift business that utilizes instant messaging app LINE was added to the segment from FY03/21. The company does not disclose sales and operating profit by business (subsegment) within the Community Pharmacy Network segment.

Community Pharmacy

Dispensing fee revenue in Q1 amounted to JPY23.5bn (+4.8% YoY) on an all-store basis. On a comparable store basis, dispensing fee revenue grew 3.3% YoY. Although the price per prescription fell due to the impact of off-year NHI drug price revisions and the end of the transitional measures for community support system premiums, the number of prescriptions filled increased, as patients felt more at ease with seeking medical consultations following the downgrading of COVID-19 to a Class 5 infectious disease. During Q1, the company opened two community pharmacies, including one inside a medical mall. As of end-June 2023, the company had 430 community pharmacies, one in-home care plan support center, and nine cosmetics/drug stores.

Pharmaceuticals Network

As of end-June 2023, pharmaceutical network members totaled 9,172 (+260 from end-FY03/23), comprising 430 directly operated pharmacies and 8,742 affiliates. Network membership expanded due to the company's efforts to improve distribution and growing interest in its management support services. However, in view of the progress of drug price negotiations and other factors, some pharmacies postponed joining the network, resulting in the number of new affiliates in Q1 slightly falling below the company's plan. Nevertheless, the group's pharmaceutical order value increased to JPY149.4bn (+20.9% YoY), driven by an uptick in the number of prescriptions at both directly operated pharmacies and affiliates. Network fee income rose in line with order growth.

Manufacture and Market Pharmaceuticals

In this business, the company group aims to provide a stable supply of high-quality, low-priced generic drugs. As of end-June 2023, the company offered 96 products (46 ingredients) and supplied these to 3,642 pharmacies (+727 YoY), including group pharmacies, network affiliates, and other customers. Feldsenf Pharm, which operates this business, reported Q1 sales of JPY0.7bn (+4.8% YoY).

Digital Shift

Aiming to create a "new pharmaceutical platform" for the digital age, the company established PharmaShift Co., Ltd. on October 1, 2020 and launched the "Tsunagaru Pharmacy" service via its official LINE account in March 2021. By end-FY03/24, the company aims to have 1mn registered users and to introduce the service to 5,300 stores. As of end-June 2023, the number of registered users stood at 744,000 and the number of stores using the service was 3,797 (+406 stores from end-FY03/23).

Leasing and Facility-related

- Segment sales: JPY800mn (+0.8% YoY)
- Segment profit: JPY22mn (versus loss of JPY43mn in Q1 FY03/23)

Operating conditions of serviced elderly housing facilities

Segment sales grew 0.8% YoY, driven by a steady increase in management fee income from managed properties. The segment returned to profitability as a result of the transfer of the costs of the business development division to the Community Pharmacy Network segment (see above) and the absence of one-time advertising expenses for the Wisteria serviced residence for the elderly booked in the previous fiscal year.

As of end-June 2023, the company reported stable occupancy rates at three of its five properties (the total occupancy rate at the five serviced residences for the elderly stood at 80.6%), while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 68.3% (with 56 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).

Meal Catering

- Segment sales: JPY590bn (+3.0% YoY)
- Segment loss: JPY14mn (versus loss of JPY11mn in Q1 FY03/23)

Lower sales and operating loss

While sales grew owing to a revision of the contract unit price, the gross profit margin declined due to rising purchase prices. The segment loss widened as a result.

Other (mostly home-visit nursing care)

- Segment sales: JPY78mn (+1.3% YoY)
- Segment loss: JPY8mn (versus a loss of JPY2mn in Q1 FY03/23)

Full-year FY03/23 results (out May 9, 2023)

Overview

Full-year FY03/23 (April 2022—March 2023) earnings results

- Sales: JPY109.6bn (+2.7% YoY)
- Operating profit: JPY3.2bn (-17.9% YoY)
- Recurring profit: JPY3.4bn (-22.2% YoY)
- Net income attributable to owners of the parent: JPY1.6bn (-32.7% YoY)

Operating results and business conditions

Sales rose 2.7% YoY, thanks in part to higher sales in the mainstay Community Pharmacy Network segment, owing to two factors. First, in the segment's Community Pharmacy business, the price per prescription fell due to the impact of the NHI drug price and dispensing fee revisions, but the opening of new stores and acquisition of stores contributed to earnings. Secondly, in the Pharmaceutical Network business, the company was successful in securing a record number of new network members, as its ongoing efforts to improve pharmaceutical distribution also gained the backing of pharmaceutical wholesalers.

Gross profit was JPY45.9bn (+3.4% YoY) and GPM was 41.9% (+0.3pp YoY). The main reason for the increase in gross profit was an annual increase in membership fees in the Pharmaceutical Network business, as well as a rise in technical fees and the drug-price margin (difference between a product's NHI reimbursement price and its actual market price) in the Community Pharmacy business. However, SG&A expenses increased to JPY42.8bn (+5.4% YoY), and operating profit fell 17.9% YoY. The main factors behind the increase in SG&A expenses were the impact of NHI drug price and dispensing fee revisions in the Community Pharmacy business, increased labor expenses accompanying efforts to strengthen interpersonal services, and an increase in utility costs in the Leasing and Facility-related business. EBITDA was JPY6.1bn (-8.7% YoY).

Segment results

Full-year FY03/23 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY104.3bn (+2.9% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY5.9bn (-3.8% 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 utilizes instant messaging app LINE was added to the segment from FY03/21.

Community Pharmacy

The price per prescription fell due to the impact of the NHI drug price and dispensing fee revisions, but the prescription count rose on the back of the contribution of stores newly opened and acquired. During FY03/23, the company opened eight community pharmacies, including six inside medical malls. As of end-March 2023, the company had 428 community pharmacies, one in-home care plan support center, and nine cosmetics/drug stores. Dispensing fees for FY03/23 were JPY93.0bn (+2.2% YoY) on a companywide basis and JPY88.6bn (+0.2% YoY) on an existing store basis.

Pharmaceuticals Network

The company had success in gaining a record number of new network members as its ongoing efforts to improve pharmaceutical distribution also gained the backing of pharmaceutical wholesalers. As of end-March 2023, pharmaceutical network members totaled 8,912 (an increase of 1,511 from March 31, 2022), comprising 428 directly operated pharmacies and 8,484 affiliates. Pharmaceutical orders handled by the company's network totaled JPY526.2bn (+17.1% YoY).

Manufacture and Market Pharmaceuticals

In this business, the company group aims to provide a stable supply of good-quality, low-priced generic drugs. The company offered 93 products (45 ingredients) as of end-March 2023, and supplied these to 2,161 general network affiliates (an increase of 463 from March 31, 2022) and 1,148 other customers. Feldsenf Pharma's sales were JPY2.6bn (1.4x YoY).

Digital Shift

The company established subsidiary PharmaShift Co., Ltd. on October 1, 2020, to create a "new pharmaceutical platform" for the digital age. In March 2021, the subsidiary launched the "Tsunagaru Pharmacy" service utilizing its official LINE account. As of end-March 2023, the number of pharmacies using the service was 3,391 (an increase of 2,480 from March 31, 2022) while 3,787 had placed orders for the service use (an increase of 2,144 from March 31, 2022).

Leasing and Facility-related

- Segment sales: JPY3.5bn (+5.1% YoY)
- Segment loss: JPY92mn (versus profit of JPY39mn in FY03/22)

Operating conditions of serviced elderly housing facilities

Segment sales grew 5.1% YoY, supported by firm inflow of income from property lease and management. However, the segment posted an operating loss, due to factors such as higher labor expenses resulting from an increase in the number of employees to strengthen sales, and an increase in utility expenses due to the energy cost hike. As of end-March 2023, the company reported stable occupancy rates at three of its five properties (the overall occupancy rate at the five serviced residences for the elderly stood at 80.4%), while for the remaining two, at Wisteria Senri-Chuo it reported an occupancy rate of 72.0% (with 59 out of 82 units occupied), and at Wisteria Minami Ichijo it reported an occupancy rate of 68.1% (with 79 out of 116 units occupied). The company was aiming for an occupancy rate of 90% or higher for all five properties, but at the end of FY03/23 it was only 80.4%.

Meal Catering

- Segment sales: JPY2.3bn (-1.4% YoY)
- Segment loss: JPY65mn (versus profit of JPY1mn in FY03/22)

Lower sales and operating loss

In FY03/23, sales decreased along with the decline in the number of meals supplied due to the COVID-19 pandemic, and a loss followed lower gross profit margin due to higher purchase prices.

Other (mostly home-visit nursing care)

- Segment sales: JPY304mn (-0.3% YoY)
- Segment loss: JPY22mn (versus a loss of JPY12mn in FY03/22)

Cumulative Q3 FY03/23 results (out February 3, 2023)

Overview

Q3 FY03/23 (April–December 2022) earnings results

- Sales: JPY81.9bn (+2.5% YoY)
- Operating profit: JPY2.3bn (-23.5% YoY)
- Recurring profit: JPY2.5bn (-28.3% YoY)
- Net income attributable to owners of the parent: JPY1.2bn (-44.3% YoY)

Trends and outlook

Sales increased 2.5% YoY, driven by the growth in sales of the Community Pharmacy Network business. This was primarily due to earnings contributions from newly acquired stores and store openings, offsetting the impact of the NHI drug price and dispensing fee revisions on the price per prescription in the Community Pharmacy segment. Additionally, the Pharmaceutical Network segment saw steady growth in the number of new network affiliates.

Gross profit was JPY34.3bn (+2.5% YoY), and the gross profit margin remained flat at 41.9%. Despite the impact of NHI drug price and dispensing fee revisions on the Community Pharmacy business, the company achieved improvements in procurement costs through changes to its drug procurement routes. However, due to an increase in investments in human resources related to strengthening interpersonal services and sales activities, SG&A expenses rose to JPY31.9bn (+5.1% YoY), causing operating profit to fall by 23.5% YoY. EBITDA for the period was JPY4.5bn (-12.5%).

Segment results

Cumulative Q3 FY03/23 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY78.1n (+2.8% YoY; including intra-group sales and transfers between segments, same applies below)
- Segment profit: JPY4.3bn (-7.8% 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 utilizes instant messaging app LINE was added to the segment from FY03/21.

Community Pharmacy

Although the NHI drug price and dispensing fee revisions led to a decline in the price per prescription, the company saw an increase in prescription demand due to the contribution of newly opened and acquired stores. The dispensing fee on a per-store basis increased by JPY1.2bn YoY to JPY69.5bn (+1.7% YoY). The company opened six new community pharmacies during the cumulative Q3 period, including five inside medical malls. As of December 31, 2022, the company had a total of 429 community pharmacies, one in-home care plan support center, and nine cosmetics/drug stores.

Pharmaceuticals Network

Amid increasing demand for business efficiency at dispensing pharmacies, as pharmacists concentrate further on interpersonal work due to the impact of dispensing fee revisions, the number of new network members continued to grow steadily. As of the end of December 2022, the total number of pharmaceutical network members was 8,555 (an increase of 1,154 from the end of March 2022), including 429 directly operated pharmacies and 8,126 affiliate pharmacies. The volume of pharmaceuticals orders placed through the network during the period was JPY391.4bn (+16.6% YoY).

Manufacture and Market Pharmaceuticals

In this business, the company group aims to provide a stable supply of good-quality, low-priced generic drugs. The company offered 90 products (44 ingredients) as of December 31, 2022, and supplied these to 2,042 general network affiliates (an increase of 344 from March 31, 2022). Feldsenf Pharma's sales in cumulative Q3 were JPY2.0bn (+43.8% YoY).

Digital Shift

In order to create a "new pharmaceutical platform" for the digital age, the company established PharmaShift Co., Ltd. on October 1, 2020, and in March 2021, it launched the "Tsunagaru Pharmacy" service utilizing its official LINE account. The company prioritized the expansion of the service introduction to more pharmacies, and as of the end of December 2022, the number of pharmacies using the service had increased to 3,071 (an increase of 2,160 from the end of March 2022), while 3,381 had placed orders for the service use (an increase of 1,738 from the end of March 2022).

Leasing and Facility-related

- Segment sales: JPY2.5bn (-0.5% YoY)
- Segment loss: JPY97mn (versus profit of JPY53mn in 1H FY03/22)

Operating conditions of serviced elderly housing facilities

Despite generally strong property leasing revenue, sales for the cumulative Q3 period decreased by 0.5% YoY, mainly due to a drop in construction projects. This was because the timing of recording sales for construction projects was concentrated in Q4. The segment posted an operating loss due to higher labor expenses resulting from an increase in the number of employees to strengthen sales, as well as increased advertising expenses related to aggressive sales promotion activities for the Wisteria serviced residences for the elderly and support services for physicians opening their own practices.

As of the end of December 2022, the company reported stable occupancy rates at three of its five properties, with the overall occupancy rate for the five serviced residences for the elderly at 81.8%. For the remaining two properties, Wisteria Senri-Chuo had an occupancy rate of 72.0% (with 59 out of 82 units occupied) and Wisteria Minami Ichijo had an occupancy rate of 71.6% (with 83 out of 116 units occupied).

Meal Catering

- Segment sales: JPY1.7bn (-2.9% YoY)
- Segment loss: JPY55mn (versus profit of JPY7mn in 1H FY03/22)

Lower sales and operating loss

In Q3 FY03/23, sales decreased along with the decline in the number of meals supplied due to the COVID-19 pandemic, and a loss followed lower gross profit margin due to higher purchase prices.

Other (mostly home-visit nursing care)

- Segment sales: JPY228mn (-1.7% YoY)
- Segment loss: JPY14mn (versus a loss of JPY10mn in Q3 FY03/22)

News and topics

Revision to full-year FY03/24 earnings and dividend forecast; Dissolution of joint venture contract and acquisition of shares in joint venture company (consolidated subsidiary) and the acceptance of business transfer by consolidated subsidiary

2023-11-07

Medical System Network Co., Ltd. announced a revision to its full-year FY03/24 earnings forecast.

Revised full-year FY03/24 earnings and dividend forecast

- Sales: JPY113.8bn (from previously forecast JPY112.4bn)
- Operating profit: JPY3.5bn (from JPY2.6bn)
- Recurring profit: JPY3.5bn (from JPY2.6bn)
- Net income attributable to owners of the parent: JPY1.7bn (from JPY1.0bn)
- EPS: JPY54.67 (from JPY33.14)

Reasons for revision

Although the company foresees the impacts of shipment adjustments in the Manufacture and Market Pharmaceuticals business from Q3 onwards, it has revised upwards its full-year earnings forecasts in light of the better-than exceeded 1H results. In terms of sales, the number of prescriptions filled in the Community Pharmacy business was ahead of plan, and in the Pharmaceutical Network business, the number of new network affiliates steadily increased, and the value of pharmaceutical orders placed by network affiliates exceeded plan. On the profit side, efforts to improve productivity across the company and contain various expenses were successful.

Another factor in the upward revision of the full-year forecast was that the company expects to gradually resume shipments of products currently under shipment adjustment in the Manufacture and Market Pharmaceuticals business in 2H.

Revision of dividend forecast

- Revised dividend forecast: interim dividend of JPY6 per share and year-end dividend of JPY6 per share, for a total annual dividend of JPY12 per share
- Previous dividend forecast: interim dividend of JPY5 per share and year-end dividend of JPY5 per share, for a total annual dividend of JPY10 per share

Based on the 1H results and the revised full-year earnings forecast, the company raised the forecast for the interim and full-year dividends for FY03/24 by JPY1 to JPY6 per share, for a total annual dividend of JPY12 per share (also JPY12 in FY12/23).

Dissolution of joint venture contract and acquisition of shares in joint venture company (consolidated subsidiary) and the acceptance of business transfer by consolidated subsidiary

On November 7, 2023, Medical System Network announced the dissolution of a joint venture contract and acquisition of shares in a joint venture company (consolidated subsidiary), as well as the acceptance of a business transfer by its consolidated subsidiary.

At a Board of Directors meeting held on the same day, the company decided to dissolve its joint venture contract with Re:teigi, Inc, a wholly-owned subsidiary of Digital Holdings, Inc. (TSE Prime: 4350). It also decided to acquire all shares in PharmaShift Co., Ltd., (a joint venture with 51% stake for Medical System Network and 49% stake for RePharmacy Co., Ltd., which is a wholly-owned subsidiary of Re:teigi), making PharmaShift a wholly owned subsidiary.

The company decided to dissolve the joint venture after careful consideration of its future growth and that of the Digital Holdings Group in light of changes in the business environment.

By dissolving the joint venture contract with Re:teigi, Medical System Network will acquire all shares (49% of total issued shares) of PharmaShift held by RePharmacy. As a result, PharmaShift becomes a wholly-owned subsidiary of the company, and the development of services such as the LINE official account "Tsunagaru Pharmacy" and development of business management tools for pharmacies, which were operated by RePharmacy, will also be transferred. The execution date for the dissolution of the joint venture contract and the transfer of shares is scheduled for November 30, 2023. The impact of this matter on the company's earnings forecast for FY03/24 is minimal.

Transition to company with Audit & Supervisory Committee

2023-03-17

Medical System Network Co., Ltd. announced the transition to a company with an Audit & Supervisory Committee.

At its Board of Directors meeting held on March 17, 2022, the company resolved to transition to a company with an Audit & Supervisory Committee, subject to approval at its 25th general meeting of shareholders scheduled for June 2023.

The purpose of the transition is to further improve corporate governance by strengthening the supervisory function of the Board of Directors through the inclusion of Audit & Supervisory Committee members, and to expedite the Board's decision-making process for business execution by delegating decisions to the directors.

The transition will take place following the approval of the necessary amendments to the Articles of Incorporation at the 25th general meeting of shareholders scheduled for June 2023.

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 Sunmedic Co., Ltd. (now Nanohana East Japan Co., Ltd.) shares, making it a wholly owned subsidiary
	Pharmaholdings acquired 100% of Hankyu Kyoei Pharmacy (now Kyoei Pharmacy) shares, making it a wholly owned subsidiary
Jan 2007	Acquired 100% of CR Medical (now Nanohana central Co., Ltd.), making it a wholly owned subsidiary
Mar	Acquired 100% of Hokkaido Hiclips (now SMO-MDS) shares, making it a wholly owned subsidiary
Sep 2008	Listed shares on the Second Section of the Tokyo Stock Exchange
Jun 2010	Listed shares on the First Section of the Tokyo Stock Exchange
Nov 2012	Formed Business alliance with 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 2023)

Corporate governance and top management

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.

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. In terms of auditing by corporate auditors, corporate 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.

Form of organization and capital structure	
Form of organization	Company with Audit & Supervisory Board
Controlling shareholder	None
Directors and Audit & Supervisory Board members	
Number of directors under Articles of Incorporation	15
Number of directors	12
Directors' term of office under Articles of Incorporation	2 years
Chairperson of the Board of Directors	President
Number of outside directors	3
Number of independent outside directors	3
Number of members of Audit & Supervisory Board per Articles of Incorporation	4
Number of members of Audit & Supervisory Board	4
Number of outside members of Audit & Supervisory Board	3
Number of independent outside members of Audit & Supervisory Board	3
Other	
Participation in electronic voting platform	In place
Providing convocation notice in English	In place
Implementation of measures regarding director incentives	Performance-linked remuneration, Other
Disclosure of directors' compensation	None
Policy to determine amount and calculation method of remuneration	In place
Corporate takeover defenses	None

Source: Shared Research based on company materials

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 March 2023)

Dividend policy

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

Major shareholders

Top shareholders	Shares held( )	Shareholding ratio
S&S G.K.	2,769,100	9.05%
The Master Trust Bank of Japan, Ltd. (trust account)	2,699,600	8.82%
Yasuyuki Okinaka	2,506,000	8.19%
Jiro Akino	2,220,400	7.26%
CACEIS BANK /QUINTET LUXEMBOURG SUB AC/UCITS CUSTOMERS ACCOUNT	2,059,700	6.73%
EPS Holdings Co., Ltd.	950,000	3.10%
Custody Bank of Japan, Ltd.(trust account)	880,400	2.87%
Medical System Network Employees Stochkholding Association	787,600	2.57%
Inao Tajiri	757,500	2.47%
Tsuyoshi Nakamura	481,800	1.57%
SUM	16,112,100	52.63%

Source: Shared Research based on company data (as of March 31, 2023)

Employees

Segment	No. of employees	No. of temporary employees	Total
Community Pharmacy Network	3,145	512	3,657
Pharmacists	1,488	287	1,775
Leasing and Facility-related	148	14	162
Meal Catering	168	250	418
Other	38	12	50
Corporate (administration)	134	10	144
Total	3,633	798	4,017

Source: Shared Research based on company data (as of March 31, 2023)

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

IR Contact

Corporate management Department

Head Office

24-3 Kitajujo-Nishi, Chuo-ku, Sapporo, Hokkaido

Listed On

Tokyo Stock Exchange, Standard Market

Exchange Listing

2002-03-18

Fiscal Year-End

Mar

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.

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