Coverage initiated on: 2018-05-02
Last update: 2025-03-19

4350

Medical System Network

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

INDEX

Executive summary

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 2024, its pharmaceutical network had 9,756 members (+844 from end-March 2023), consisting of 450 directly operated pharmacies and 9,306 affiliated pharmacies.

The company has four business segments: Community Pharmacy Network (accounting for 95.2% of sales in FY03/24; based on sales to external customers), Leasing and Facility-related (2.5%), Meal Catering (2.0%), and Other (0.3%). Almost all segment profit (before adjustment) is generated by the Community Pharmacy Network segment.

The Community Pharmacy Network segment is a new segment that has been disclosed since FY03/20. It was formed through the integration of several former businesses, and presently consists of four business divisions. In addition to the Community Pharmacy business, which operates dispensing pharmacies, the segment includes three businesses that support the operation of dispensing pharmacies: the Pharmaceutical Network business, the Manufacture and Market Pharmaceuticals business, and the Digital Shift business added from FY03/21. The company discloses the operating conditions for each business within the 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 62,375 dispensing pharmacies in Japan in FY2022. 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 acquisitions 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 FY03/24, the company reported sales of JPY115.4bn (+5.3% YoY), EBITDA of JPY7.0bn (+14.3% YoY), operating profit of JPY3.8bn (+21.2% YoY), recurring profit of JPY3.8bn (+14.0% YoY), and net income attributable to owners of the parent of JPY1.9bn (+15.5% YoY). The mainstay Community Pharmacy Network segment recorded sales of JPY109.9bn (+5.3% YoY), driving the overall performance. The significant increase in operating profit was primarily due to higher profitability in the same segment. Meanwhile, the Leasing and Facility-related segment returned to profitability, further bolstering the company's financial results.

The company announced a revision to its 1H FY03/25 earnings forecast on October 31, 2024. It revised sales to JPY122.0bn (+5.8% YoY), EBITDA to JPY6.4bn (-8.0% YoY), operating profit to JPY3.0bn (-21.7% YoY), recurring profit to JPY3.0bn (-21.6% YoY), and net income attributable to owners of the parent to JPY1.3bn (-32.8% YoY). The company states that the revision reflects a decline in both prescription volume in the Community Pharmacy business and increased procurement costs for medicine. The company maintained its earnings forecast at the time of the Q3 earnings announcement (February 7, 2025).

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	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23	FY03/24	FY03/25
(JPYmn)	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Cons.**	**Est.**
Sales	**75,548**	**87,715**	**88,865**	**93,977**	**98,232**	**105,241**	**104,257**	**106,685**	**109,551**	**115,361**	**122,000**
YoY	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%	-0.9%	2.3%	2.7%	5.3%	5.8%
Gross profit	28,476	32,801	34,164	36,607	37,271	40,214	42,412	44,429	45,921	47,925	
YoY	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%	5.5%	4.8%	3.4%	4.4%	
Gross profit margin	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%	40.7%	41.6%	41.9%	41.5%	
Operating profit	**2,641**	**3,783**	**2,113**	**3,163**	**1,428**	**1,615**	**3,429**	**3,852**	**3,163**	**3,832**	**3,000**
YoY	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%	112.3%	12.3%	-17.9%	21.2%	-21.7%
Operating profit margin	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%	3.3%	3.6%	2.9%	3.3%	2.5%
Recurring profit	**2,540**	**3,860**	**2,109**	**3,250**	**1,501**	**1,560**	**3,479**	**4,313**	**3,355**	**3,825**	**3,000**
YoY	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%	123.0%	24.0%	-22.2%	14.0%	-21.6%
Recurring profit margin	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%	3.3%	4.0%	3.1%	3.3%	2.5%
Net income	**885**	**1,720**	**571**	**1,022**	**462**	**-895**	**2,198**	**2,394**	**1,610**	**1,860**	**1,250**
YoY	32.4%	94.4%	-66.8%	79.0%	-54.8%	-	-	8.9%	-32.7%	15.5%	-32.8%
Net margin	1.2%	2.0%	0.6%	1.1%	0.5%	-	2.1%	2.2%	1.5%	1.6%	1.0%
Per-share data											
Shares issued at year-end (000 shares)	25,970	29,890	29,890	30,523	30,643	30,643	30,643	30,643	30,643	30,643	-
EPS	37.1	60.1	19.3	34.5	15.3	-29.5	72.5	79.4	53.4	61.9	42.8
EPS (fully diluted)	-	-	-	34.3	15.0	-	-	-	-	-	-
Dividend per share	8.0	9.5	10.0	10.0	10.0	10.0	10.0	12.0	12.0	12.0	12.0
Book value per share	243.3	334.9	345.3	351.4	354.8	310.4	370.2	439.7	478.9	519.1	-
Balance sheet (JPYmn)											
Cash and cash equivalents	2,499	2,081	2,252	10,201	11,703	11,722	10,118	8,201	8,141	8,273	
Total current assets	**11,023**	**10,783**	**11,098**	**18,736**	**21,055**	**20,578**	**19,313**	**18,701**	**20,265**	**20,773**	
Tangible fixed assets	17,249	20,253	21,246	24,129	25,721	25,126	24,634	24,624	27,060	28,336	
Investments and other assets	3,759	4,329	4,559	4,847	5,922	6,143	6,926	6,848	7,090	7,759	
Intangible assets	13,554	13,481	13,833	15,045	16,235	14,615	13,572	12,767	11,807	11,281	
Total assets	**45,587**	**48,847**	**50,737**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**	**68,149**	
Accounts payable	8,598	9,525	9,144	9,416	10,198	10,021	9,258	9,680	9,937	10,935	
Short-term debt	9,214	6,910	3,863	7,463	9,158	8,905	10,210	5,935	6,377	6,116	
Total current liabilities	**21,626**	**21,061**	**16,920**	**21,769**	**23,844**	**23,296**	**25,418**	**20,435**	**21,349**	**23,213**	
Long-term debt	15,391	14,859	20,186	26,329	29,739	28,653	22,348	23,631	24,139	23,063	
Total fixed liabilities	**17,826**	**17,520**	**23,172**	**30,404**	**34,329**	**33,749**	**27,841**	**29,219**	**30,385**	**29,716**	
Total liabilities	**39,452**	**38,581**	**40,092**	**52,174**	**58,173**	**57,045**	**53,260**	**49,654**	**51,735**	**52,930**	
Total net assets	**6,136**	**10,265**	**10,644**	**10,584**	**10,761**	**9,418**	**11,187**	**13,286**	**14,488**	**15,219**	
Total interest-bearing debt	24,605	21,769	24,049	33,792	38,897	37,558	32,558	29,566	30,516	29,179	
Cash flow statement (JPYmn)											
Cash flows from operating activities	3,838	6,409	3,084	6,699	2,840	4,232	5,205	4,010	4,973	7,725	
Cash flows from investing activities	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383	-1,485	-2,511	-2,114	-3,649	
Cash flows from financing activities	-483	-1,792	998	8,050	4,338	-1,687	-5,312	-3,415	-2,918	-3,944	
Financial ratios											
ROA (RP-based)	5.7%	8.2%	4.2%	5.7%	2.3%	2.3%	5.3%	6.8%	5.2%	5.7%	
ROE	16.2%	21.9%	5.7%	9.8%	4.3%	-8.9%	21.3%	19.6%	11.6%	12.6%	
Equity ratio	12.7%	20.3%	20.1%	16.9%	15.6%	14.2%	17.3%	21.1%	21.8%	22.3%	

Source: Shared Research based on company data

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

Recent updates

Acquisition of shares of Pharumo through a third-party allotment

2024-12-24

Medical System Network Co., Ltd. announced on December 23, 2024, the acquisition of shares in Pharumo, Inc. (headquarters: Shinjuku, Tokyo, unlisted), a developer of ICT solutions for pharmacies, through a third-party allotment.

Medical System Network provides diverse support services to member medical institutions within its pharmaceutical network, serving over 10,000 pharmacies in Japan. In its Digital Shift Business, the company aims to create a new pharmaceutical platform by facilitating pharmacies' digital transformation. Through this acquisition, the company seeks to generate business synergies and achieve sustainable medium- to long-term growth by strengthening the relationship between Pharumo and its Pharmaceutical Network business. Pharumo expects that a strengthened partnership with Medical System Network will support its sustainable growth, enhance the value of pharmacies and pharmacists, and contribute to regional healthcare.

Pharumo delivers ICT solutions through its dispensing pharmacy information hub system "Pharumo Cloud" to optimize the value of pharmacies. Key offerings include "E-Electronic Medication Records 3.0," developed in collaboration with the Japan Pharmaceutical Association, and "EveryPick," a cloud-based drug-picking monitoring system. The customer base for these services is projected to exceed 10,000 stores by end-March 2025.

Medical System Network will appoint one director to Pharumo. Pharumo also plans to acquire 200 shares of treasury stock from MTI Ltd. (TSE Prime: 9438) by March 2025. As a result, Medical System Network's equity share will increase to 15.2%, and Pharumo will become an equity-method affiliate. The impact of this transaction on Medical System Network's consolidated financial results for FY03/25 is expected to be minimal.

Trends and outlook

Quarterly trends and results

Cumulative	FY03/23				FY03/24				FY03/25			FY03/25	
(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	26,299	53,340	81,878	109,551	27,656	56,461	86,175	115,361	29,419	59,761	91,891	75.3%	122,000
YoY	1.5%	2.2%	2.5%	2.7%	5.2%	5.9%	5.2%	5.3%	6.4%	5.8%	6.6%		5.8%
Gross profit	11,062	22,315	34,287	45,921	11,433	23,453	35,882	47,925	12,274	24,664	38,178		
YoY	3.0%	2.1%	2.5%	3.4%	3.4%	5.1%	4.7%	4.4%	7.4%	5.2%	6.4%		
Gross profit margin	42.1%	41.8%	41.9%	41.9%	41.3%	41.5%	41.6%	41.5%	41.7%	41.3%	41.5%		
SG&A expenses	10,713	21,215	31,942	42,758	10,981	21,740	32,813	44,093	11,806	23,636	35,604		
YoY	6.4%	6.1%	5.1%	5.4%	2.5%	2.5%	2.7%	3.1%	7.5%	8.7%	8.5%		
SG&A ratio	40.7%	39.8%	39.0%	39.0%	39.7%	38.5%	38.1%	38.2%	40.1%	39.6%	38.7%		
Operating profit	348	1,099	2,344	3,163	451	1,712	3,069	3,832	468	1,027	2,573	85.8%	3,000
YoY	-47.8%	-41.0%	-23.5%	-17.9%	29.6%	55.8%	30.9%	21.2%	3.8%	-40.0%	-16.2%		-21.7%
Operating profit margin	1.3%	2.1%	2.9%	2.9%	1.6%	3.0%	3.6%	3.3%	1.6%	1.7%	2.8%		2.5%
Recurring profit	392	1,242	2,499	3,355	410	1,692	3,044	3,825	468	1,020	2,623	87.4%	3,000
YoY	-58.1%	-44.4%	-28.3%	-22.2%	4.6%	36.2%	21.8%	14.0%	14.1%	-39.7%	-13.8%		-21.6%
Recurring profit margin	1.5%	2.3%	3.1%	3.1%	1.5%	3.0%	3.5%	3.3%	1.6%	1.7%	2.9%		2.5%
Net income	91	502	1,195	1,610	148	861	1,693	1,860	170	207	1,445	115.6%	1,250
YoY	-84.4%	-64.9%	-44.3%	-32.7%	62.6%	71.5%	41.7%	15.5%	14.9%	-76.0%	-14.6%		-32.8%
Net margin	0.3%	0.9%	1.5%	1.5%	0.5%	1.5%	2.0%	1.6%	0.6%	0.3%	1.6%		1.0%

Quarterly	FY03/23				FY03/24				FY03/25		
(JPYmn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	26,299	27,041	28,538	27,673	27,656	28,805	29,714	29,186	29,419	30,342	32,130
YoY	1.5%	3.0%	3.0%	3.2%	5.2%	6.5%	4.1%	5.5%	6.4%	5.3%	8.1%
Gross profit	11,062	11,253	11,972	11,634	11,433	12,020	12,429	12,043	12,274	12,390	13,514
YoY	3.0%	1.2%	3.4%	5.9%	3.4%	6.8%	3.8%	3.5%	7.4%	3.1%	8.7%
Gross profit margin	42.1%	41.6%	42.0%	42.0%	41.3%	41.7%	41.8%	41.3%	41.7%	40.8%	42.1%
SG&A expenses	10,713	10,502	10,727	10,816	10,981	10,759	11,073	11,280	11,806	11,830	11,968
YoY	6.4%	5.8%	3.3%	6.1%	2.5%	2.4%	3.2%	4.3%	7.5%	10.0%	8.1%
SG&A ratio	40.7%	38.8%	37.6%	39.1%	39.7%	37.4%	37.3%	38.6%	40.1%	39.0%	37.2%
Operating profit	348	751	1,245	819	451	1,261	1,357	763	468	559	1,546
YoY	-47.8%	-37.2%	3.7%	3.8%	29.6%	67.9%	9.0%	-6.8%	3.8%	-55.7%	13.9%
Operating profit margin	1.3%	2.8%	4.4%	3.0%	1.6%	4.4%	4.6%	2.6%	1.6%	1.8%	4.8%
Recurring profit	392	850	1,257	856	410	1,282	1,352	781	468	552	1,603
YoY	-58.1%	-34.6%	0.6%	3.4%	4.6%	50.8%	7.6%	-8.8%	14.1%	-56.9%	18.6%
Recurring profit margin	1.5%	3.1%	4.4%	3.1%	1.5%	4.5%	4.6%	2.7%	1.6%	1.8%	5.0%
Net income	91	411	693	415	148	713	832	167	170	37	1,238
YoY	-84.4%	-51.5%	-2.8%	66.0%	62.6%	73.5%	20.1%	-59.8%	14.9%	-94.8%	48.8%
Net margin	0.3%	1.5%	2.4%	1.5%	0.5%	2.5%	2.8%	0.6%	0.6%	0.1%	3.9%

Source: Shared Research based on company data

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

Quarterly results by segment

By segment (cumulative)	FY03/23				FY03/24				FY03/25		
(JPYmn)	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3	Q1–Q4	Q1	Q1–Q2	Q1–Q3
Sales	**26,299**	**53,340**	**81,878**	**109,551**	**27,656**	**56,461**	**86,175**	**115,361**	**29,419**	**59,761**	**91,891**
YoY	1.5%	2.2%	2.5%	2.7%	5.2%	5.9%	5.2%	5.3%	6.4%	5.8%	6.6%
Community Pharmacy Network	25,045	50,792	78,078	104,399	26,356	53,765	82,105	109,904	28,029	57,074	87,815
YoY	1.6%	2.3%	2.8%	2.9%	5.2%	5.9%	5.2%	5.3%	6.3%	6.2%	7.0%
% of total	94.5%	94.5%	94.7%	94.5%	94.7%	94.7%	94.7%	94.6%	94.6%	94.9%	95.0%
Leasing and Facility-related	794	1,673	2,448	3,494	800	1,687	2,560	3,611	942	1,729	2,625
YoY	7.4%	8.9%	-0.5%	5.1%	0.8%	0.8%	4.6%	3.3%	17.8%	2.5%	2.5%
% of total	3.0%	3.1%	3.0%	3.2%	2.9%	3.0%	3.0%	3.1%	3.2%	2.9%	2.8%
Meal Catering	573	1,135	1,701	2,289	590	1,189	1,781	2,360	586	1,177	1,768
YoY	-2.2%	-2.7%	-2.9%	-1.4%	3.0%	4.8%	4.7%	3.1%	-0.7%	-1.0%	-0.7%
% of total	2.2%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.0%	2.0%	2.0%	1.9%
Other	77	151	228	304	78	155	237	314	85	174	261
YoY	4.1%	-0.7%	-1.7%	-0.3%	1.3%	2.6%	3.9%	3.3%	9.0%	12.3%	10.1%
% 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	-190	-412	-579	-937	-168	-336	-510	-828	-224	-394	-578
Operating profit	**348**	**1,099**	**2,344**	**3,163**	**451**	**1,712**	**3,069**	**3,832**	**468**	**1,027**	**2,573**
YoY	-47.8%	-41.0%	-23.5%	-17.9%	29.6%	55.8%	30.9%	21.2%	3.8%	-40.0%	-16.2%
Community Pharmacy Network	1,014	2,384	4,299	5,887	1,077	2,947	4,965	6,433	1,061	2,241	4,420
YoY	-15.6%	-17.4%	-7.8%	-3.8%	6.2%	23.6%	15.5%	9.3%	-1.5%	-24.0%	-11.0%
Operating profit margin	4.0%	4.7%	5.5%	5.6%	4.1%	5.5%	6.0%	5.9%	3.8%	3.9%	5.0%
Leasing and Facility-related	-43	-65	-97	-92	22	69	129	158	56	99	188
YoY	-	-	-	-	-	-	-	-	154.5%	43.5%	45.7%
Operating profit margin	-	-	-	-	2.8%	4.1%	5.0%	4.4%	5.9%	5.7%	7.2%
Meal Catering	-11	-33	-55	-65	-14	-23	-24	-43	-2	-7	1
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	-	-	-	-	-	-	-	-	-
Other	-2	-10	-14	-22	-8	-20	-30	-43	-7	-12	-17
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	-	-	-	-	-	-	-	-	-
Segment profit adjustments	-608	-1,175	-1,787	-2,542	-626	-1,261	-1,970	-2,671	-639	-1,293	-2,019

	FY03/23				FY03/24				FY03/25		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Sales	**26,299**	**27,041**	**28,538**	**27,673**	**27,656**	**28,805**	**29,714**	**29,186**	**29,419**	**30,342**	**32,130**
YoY	1.5%	3.0%	3.0%	3.2%	5.2%	6.5%	4.1%	5.5%	6.4%	5.3%	8.1%
Community Pharmacy Network	25,045	25,747	27,286	26,321	26,356	27,409	28,340	27,799	28,029	29,045	30,741
YoY	1.6%	3.0%	3.7%	3.3%	5.2%	6.5%	3.9%	5.6%	6.3%	6.0%	8.5%
% of total	94.5%	94.4%	95.1%	93.9%	94.7%	94.6%	94.8%	94.2%	94.6%	95.2%	95.1%
Leasing and Facility-related	794	879	775	1,046	800	887	873	1,051	942	787	896
YoY	7.4%	10.3%	-16.2%	20.9%	0.8%	0.9%	12.6%	0.5%	17.8%	-11.3%	2.6%

% of total	3.0%	3.2%	2.7%	3.7%	2.9%	3.1%	2.9%	3.6%	3.2%	2.6%	2.8%
Meal Catering	573	562	566	588	590	599	592	579	586	591	591
YoY	-2.2%	-3.1%	-3.4%	3.2%	3.0%	6.6%	4.6%	-1.5%	-0.7%	-1.3%	-0.2%
% of total	2.2%	2.1%	2.0%	2.1%	2.1%	2.1%	2.0%	2.0%	2.0%	1.9%	1.8%
Other	77	74	77	76	78	77	82	77	85	89	87
YoY	4.1%	-5.1%	-3.8%	4.1%	1.3%	4.1%	6.5%	1.3%	9.0%	15.6%	6.1%
% 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	-190	-222	-167	-358	-168	-168	-174	-318	-224	-170	-184
Operating profit	**348**	**751**	**1,245**	**819**	**451**	**1,261**	**1,357**	**763**	**468**	**559**	**1,546**
YoY	-47.8%	-37.2%	3.7%	3.8%	29.6%	67.9%	9.0%	-6.8%	3.8%	-55.7%	13.9%
Community Pharmacy Network	1,014	1,370	1,915	1,588	1,077	1,870	2,018	1,468	1,061	1,180	2,179
YoY	-15.6%	-18.6%	7.7%	9.2%	6.2%	36.5%	5.4%	-7.6%	-1.5%	-36.9%	8.0%
Operating profit margin	4.0%	5.3%	7.0%	6.0%	4.1%	6.8%	7.1%	5.3%	3.8%	4.1%	7.1%
Leasing and Facility-related	-43	-22	-32	5	22	47	60	29	56	43	89
YoY	-	-	-	-	-	-	-	480.0%	154.5%	-8.5%	48.3%
Operating profit margin	-	-	-	-	2.8%	5.3%	6.9%	2.8%	5.9%	5.5%	9.9%
Meal Catering	-11	-22	-22	-10	-14	-9	-1	-19	-2	-5	8
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	-	-	-	-	-	-	-	-	-
Other	-2	-8	-4	-8	-8	-12	-10	-13	-7	-5	-5
YoY	-	-	-	-	-	-	-	-	-	-	-
Operating profit margin	-	-	-	-	-	-	-	-	-	-	-
Segment profit adjustments	-608	-567	-612	-755	-626	-635	-709	-701	-639	-654	-726

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)

	FY03/22				FY03/23				FY03/24				FY03/25		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Price per prescription	10,177	10,254	10,308	10,410	10,041	10,061	10,173	10,235	9,871	10,033	10,070	10,141	10,027	10,228	10,231
YoY	-6.9%	-4.0%	-3.0%	-2.3%	-1.3%	-1.9%	-1.3%	-1.7%	-1.7%	-0.3%	-1.0%	-0.9%	1.6%	1.9%	1.6%
Drug fee	7,742	7,819	7,882	7,984	7,620	7,634	7,733	7,789	7,526	7,687	7,709	7,773	7,640	7,828	7,813
Technical fee	2,435	2,435	2,426	2,426	2,421	2,427	2,440	2,446	2,345	2,346	2,361	2,368	2,387	2,400	2,419
Number of prescriptions filled ('000)	2,185	4,367	6,625	8,746	2,230	4,517	6,828	9,088	2,379	4,777	7,266	9,640	2,481	4,947	7,568
YoY	11.3%	8.0%	6.6%	5.5%	2.1%	3.4%	3.1%	3.9%	6.7%	5.8%	6.4%	6.1%	4.3%	3.6%	4.2%
Dispensing fees	22,238	44,784	68,296	91,056	22,399	45,448	69,472	93,029	23,484	47,935	73,168	97,765	24,878	50,600	77,438
YoY	3.5%	3.7%	3.4%	3.1%	0.7%	1.5%	1.7%	2.2%	4.8%	5.5%	5.3%	5.1%	5.9%	5.6%	5.8%

Source: Shared Research based on company materials

Number of network members by region

Area	Directly operated pharmacies	Affiliates	Total
Hokkaido	123	230	353
Tohoku	34	754	788
Kanto and Koshinetsu	107	3,285	3,392
Tokai and Hokuriku	44	1,709	1,753
Kinki	54	1,713	1,767
Chugoku and Shikoku	21	1,018	1,039
Kyushu and Okinawa	72	1,573	1,645
Total	**455**	**10,282**	**10,737**

Source: Shared Research based on company data (as of December 31, 2024)

Cumulative Q3 FY03/25 results (out February 7, 2025)

Overview

Cumulative Q3 FY03/25 results (April–December 2024)

- Sales: JPY91.9bn (+6.6% YoY)
- Operating profit: JPY2.6bn (-16.2% YoY)
- Recurring profit: JPY2.6bn (-13.8% YoY)
- Net income attributable to owners of the parent: JPY1.4bn (-14.6% YoY)

Operating results and business conditions

The Japanese economy showed a gradual recovery during the cumulative Q3, driven by improved employment and income. However, concerns persist over ongoing price increases and potential financial policy revisions, creating uncertainty in economic conditions.

The company's sales increased by 6.6% YoY in cumulative Q3.

Gross profit increased to JPY38.2bn (+6.4% YoY), while the profit margin remained largely unchanged at 41.5% (-0.1pp). In the Community Pharmacy business, store expansion through new openings and M&A offset sluggish growth in number of prescriptions filled at existing directly operated dispensing pharmacies and higher procurement costs for pharmaceuticals. Strong growth in new memberships in the Pharmaceutical Network business contributed to the profit increase. SG&A expenses rose by 8.5% YoY to JPY35.6bn due to higher personnel and related expenses, as well as expenses associated with M&A in the pharmacy business. Operating profit declined by 16.2% YoY, and the OPM declined by 0.8pp to 2.8%. EBITDA was JPY5.1bn (-5.7% YoY). Recurring profit fell by 13.8% YoY, and net income attributable to owners of the parent declined by 14.6%.

Profit in the mainstay Community Pharmacy Network business decreased YoY due to a decrease in number of prescriptions filled at existing pharmacies, rising procurement costs for medicine, and wage increases.

Progress toward the full-year earnings forecast by the end of cumulative Q3 was 75.3% for sales, 85.8% for operating profit, 87.4% for recurring profit, and 115.6% for net income.

Segment results

Cumulative Q3 FY03/25 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY87.8bn (+7.0% YoY)
- Segment profit: JPY4.4bn (-11.0% YoY)
- This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other. A digital shift business that utilizes instant messaging app LINE was added to the segment from FY03/21.

Community Pharmacy

This segment primarily generates revenue from the company's directly operated insurance pharmacies, mainly under the "Nanohana Pharmacy" brand. In cumulative Q3, dispensing fees (on a total store basis) increased by 5.8% YoY to JPY77.4bn. This broke down to 7,568,000 prescriptions (+4.2% YoY) and an average price per prescription of JPY10,231 (+1.6% YoY). Higher technical and drug fees led to an increase in the average price per prescription. Dispensing fees exceeded cumulative Q3 FY03/24 levels in cumulative Q3 FY03/25, driven by new pharmacy openings or acquisitions in FY03/24, the use of digital technologies like the LINE official account "Tsunagaru Pharmacy" for prescription transmission, and improved patient follow-up during medication periods.

Due to the revision of dispensing fees in 2024, the points for the community support system premiums decreased. However, the weighted average medical fees at end-Q3 improved to 80.4 points, exceeding the 70.3 points recorded at end-FY03/24 (excluding points from stores acquired in Q4 FY03/24) due to the strengthening of interpersonal interactions and the digitalization of healthcare premium.

During the period under review, the company opened 17 community pharmacies, acquired one store, and closed or transferred 14 stores. As of end-December 2024, the company operated 455 community pharmacies, one in-home care plan support center, and eight drug stores.

Pharmaceuticals Network

Service improvements supported the increase in the number of new network affiliates. As of end-December 2024, pharmaceutical network affiliates totaled 10,737 (+981 from end-FY03/24), comprising 455 directly operated pharmacies and 10,282 affiliates.

Manufacture and Market Pharmaceuticals

The company offered 117 products (52 ingredients) as of end-December 2024. The number of new partner pharmacies steadily grew, with the total number of partner pharmacies reaching 6,562 (+2,148 YoY) as of end-December 2024. Revenue for consolidated subsidiary Feldsenf Pharma increased 59% to JPY3.5bn.

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.

The number of new stores using the service steadily grew in response to increased demand to address the NHI drug price revision. As of end-December 2024, the number of pharmacies using the service was 5,823 (+1,141 from end-FY03/24).

Segment profit

Segment profit fell 11.0% YoY, with the segment profit margin down 1.0pp to 5.0%, mainly due to fewer number of prescriptions filled at existing pharmacies in the Community Pharmacy business, higher pharmaceutical procurement costs, and increased labor costs from wage increases. Additionally, this segment absorbed the preparation costs for the Pharmaceutical Logistics business launched in FY03/25, reducing profitability.

Leasing and Facility-related

- Segment sales: JPY2.6bn (+2.5% YoY)
- Segment profit: JPY188mn (+45.7% YoY)

Operating conditions and results of serviced elderly housing facilities

Segment sales grew 2.5% YoY, driven by an increase in construction orders. Segment profit increased 45.7%, and segment profit margin increased 2.2pp to 7.2%. Profit growth was attributed to improved occupancy rates and expense control, including a review of advertising expenses related to the Wisteria serviced residences for the elderly.

As of end-December 2024, three of the four serviced residences maintained stable occupancy rates, with an overall occupancy rate of 89.0%. Wisteria Minami Ichijo reported an occupancy rate of 78.4% (91 out of 116 units occupied). The company sold Wisteria Senri-Chuo and related fixed assets on October 1, 2024.

Meal Catering

- Segment sales: JPY1.8bn (-0.7% YoY)
- Segment profit: JPY1mn (versus a loss of JPY24mn in cumulative Q3 FY03/24)

Lower sales but a return to profitability

Sales declined due to the closure of unprofitable facilities in FY03/24. However, a review of contract unit prices improved the gross profit margin, leading to a turnaround in profitability.

Other (mostly home-visit nursing care)

- Segment sales: JPY261mn (+10.1% YoY)
- Segment loss: JPY17mn (versus a loss of JPY30mn in cumulative Q3 FY03/24)

Company forecast for FY03/25

Recent performance and FY03/25 company forecast

	FY03/23			FY03/24			FY03/25		
(JPYmn)	1H Act.	2H Act.	FY Act.	1H Act.	2H Act.	FY Act.	1H Act.	2H Est.	FY Est.
Sales	**53,340**	**56,211**	**109,551**	**56,461**	**58,900**	**115,361**	**59,761**	**62,239**	**122,000**
YoY	2.2%	3.1%	2.7%	5.9%	4.8%	5.3%	5.8%	5.7%	5.8%
Cost of sales	31,024	32,606	63,630	31,024	36,412	67,436	35,097		
Gross profit	**22,315**	**23,606**	**45,921**	**23,453**	**24,472**	**47,925**	**24,664**		
Gross profit margin	41.8%	42.0%	41.9%	41.5%	41.5%	41.5%	41.3%		
SG&A expenses	21,215	21,543	42,758	21,740	22,353	44,093	23,636		
SG&A ratio	39.8%	38.3%	39.0%	38.5%	38.0%	38.2%	39.6%		
Operating profit	**1,099**	**2,064**	**3,163**	**1,712**	**2,120**	**3,832**	**1,027**	**1,973**	**3,000**
YoY	-41.0%	3.7%	-17.9%	55.8%	2.7%	21.2%	-40.0%	-6.9%	-21.7%
Operating profit margin	2.1%	3.7%	2.9%	3.0%	3.6%	3.3%	1.7%	3.2%	2.5%
Recurring profit	**1,242**	**2,113**	**3,355**	**1,692**	**2,133**	**3,825**	**1,020**	**1,980**	**3,000**
YoY	-44.4%	1.7%	-22.2%	36.2%	0.9%	14.0%	-39.7%	-7.2%	-21.6%
Recurring profit margin	2.3%	3.8%	3.1%	3.0%	3.6%	3.3%	1.7%	3.2%	2.5%
Net income	**502**	**1,108**	**1,610**	**861**	**999**	**1,860**	**207**	**1,043**	**1,250**
YoY	-64.9%	15.1%	-32.7%	71.5%	-9.8%	15.5%	-76.0%	4.4%	-32.8%
Net margin	0.9%	2.0%	1.5%	1.5%	1.7%	1.6%	0.3%	1.7%	1.0%

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

The company maintained its full-year FY03/25 earnings forecast, which had been revised downward on October 31, 2024, at the time of the Q3 earnings announcement (February 7, 2025). The details are as follows:

- Sales: JPY122.0bn (no change from the previous forecast)

- EBITDA: JPY6.4bn (down JPY1.0bn from the previous forecast JPY7.5bn)
- Operating profit: JPY3.0bn (down JPY1.0bn from JPY4.0bn)
- Recurring profit: JPY3.0bn (down JPY950mn from JPY4.0bn)
- Net income attributable to owners of the parent: JPY1.3bn (down JPY750mn from 2.0bn)
- Net income per share: JPY42.77 (from the previous forecast JPY68.43, JPY61.83 in FY03/24)

Performance outlook

Following the revisions to NHI drug prices and dispensing fees in 2024, pharmacies will aim to enhance interpersonal interactions while navigating a challenging business environment. The company anticipates continued demand within the pharmacy industry for operational efficiency and management stability, as well as increased expectations for the company's network.

For the Community Pharmacy Network segment, the company has established specific business strategies for each area of operation. In the Community Pharmacy business, it will enhance interpersonal services at dispensing pharmacies and support the digitalization of healthcare, including promoting the use of Individual Number Cards as health insurance cards. In the Pharmaceuticals Network business, the company intends to expand its service offerings, acquire new network affiliates, and improve the efficiency of pharmaceutical distribution. In the Manufacture and Market Pharmaceuticals business, efforts will be concentrated on ensuring a stable supply and broadening the customer base. For the Digital Shift business, the focus will be on increasing the adoption of the official LINE account "Tsunagaru (Connected) Pharmacy" and enhancing new services.

In April 2024, the company established a wholly-owned subsidiary, MediLogiNet Co., Ltd., engaged in pharmaceutical distribution, expecting short-term upfront costs. The company also incorporated extraordinary gains from the transfer of the Wisteria Senri-Chuo business, recorded as a gain on the sale of fixed assets in Q3, into its earnings forecast.

Forecast by key segment

- Community Pharmacy Network segment: sales of JPY116.4bn (+5.9% YoY), segment profit of JPY5.5bn (-14.0% YoY).

In the Community Pharmacy business, the company will continue supporting the digitalization of healthcare, enhancing interpersonal services through the official LINE account "Tsunagaru (Connected) Pharmacy", and increasing the number of prescriptions filled. The company also set numerical targets for the three subdivisions that support the Community Pharmacy business:
1) Pharmaceutical Network business: 10,756 network affiliates (+1,000 YoY)
2) Manufacture and Market Pharmaceuticals business: 7,000 partner pharmacies (+2,002 YoY)
3) Digital Shift business: 5,700 pharmacies adopting the company's service (+1,018 stores YoY) and 1.4mn registered users (+350,000 YoY)

- Other three segments (total for Leasing and Facility-related, Meal Catering, and Home-visit Nursing Care): sales of JPY6.2bn (-1.4% YoY), segment profit of JPY200mn (+285.7% YoY).

- Adjustments: -JPY548mn for sales, -JPY2.7bn for segment profit.

Priority measures

In FY03/25, the company aims to take measures in anticipation of changes in its business environment and advance specific initiatives to support inter-business collaboration as it heads toward FY03/26, the final year of its sixth medium-term management plan. For example, in the Community Pharmacy Network segment, the company plans to enhance pharmacy functions in the Community Pharmacy business and strengthen inter-business collaboration in the three supporting businesses mainly by introducing the inventory management system LINCLE. In the Leasing and Equipment-related segment and other businesses, it intends to take measures to address inflationary pressures and review unprofitable operations.

As part of initiatives in new growth areas, the company plans to establish the pharmaceutical logistics company MediLogiNet as a new business and make investments centered on core systems for its pharmaceutical network and customer management systems.

Medical fee revisions

In the NHI drug price and dispensing fee revisions of April 2024, drug prices were reduced by 0.97% on average, while dispensing fees were increased by 0.16% and by another 0.28% as part of the government's measures to propel wage increases. 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. For more details, see "FY2024 medical fee revisions" in the "Market and valuation" section.

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. The quantitative targets for the final year (FY03/26) of the plan are 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). The company maintained these targets as of end-FY03/24.

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." 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 Tsunagaru Pharmacy service on the official LINE account 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 (FY03/26).

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-FY03/24, 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. With the exception of the Other segment, all business segments continue to be operated by the 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%
(Manufacture and market pharmaceuticals)	Feldsenf Pharma Co., Ltd.	Sapporo, Hokkaido	80.0%
(Digital Shift)	PharmaShift Co., Ltd.	Minato-ku, Tokyo	100.0%
Leasing and Facility-related	Paltecno Co., Ltd.	Sapporo, Hokkaido	100.0%
Meal Catering	Sakura Foods Co., Ltd.	Kasuya, Fukuoka	100.0%

Source: Shared Research based on data from the company website.
**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 March 31, 2024

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 FY03/24, 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

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)	FY03/20	FY03/21	FY03/22	FY03/23	FY03/24
Dispensing fees	89,919	88,320	91,056	93,029	97,765
Rate of change	8.6%	-1.8%	3.1%	2.2%	5.1%

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 community pharmacies, mostly of the Nanohana brand, totaled 450 at end-March 2024. 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 companies by sales.

Sales and number of pharmacies in dispensing pharmacy-related businesses

	FY end	Sales (JPYmn)	No. of pharmacies
1 Ain Holdings	April	321,577	1,209
2 Qol	March	165,188	920
3 Nihon Chouzai	March	302,805	736
4 TOHO Holdings	March	93,789	706
5 Suzuken	March	87,344	559
6 Medical System Network	March	109,854	450
7 Pharmarise Holdings	May	42,327	300
8 Tokai Corp.	March	52,287	154
9 Ship Healthcare Holdings	March	32,831	129
10 Medical Ikkou Co., Ltd.	February	23,537	94

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 2024.

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

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 business—the predecessor of the business—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 small- to mid-sized dispensing pharmacies not affiliated with any of the major chains.

As of the end of FY03/24, the number of pharmaceutical network member stores (the total of directly operated stores and general network affiliates) reached 9,756, translating into average annual growth of about 25% over the past 10 years. According to the Ministry of Health, Labour and Welfare, there were 62,375 dispensing pharmacies in Japan in FY2021, and the share of the company's network member stores exceeded 15%, 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 JPY618.2bn (+17.5% YoY) in FY03/24, among the largest in Japan and a significant scale even for a pharmaceutical wholesaler.

Number of directly operated pharmacies and affiliates, and total value of drug orders

	FY03/15	FY03/16	FY03/17	FY03/18	FY03/19	FY03/20	FY03/21	FY03/22	FY03/23	FY03/24
Directly operated pharmacies	345	353	377	399	420	450	416	425	428	450
Affiliates	855	1,047	1,393	2,110	3,370	4,829	5,700	6,976	8,484	9,306
Pharmaceutical network member stores	1,200	1,400	1,770	2,509	3,790	5,279	6,116	7,401	8,912	9,756
Pharmaceutical order value (JPYbn)	97.7	123.7	137.4	169.2	233.7	336.8	391.7	449.2	526.2	618.2

Source: Shared Research based on company data

Four functions

The business offers comprehensive support to dispensing pharmacies, not only in the form of distribution support contributing to the sourcing of drugs that are essential for business operation, but also in terms of pharmacist training and financing. It can be broken down into the following major functions.

(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.

In FY03/24, 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 15% of the domestic dispensing pharmacy market. Shared Research understands that the company's 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. For affiliates, reductions in wasted pharmaceutical contribute to greater operational efficiency and stable management. 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. ISK is registered as an organization that conducts practical training sessions for groups. By attending the workshops and earning the required credits, participants can obtain the qualification of a certified pharmacist in-training from the Japan Pharmacists Education Center (JPEC), a public interest incorporated foundation.

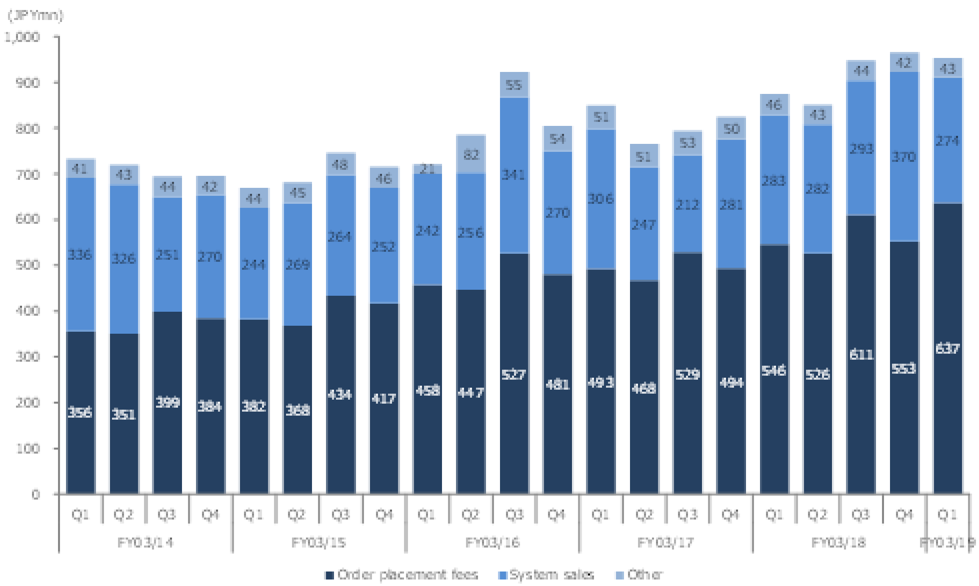
ISK is one of the few private-sector organizations registered as a provider of various certification programs for pharmacists. Medical System Network and ISK help pharmacies run training sessions and apply for accreditation, which enables them to become members of the ISK organization and run JPEC accredited 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 (through Q1 FY03/19)



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

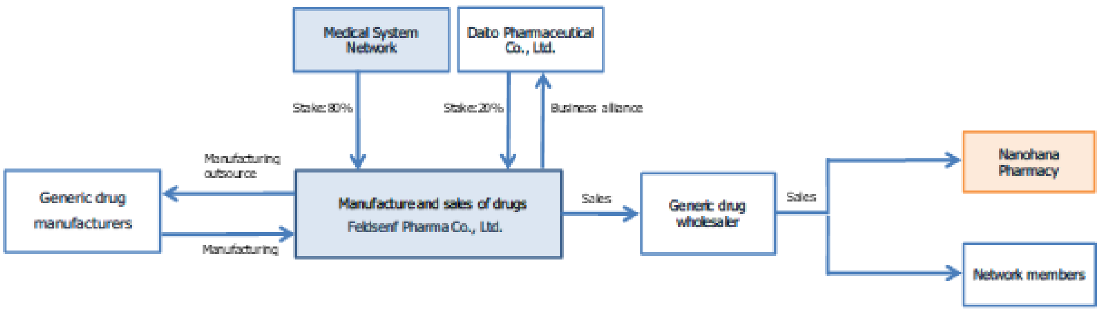
Business overview

The Manufacture and Market Pharmaceuticals business was transferred from the Other business to the Community Pharmacy Network segment 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 FY03/24, it supplied drugs to 4,998 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 48 APIs across 103 products as of FY03/24. 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 JPY3.2bn in FY03/24, 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	FY03/24
Sales	0.1	0.4	1.1	1.8	2.6	3.2
Number of items handled	17 ingredients, 34 items	23 ingredients, 51 items	34 ingredients, 68 items	41 ingredients, 82 items	45 ingredients, 93 items	48 ingredients, 103 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).
PharmaShift became a wholly owned subsidiary of the company in FY03/24.

PharmaShift's main business is Family Pharmacy Support Service. Medical System Network created the Digital Shift business as a new business in its Community Pharmacy Network segment with the establishment of PharmaShift.

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 further integrate various functions based on the company's 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. It aims to develop services 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 FY03/24, the number of registered friends (users) increased about 1.6x YoY to 1.0mn as the number of directly operated and affiliated pharmacies using the service expanded. 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 predetermined fee for using the service, and the number of pharmacies using the service has risen to 4,682.

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 also plans to promote the system as a standard service of its network among dispensing pharmacy operators that are not affiliates.

LINE is a messaging application developed and operated by LY Corporation (TSE Prime: 4689; formed through the merger of the former LINE Corporation and the former Yahoo! Japan Corporation in October 2023). 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 the two directly operated 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 FY03/24, the segment was adversely affected by factors such as a slowdown in the number of new residents entering facilities due to effects from the pandemic, and higher utility costs amid rising energy costs. However, segment sales grew 3.3% YoY to JPY3.6bn, and the segment profit came to JPY158mn (a loss of JPY92mn in FY03/23).

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 FY03/24, the number of meals supplied decreased owing to effects from the pandemic, and procurement prices increased. Sales were JPY2.4bn (+3.1% YoY) and the segment loss was JPY43mn (a loss of JPY65mn in FY03/23).

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

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, and thereafter surpassed 70% in FY2016 and reached 80.3% in FY2023.

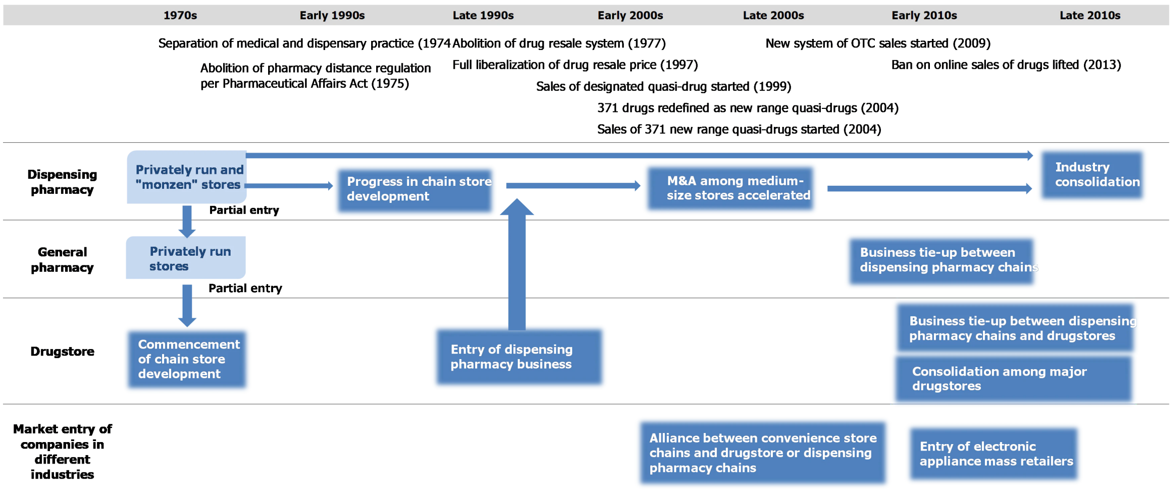
The number of dispensing pharmacies steadily increased as separation of prescribing/dispensing advanced and pharmacies that previously marketed OTC drugs became dispensing pharmacies. There was also a pronounced increase in independent pharmacies operating near large hospitals—so-called "monzen" (Japanese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

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
No. of pharmacies	46,763	48,252	49,332	49,956	50,600	51,233	51,952	52,539
	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
No. of pharmacies	53,304	53,642	53,001	54,780	55,797	57,071	57,784	58,326
	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	
No. of pharmacies	58,678	59,138	59,613	60,171	60,951	61,791	62,375	

Source: Shared Research based on MHLW's Report on Public Health Administration and Services
Note: Data for FY2010 does not include parts of Miyagi and Fukushima Prefectures

Developments surrounding dispensing pharmacies



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

Number of prescriptions

	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
Number of prescriptions filed (mn)	720.08	730.56	761.69	778.51	789.86	794.30	808.31	823.72
	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	
Number of prescriptions filed (mn)	829.99	838.86	843.61	842.84	764.97	802.05	837.62	

Source: Shared Research based on MHLW's Trends in Dispensing and Medical Care Expenses
Note: Shared Research attributes the decline in the number of prescriptions in 2020 to an increase in long-term prescriptions amid the spread of COVID-19.

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. This perspective is based on the community-based integrated care system promoted by MHLW, a framework under which the functions required of dispensing pharmacies and pharmacists are diversifying.

Community-based integrated care system
This is a social collaboration concept promoted by MHLW. It is defined as a system that ensures comprehensive support for healthcare, nursing care, prevention of long-term care, housing, and independent daily living, enabling elderly individuals to lead independent daily lives in their familiar communities to the extent possible in accordance with their capabilities. The system consists of five components: housing, healthcare, nursing care, preventive care, and daily living support. These elements are expected to work together, forming organic relationships. The practical implementation of the system is not uniform but needs to be tailored to the characteristics of each region. For example, different models include those geared toward rural villages (hilly and mountainous areas), island/coastal areas, urban areas, metropolitan areas, and housing complexes. Once established, the system is expected to yield various benefits such as reducing the number of bedridden elderly, slowing the growth rate of medical expenses, and stimulating regional economic activity.

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.

Dispensing and medical care expenses

(JPYbn)	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Dispensing fee (total)	7,038.0	7,198.7	7,874.6	7,495.3	7,712.9	7,474.6	7,746.4	7,544.7	7,751.5	7,882.1
Technical fee	1,737.1	1,768.2	1,828.3	1,849.0	1,912.2	1,931.1	1,977.1	1,877.9	2,010.3	2,126.4
Drug fee	5,244.4	5,371.1	5,978.3	5,577.8	5,741.3	5,483.4	5,711.4	5,605.8	5,680.0	5,690.8

Source: Shared Research based on MHLW's Trends in Dispensing and Medical Care Expenses

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.

Expanding roles of dispensing pharmacists

Number of pharmacists

('000)	FY2006	FY2008	FY2010	FY2012	FY2014	FY2016	FY2018	FY2020	FY2022
Pharmacies	125.25	135.72	145.60	153.01	161.20	172.14	180.42	188.98	190.74
Hospitals and clinics	48.96	50.34	52.01	52.70	54.88	58.04	59.96	61.60	62.46
Other	78.32	81.70	78.90	74.34	72.07	71.14	70.92	71.40	70.49
Total	252.53	267.75	276.52	280.05	288.15	301.32	311.29	321.98	323.69

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

Amid changes in business conditions such as the advancement and increasing complexity of medical care and Japan's declining birthrate and aging society, the roles and tasks required of pharmacists are evolving. In 2019, the Act on Pharmaceuticals and Medical Devices Law was revised to the Act on Securing Quality, Efficacy and Safety of Products Including Pharmaceuticals and Medical Devices, which redefined the roles of pharmacists and dispensing pharmacies.

Specific changes involved the promotion of family pharmacists and pharmacies, the advancement of team-based medical care in medical institutions, and measures undertaken as a member of the community-based integrated care system. These changes reflected a shift in roles and tasks beyond traditional dispensing operations.

As the community-based integrated care system is further developed, dispensing pharmacies and pharmacists will be called on to fulfill their roles by collaborating and sharing information with physicians and other professionals as well as related medical institutions in accordance with regional conditions. This collaboration will ensure the provision of uniform and continuous drug therapies to patients.

Pharmacists are expected to exercise pharmaceutical management by keeping track of medication conditions not only when drugs are dispensed but continuously throughout the medication period. They must provide information and guidance to patients based on their pharmaceutical expertise as necessary. Such information also needs to be shared with primary care physicians, dentists, and other professionals, as well as related organizations. Moreover, to ensure appropriate pharmaceutical management and encourage necessary medical consultations, pharmacists have to understand the usage conditions and other details for prescribed medications, over-the-counter drugs, and so-called "health foods" that require medication guidance.

As the roles of pharmacists expand, dispensing pharmacies need to create a work environment that allows pharmacists to fully perform their duties. This includes strengthening interpersonal services provided by pharmacists. From this perspective, it is necessary to improve the efficiency of tasks such as dispensing drugs with the underlying aim of ensuring service quality.

FY2024 medical fee revisions

The FY2024 medical fee revisions were as follows.

Net medical fee revision -0.12% = medical fee +0.88% + drug reimbursement price, etc. -1.00%

The increase in the core medical fee includes +0.61% for wage increases, +0.06% for inpatient meal costs, -0.25% for the optimization of prescription fees, etc., and +0.46% for other revisions (+0.52% for medical fees, +0.57% for dental fees, and +0.16% for dispensing fees). While the overall medical fee has increased, the breakdown includes reductions of -0.97% for NHI drug prices and -0.02% for medical material prices. Shared Research thinks 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 an ongoing recognition of pharmacies that contribute to community-based medical care such as through provision of medication information to hospitals.

The Ministry of Health, Labour and Welfare released information concerning temporary revisions to the medical fee reimbursement system starting from April 1, 2024. Under these temporary revisions, the following three special measures apply. Shared Research understands 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	2006	2008	2010	2012	2014	2016	2018	2019	2020	2022	2024
Core medical fees (actual)	-1.36	+0.38	+1.55	+1.379	+0.10	+0.49	+0.55	+0.41	+0.55	+0.43	+0.88
Dispensing fee	-0.60	+0.17	+0.52	+0.46	+0.04	+0.17	+0.19	+0.12	+0.16	+0.08	+0.16
Drug prices (actual)	-1.80	-1.20	-1.36	-1.375	-1.36	-1.33	-1.74	-0.95	-1.01	-1.35	-1.00
NHI basis	-6.70	-5.20	-5.75	-6.00	-5.64	-5.57	-7.48	-2.40	-4.38	-1.44	-0.97
Consumption tax addition	-	-	-	-	+1.36	-	-	+0.48	-	-	-
Total (nominal)	-3.16	-0.82	+0.19	+0.004	+0.10	-0.84	-1.19	-0.07	-0.46	-0.94	-0.12

Source: Shared Research based on company data

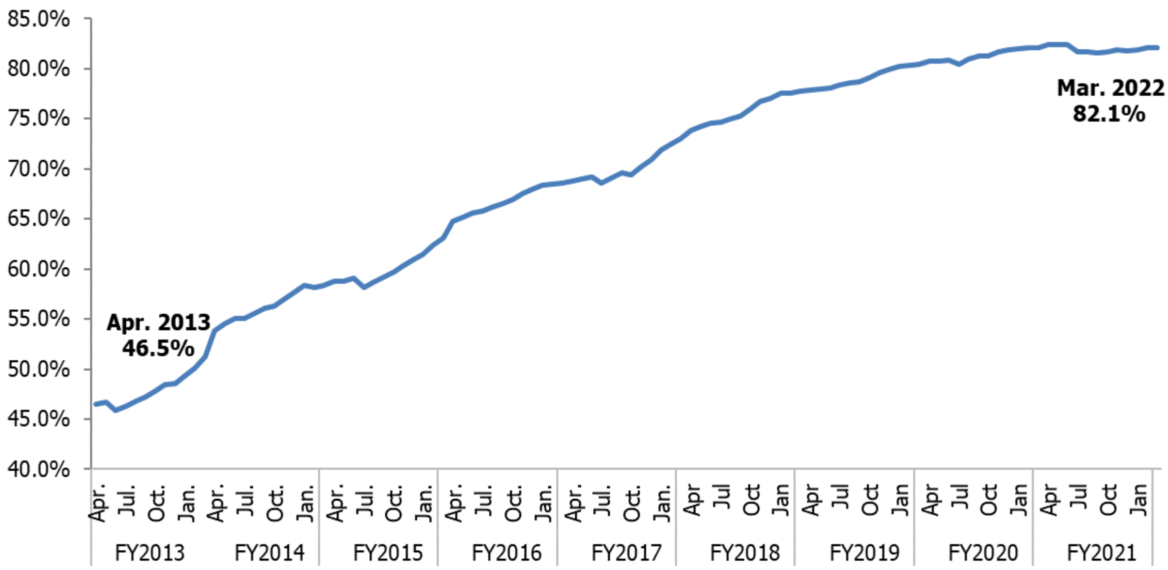
The key point regarding dispensing fees raised around the time of the FY2018 revision is a reassessment of the role of dispensing pharmacies with an emphasis on patient-centered service. Specifically, it promotes evaluation of family pharmacies and pharmacists, patient-centric businesses and at-home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

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 (medical fee revision continues to be held every one year), with the first mid-year revision conducted in April 2021. The shift is driven by the intention of the Japanese government and MHLW to reduce healthcare expenditures by reflecting the drop in market values more quickly into official pricing, and thereby also properly reflect market values into NHI drug prices.

It is appropriate to widen the scope of the mid-year revision of NHI drug prices as much as possible to reduce the national burden. Under such an approach, revisions are implemented for all categories of pharmaceuticals with a high pricing differential, such as new drugs, long-listed drugs, generics, and others. However, the annual revisions to NHI drug prices are occurring in an environment of rising manufacturing costs due to energy and raw material price increases, and this is creating management pressures and other problems for pharmaceutical manufacturers (including new drug and generic drug manufacturers). Shared Research anticipates the impact of the annual NHI price revisions will be far-reaching, not limited to generic and brand drug manufacturers but also extending to pharmaceutical distribution-related companies and dispensing pharmacies. MHLW has also stated that it will continue to study the structure of the new system.

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	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
2796	Pharmarise Holdings	May	2.0%	3.5%	2.3%	3.4%	3.4%	4.1%	4.0%	-
3034	Qol Holdings	March	5.1%	6.4%	4.7%	4.7%	6.5%	7.7%	7.4%	6.5%
3341	Nihon Chouzai	March	5.0%	6.0%	4.2%	4.2%	4.3%	4.3%	5.2%	5.0%
4350	Medical System Network	March	2.8%	3.5%	3.6%	3.8%	5.7%	6.0%	5.6%	32.3%
-	Sogo Medical Holdings	March	6.3%	6.5%	5.0%	-	-	-	-	-
7649	Sugi Holdings	February	5.3%	5.4%	5.3%	5.5%	5.6%	5.1%	4.7%	4.9%
9627	Ain Holdings	April	8.6%	9.5%	7.5%	7.9%	8.0%	8.9%	7.5%	-

Source: Shared Research based on materials and websites of the various companies (as of end-May 2024)
Notes:* Values for Medical System Network are profit margins of the Community Pharmacy Network business from 2019.
** Sogo Medical Holdings was 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	52,030	2.8%	5.1%	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	180,052	4.6%	9.6%	Major pharmacy chain. Started as monzen pharmacy. Opened stores with Lawson and Bic Camera. Also developing MR and pharmacist dispatch business.
3341	Nihon Chouzai	340,310	2.7%	4.4%	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	115,361	3.3%	12.6%	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	744,477	4.9%	9.8%	Developed drugstore/dispensing pharmacy, Sugi Pharmacy, in its stronghold Tokai area. The holding company also has discount stores.
9627	Ain Holdings	358,742	4.5%	7.5%	Top-ranked dispensing pharmacy chain. Originated in Hokkaido, expanded into metropolitan areas, with nationwide coverage of mainly monzen pharmacies. Concluded capital and business tie-up with Seven & i Holdings.

Source: Shared Research based on company data

Medical System Network (specifically, its Community Pharmacy Network segment) 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).

In terms of unifying the management style of dispensing pharmacies under one group, the company envisions two scenarios. One involves dispensing pharmacies joining the Nanohana Pharmacy group through capital means such as M&A, which is the approach taken by other major chains. Under the second scenario, dispensing pharmacies retain their original management structure, but join the company's network as members. In this way, independently managed dispensing pharmacies can benefit from the same operational services as large chains without losing their management rights.

Financials of industry peers

(JPYmn)	Medical System Network(4350)			Pharmarise Holdings (2796)			Qol Holdings (3034)		
	FY03/22	FY03/23	FY03/24	FY05/21	FY05/22	FY05/23	FY03/22	FY03/23	FY03/24
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	106,685	109,551	115,361	52,324	51,608	52,030	166,199	170,036	180,052
Gross profit	44,429	45,921	47,925	8,067	8,117	8,134	23,163	23,504	23,249
SG&A expenses	40,576	42,758	44,093	6,821	6,596	6,695	13,308	14,009	14,925
Operating profit	3,852	3,163	3,832	1,246	1,520	1,438	9,855	9,495	8,324
Recurring profit	4,313	3,355	3,825	1,288	1,517	1,431	10,094	10,098	9,256
Net income	2,394	1,610	1,860	426	447	333	5,489	5,656	4,880
ROE	19.6%	11.6%	12.6%	7.3%	7.2%	5.1%	12.9%	12.2%	9.6%
ROA (RP-based)	6.8%	5.2%	5.7%	5.2%	6.3%	6.1%	10.3%	10.2%	8.4%
Operating profit margin	3.6%	2.9%	3.3%	2.4%	2.9%	2.8%	5.9%	5.6%	4.6%
Total assets	62,941	66,223	68,149	24,724	23,746	23,421	95,984	101,905	117,779
Net assets	13,286	14,488	15,219	6,331	6,699	6,987	43,881	48,856	52,837
Equity ratio	21.1%	21.8%	22.3%	24.3%	26.9%	28.5%	45.7%	47.9%	44.8%
Operating CF	4,010	4,973	7,725	1,945	713	2,520	10,112	11,662	13,533
Investing CF	-2,511	-2,114	-3,649	-1,076	-292	-703	-3,087	-7,013	-13,155
Financing CF	-3,415	-2,918	-3,944	-728	-1,034	-1,072	-10,006	-2,569	7,969
Cash and deposits	8,201	8,111	8,242	4,604	3,991	4,734	16,516	18,596	26,944
Interest-bearing debt	29,566	30,516	29,179	10,251	9,575	7,411	23,282	22,750	31,632
Net debt	21,365	22,405	20,937	5,647	5,584	2,677	6,766	4,154	4,688
	Nihon Chouzai (3341)			Sugi Holdings (7649)			Ain Holdings (9627)		
	FY03/22	FY03/23	FY03/24	FY02/22	FY02/23	FY02/24	FY04/21	FY04/22	FY04/23
	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.	Cons.
Sales	299,392	313,318	340,310	625,477	667,647	744,477	297,305	316,247	358,742
Gross profit	52,422	53,643	57,236	191,490	202,524	228,837	46,155	49,971	53,698
SG&A expenses	45,833	46,057	48,093	159,353	170,865	192,215	35,222	34,832	37,694
Operating profit	6,589	7,586	9,142	32,137	31,658	36,622	10,932	15,139	16,004
Recurring profit	6,767	7,682	9,439	33,082	32,391	38,039	12,649	16,041	17,064
Net income	3,705	4,458	2,553	19,389	19,007	21,979	6,697	7,092	9,234
ROE	7.2%	8.2%	4.4%	9.4%	8.8%	9.8%	5.9%	6.0%	7.5%
ROA (RP-based)	3.7%	4.2%	5.0%	9.7%	9.4%	10.2%	6.4%	7.7%	7.7%
Operating profit margin	2.2%	2.4%	2.7%	5.1%	4.7%	4.9%	3.7%	4.8%	4.5%
Total assets	178,753	185,297	195,087	334,758	351,895	390,563	203,662	212,461	23,175
Net assets	52,876	56,483	58,351	213,890	216,538	233,362	115,837	119,010	126,546
Equity ratio	29.6%	30.5%	29.9%	63.9%	61.5%	59.8%	56.8%	56.0%	54.6%
Operating CF	19,411	7,532	20,421	7,174	38,279	39,041	14,928	26,156	20,267
Investing CF	-9,313	-10,018	-13,726	-23,892	-23,256	-30,976	-9,493	-13,943	-22,292
Financing CF	-17,448	713	-4,430	-5,295	-14,209	-5,284	3,643	-7,753	-11,237
Cash and deposits	25,543	23,770	26,034	33,831	34,622	37,406	55,009	59,470	46,217
Interest-bearing debt	42,806	58,126	54,923	0	0	837	12,004	8,467	8,723
Net debt	17,263	34,356	28,889	-33,831	-34,622	-36,569	-43,005	-51,003	-37,494

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 sales 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 improves 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. 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 JPY68.0bn. In order to advance acquisitions and increase pharmacy outlets in regions other than its Hokkaido, its primary trading area, 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	FY03/15	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.
Sales	**75,548**	**87,715**	**88,865**	**93,977**	**98,232**	**105,241**	**104,257**	**106,685**	**109,551**	**115,361**
YoY	14.2%	16.1%	1.3%	5.8%	4.5%	7.1%	-0.9%	2.3%	2.7%	5.3%
Cost of sales	47,072	54,913	54,700	57,369	60,961	65,027	61,845	62,256	63,630	67,435
Gross profit	**28,476**	**32,801**	**34,164**	**36,607**	**37,271**	**40,214**	**42,412**	**44,429**	**45,921**	**47,925**
YoY	25.2%	15.2%	4.2%	7.2%	1.8%	7.9%	5.5%	4.8%	3.4%	4.4%
Gross profit margin	37.7%	37.4%	38.4%	39.0%	37.9%	38.2%	40.7%	41.6%	41.9%	41.5%
SG&A expenses	25,835	29,018	32,050	33,444	35,842	38,599	38,982	40,576	42,758	44,093
SG&A ratio	34.2%	33.1%	36.1%	35.6%	36.5%	36.7%	37.4%	38.0%	39.0%	38.2%
Operating profit	**2,641**	**3,783**	**2,113**	**3,163**	**1,428**	**1,615**	**3,429**	**3,852**	**3,163**	**3,832**
YoY	26.3%	43.2%	-44.1%	49.7%	-54.9%	13.1%	112.3%	12.3%	-17.9%	21.2%
Operating profit margin	3.5%	4.3%	2.4%	3.4%	1.5%	1.5%	3.3%	3.6%	2.9%	3.3%
Non-operating income		457	275	378	405	288	361	758	550	392
Non-operating expenses	349	380	279	291	333	343	312	296	358	392
Recurring profit	**2,540**	**3,860**	**2,109**	**3,250**	**1,501**	**1,560**	**3,479**	**4,313**	**3,355**	**3,825**
YoY	25.8%	52.0%	-45.4%	54.1%	-53.8%	3.9%	123.0%	24.0%	-22.2%	14.0%
Recurring profit margin	3.4%	4.4%	2.4%	3.5%	1.5%	1.5%	3.3%	4.0%	3.1%	3.3%
Extraordinary gains	169	88	57	19	49	48	914	146	7	119
Extraordinary losses	415	470	260	976	128	1,586	426	447	343	493
Income taxes	1,315	1,599	1,262	1,271	962	918	1,769	1,624	1,389	1,579
Implied tax rate	57.3%	46.0%	66.2%	55.4%	67.7%	4172.7%	44.6%	40.5%	46.0%	45.8%
Net income attributable to non-controlling interests	92	158	72	0	-2	0	0	-5	19	10
Net income	**885**	**1,720**	**571**	**1,022**	**462**	**-895**	**2,198**	**2,394**	**1,610**	**1,860**
YoY	32.4%	94.4%	-66.8%	79.0%	-54.8%	-293.7%	-345.6%	8.9%	-32.7%	15.5%
Net margin	1.2%	2.0%	0.6%	1.1%	0.5%	-0.9%	2.1%	2.2%	1.5%	1.6%

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 from FY03/13. 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.

OPM has remained in the 1% range in FY03/19 and FY03/20 amid a severe business environment characterized by NHI drug price 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, OPM 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, OPM was below 3% due to increases in personnel, utilities, and other costs. In FY03/24, the company made progress in controlling expenses and returned to the 3% of OPM.

SG&A expenses

SG&A expenses	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.
Salaries and allowances	9,266	10,406	12,088	12,481	13,467	14,195	14,435	15,301	15,938	16,215
Provision for employee bonuses	939	1,062	1,133	1,418	1,333	1,393	1,486	1,526	1,561	1,675
Retirement benefit expenses	264	329	361	466	457	596	566	576	602	647
Provision for directors' bonuses	76	55	47	35	33	41	42	39	40	37
Provision for directors' stock benefits		33	52	38	33	35	29	32	32	34
Taxes and dues	3,870	4,479	4,374	4,420	4,692	5,691	5,818	6,068	6,247	6,645
Depreciation	945	1,029	1,052	1,491	1,624	1,811	1,859	1,727	1,825	2,031
Amortization of goodwill	849	917	1,009	1,056	1,147	1,217	1,136	1,128	1,132	1,132
Other	7,537	8,486	9,630	9,559	15,827	16,648	16,606	14,179	15,381	15,677
Total	25,835	29,018	32,050	33,444	35,842	38,599	38,982	40,576	42,758	44,093

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	FY03/15	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.
Assets										
Cash and deposits	2,499	2,081	2,252	10,201	11,703	11,722	10,118	8,201	8,141	8,273
Notes and accounts receivable	2,484	2,614	2,223	2,332	2,420	2,313	2,646	2,891	3,437	4,239
Inventories	3,846	3,431	4,053	3,520	4,361	4,544	4,483	4,869	5,268	5,539
Other	709	927	958	868	1,464	848	919	1,346	1,928	1,235
Allowance for doubtful accounts	-7	-7	-10	-11	-12	-12	-12	-3	-11	-14
Total current assets	**11,023**	**10,783**	**11,098**	**18,736**	**21,055**	**20,578**	**19,313**	**18,701**	**20,265**	**20,773**
Total tangible fixed assets	**17,249**	**20,253**	**21,246**	**24,129**	**25,721**	**25,126**	**24,634**	**24,624**	**27,060**	**28,336**
Total intangible assets	**13,554**	**13,481**	**13,833**	**15,045**	**16,235**	**14,615**	**13,572**	**12,767**	**11,807**	**11,281**
Investment securities	157	524	583	812	726	483	397	155	159	184
Long-term loans receivable										
Other	3,631	3,838	4,008	4,066	5,217	5,686	6,549	6,712	6,950	7,594
Allowance for doubtful accounts	-29	-33	-32	-31	-21	-26	-20	-19	-19	-19
Investment and other assets	**3,759**	**4,329**	**4,559**	**4,847**	**5,922**	**6,143**	**6,926**	**6,848**	**7,090**	**7,759**
Total fixed assets	**34,564**	**38,063**	**39,639**	**44,023**	**47,879**	**45,885**	**45,134**	**44,239**	**45,958**	**47,376**
Total assets	**45,587**	**48,847**	**50,737**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**	**68,149**
Liabilities										
Notes and accounts payable	8,598	9,525	9,144	9,416	10,198	10,021	9,258	9,680	9,937	10,935
Short-term debt	9,214	6,910	3,863	7,463	9,158	8,905	10,210	5,935	6,377	6,116
Income taxes payable	599	1,065	413	1,135	695	454	1,556	617	600	999
Other	3,215	3,561	3,500	3,755	3,793	3,916	4,394	4,203	4,435	5,163
Total current liabilities	**21,626**	**21,061**	**16,920**	**21,769**	**23,844**	**23,296**	**25,418**	**20,435**	**21,349**	**23,213**
Long-term debt	15,391	14,859	20,186	26,329	29,739	28,653	22,348	23,631	24,139	23,063
Deferred tax liabilities	1	1	1							
Other	2,434	2,660	2,985	4,075	4,590	5,096	5,493	5,588	6,246	6,653
Total fixed liabilities	**17,826**	**17,520**	**23,172**	**30,404**	**34,329**	**33,749**	**27,841**	**29,219**	**30,385**	**29,716**
Total liabilities	**39,452**	**38,581**	**40,092**	**52,174**	**58,173**	**57,045**	**53,260**	**49,654**	**51,735**	**52,930**
Net assets										
Capital stock	1,091	1,932	1,932	2,097	2,128	2,128	2,128	2,128	2,128	2,128
Capital surplus	901	1,742	1,742	1,160	1,185	1,183	1,182	1,182	1,182	937
Retained earnings	4,980	6,467	6,735	7,459	7,616	6,414	8,305	10,393	11,606	13,100
Treasury stock	-1,147	-328	-302	-275	-233	-206	-344	-326	-326	-882
Valuation differences on securities	11	15	49	143	83	-37	-24	-7	-2	19
Other	-28	-17	23	52,316	58,239	56,945	53,154	49,547	51,596	52,819
Non-controlling interests	338	469	514	2	0	0	23	17	37	47
Total net assets	**6,136**	**10,265**	**10,644**	**10,584**	**10,761**	**9,418**	**11,187**	**13,286**	**14,488**	**15,219**
Total liabilities and net assets	**45,588**	**48,846**	**50,736**	**62,759**	**68,935**	**66,464**	**64,448**	**62,941**	**66,223**	**68,149**
Working capital	-2,268	-3,480	-2,868	-3,564	-3,417	-3,164	-2,129	-1,920	-1,232	-1,157
Total interest-bearing debt	24,605	21,769	24,049	33,792	38,897	37,558	32,558	29,566	30,516	29,179
Net debt	22,120	19,708	21,814	23,591	27,194	25,836	22,440	21,365	22,375	20,906

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

Assets

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 was 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 pharmaceutical network operations. Note that H&M Co., Ltd. was dissolved in February 2020.

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. Tangible fixed assets increased due to store development centered on medical malls in FY03/23, and due to M&A activity and other factors in FY03/24.

Liabilities

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 have continued to rise gradually thereafter. Short- and long-term borrowings have been over JPY30.0bn since FY03/18. Profits recovered 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 and FY03/24.

Net assets

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 and FY03/24, net assets continued to expand due to an increase in retained earnings.

Cash flow statement

Cash flow statement	**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.**
Cash flows from operating activities (1)	3,838	6,409	3,084	6,699	2,840	4,232	5,205	4,010	4,973	7,725
Pre-tax profit	2,294	3,479	1,906	2,293	1,422	22	3,967	4,012	3,019	3,451
Depreciation	1,209	1,362	1,594	1,491	1,624	1,811	1,859	1,727	1,825	2,031
Amortization of goodwill	849	917	1,009	1,056	1,147	1,217	1,136	1,128	1,132	1,054
Change in trade receivables	935	191	812	496	500	285	-239	-214	-505	-421
Change in inventories	-689	455	-472	759	-620	-140	72	-406	-377	-192
Change in trade payables	-295	683	-765	-569	69	-328	-864	400	211	735
Cash flows from investing activities (2)	-3,958	-5,040	-3,909	-6,848	-5,921	-2,383	-1,485	-2,511	-2,114	-3,649
Purchase of tangible fixed assets	-2,360	-3,674	-2,170	-4,050	-3,094	-1,351	-1,375	-1,934	-1,343	-1,765
Purchase of intangible assets	-93	-273	-192	-190	-82	-107	-154	-194	-234	-248
Purchase, sale, and redemption of investment securities		-267	-19	-39	-16	102	18	379	0	6
Change in loans (short- and long-term; net)	-106	-106	-38	-95	-3	-102	-233	7	-124	-43
Free cash flow (1+2)	**-120**	**1,369**	**-825**	**-149**	**-3,081**	**1,849**	**3,720**	**1,499**	**2,859**	**4,076**
Cash flows from financing activities	-483	-1,792	998	8,050	4,338	-1,687	-5,312	-3,415	-2,918	-3,944
Change in short-term borrowings	-4,334	-2,314	-3,241	2,598	1,471	-505	0	-2,901	-	-428
Change in long-term borrowings	4,816	-896	5,292	7,292	3,701	-376	-4,634	33	-2,269	-1,946
Acquisition of treasury stock		1,005	0							
Dividends paid	-190	-229	-297	-297	-304	-305	-304	-304	-395	-365

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 the 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 an earnings recovery. In FY03/23, operating cash flow increased due to a decline in corporate tax payments. In FY03/24, operating cash flow rose further due to growth in pre-tax profit and depreciation.

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 flows 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. T

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 the opening of Wisteria Minami Ichijo in November 2018 would mark 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 to FY03/24, free cash flow has remained positive after taking into account M&A deals and other factors.

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, and this trend continued thereafter. As a result, cash flows from financing activities have remained positive in FY03/23 and FY03/24.

Historical performance

1H FY03/25 results (out November 8, 2024)

Overview

1H FY03/25 (April—September 2024) earnings results

- Sales: JPY59.8bn (+5.8% YoY)
- Operating profit: JPY1.0bn (-40.0% YoY)
- Recurring profit: JPY1.0bn (-39.7% YoY)
- Net income attributable to owners of the parent: JPY207mn (-76.0% YoY)

Operating results and business conditions

The Japanese economy saw a gradual recovery in 1H, driven by improved employment and income. However, economic conditions remain uncertain due to concerns over persistent price increases and potential revisions to financial policies.

Sales increased 5.8% YoY in 1H FY03/25, driven by a 6.2% YoY rise in the Community Pharmacy Network business. Sales in all other segments, except Meal Catering, also grew.

Gross profit increased 5.2% YoY to JPY24.7bn, but the gross profit margin declined by 0.2pp to 41.3%. Growth in the number of affiliates in the Pharmaceuticals Network business and higher technical fees (a portion of prescription unit prices) contributed to the increase in gross profit, while pharmaceutical procurement costs also rose. SG&A expenses grew 8.7% YoY to JPY23.6bn, primarily due to higher personnel costs from wage increases and M&A-related costs incurred in 2H FY03/24. As a result, operating profit declined 40.0% YoY, and the operating profit margin fell 1.3pp to 1.7%, and EBITDA decreased 16.9% YoY to JPY2.7bn.

Following the revision of the company's 1H earnings forecast on October 31, 2024, the progress rate reached 100.0% for sales, operating profit, recurring profit, and net income. The rate of progress toward the company's full-year earnings forecast was 49.0% for sales, 34.2% for operating profit, 34.0% for recurring profit, and 16.6% for net income.

Segment results

1H FY03/25 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY57.1bn (+6.2% YoY)
- Segment profit: JPY2.2bn (-24.0% YoY)
- This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other. A digital shift business that utilizes the LINE messaging app was added to the segment from FY03/21, expanding it to include four businesses.

Community Pharmacy

A weighted average of medical fees per patient visit in 1H was 75.5 points (equivalent to JPY755), up 5.2 points (equivalent to JPY52) from end-FY03/24, driven by new stores developed and acquired through M&A in FY03/24, the use of digital technologies like the LINE messaging app for prescription transmission, and improved patient follow-up during medication periods. Dispensing fees were JPY50.6bn (+5.6%) for all stores and JPY47.8bn (+1.5%) for existing stores. Prescriptions filled for all stores amounted to 4,947,000 (+3.6%), and dispensing fees (drug fees + technical fees) for all stores were JPY10,228 (+1.9%).

As of end-September 2024, the company operated 452 community pharmacies, one in-home care plan support center, and nine cosmetics/drug stores. During the period under review, the company opened 11 community pharmacies, acquired one store, and closed or transferred ten stores.

Pharmaceuticals Network

Service improvements supported the increase in the number of new network affiliates despite some churn. As of end-September 2024, pharmaceutical network affiliates totaled 10,435 (+679 from end-FY03/24; 97% of the full-year target), comprising 452 directly operated pharmacies and 9,983 affiliates. Sales of pharmaceutical products grew by 8.3% YoY to JPY328.8bn, driven by the addition of new network affiliates.

Manufacture and Market Pharmaceuticals

The company offered 113 products (49 ingredients) as of end-September 2024. The number of new partner pharmacies steadily grew, with the total number of partner pharmacies reaching 5,700 (+1,806 YoY; 81% of full-year forecast) as of end-September 2024. Revenue at the mainstay subsidiary, Feldsenf Pharma, rose 61.5% YoY to JPY2.1bn.

Digital Shift

The company established a 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. The number of new stores using the service steadily grew in response to increased demand to address the NHI drug price revision. As of end-September 2024, the number of pharmacies using the service was 5,576 (+894 from end-FY03/24; 98% of annual plan). The number of LINE app registrations reached 1.25mn at end-1H, compared to the full-year target of 1.4mn.

Segment profit

Segment profit declined by 24.0% YoY to JPY2.2bn, with the operating profit margin decreasing by 1.6pp to 3.9%. While revenue from the three subdivisions supporting the Community Pharmacy business remained steady, segment expenses increased due to costs associated with new store openings and higher pharmaceutical procurement costs in the Community Pharmacy business.

Leasing and Facility-related

- Segment sales: JPY1.7bn (+2.5% YoY)
- Segment profit: JPY99mn (+43.5% YoY)

Operating conditions of serviced elderly housing facilities

Segment sales grew 2.5% YoY, driven by an increase in construction orders. As of end-September 2024, occupancy rates were stable at three of the five Wisteria properties (the total occupancy rate at the five serviced residences for the elderly stood at 83.7%). For the remaining two properties, Wisteria Senri-Chuo reported an occupancy rate of 61.0% (with 50 out of 82 units occupied), and Wisteria Minami Ichijo reported an occupancy rate of 75.0% (with 87 out of 116 units occupied). On October 1, 2024, the company transferred its Wisteria Senri-Chuo business and sold related fixed assets, which will be recorded as a gain on the sale of fixed assets in Q3.

Segment profit

Segment profit increased 43.5% YoY to JPY99mn, while the segment profit margin rose 1.6pp to 5.7%. The segment profit was attributed to the review of advertising expenses for the Wisteria serviced residence for the elderly.

Meal Catering

- Segment sales: JPY1.2bn (-1.0% YoY)
- Segment loss: JPY7mn (versus a loss of JPY23mn in 1H FY03/24)

Lower sales but a narrowed operating loss

Sales declined due to the closure of unprofitable facilities in 1H FY03/24. However, a review of the contract unit price improved the gross profit margin, which in turn narrowed the operating loss.

Other (mostly home-visit nursing care)

- Segment sales: JPY174mn (+12.3% YoY)
- Segment loss: JPY12mn (versus a loss of JPY20mn in 1H FY03/24)

Q1 FY03/25 results (out August 7, 2024)

Overview

Q1 FY03/25 (April–June 2024) earnings results

- Sales: JPY29.4bn (+6.4% YoY)
- Operating profit: JPY468mn (+3.8% YoY)
- Recurring profit: JPY468mn (+14.1% YoY)
- Net income attributable to owners of the parent: JPY170mn (+14.9% YoY)

Operating results and business conditions

Sales rose by 6.4% YoY. This increase was driven by a rise in the number of prescriptions filled within the Community Pharmacy business, which led to higher sales in the Community Pharmacy Network segment. The increase in prescription volume was primarily attributed to the development and acquisition of new stores through M&A in FY03/24, though it was somewhat offset by the absence of the exceptionally high demand seen in FY03/23 due to a high prevalence of multiple respiratory infections. Additionally, the use of digital technologies, such as the LINE instant messaging app for sending and receiving electronic prescriptions, and improved patient follow-up during medication periods, contributed to the overall increase.

Gross profit was JPY12.3bn (+7.4% YoY), and the gross profit margin was 41.7%, up 0.4pp YoY. This increase was driven by a higher number of prescriptions filled by the Community Pharmacy business and growth in the number of member pharmacies within the company's network. SG&A expenses totaled JPY11.8bn (+7.5% YoY), primarily due to M&A-related expenses incurred in Q4 FY03/24 and higher personnel costs resulting from salary revisions. Consequently, operating profit increased by 3.8% YoY, with the operating profit margin remaining stable at 1.6%. EBITDA amounted to JPY1.3bn (+6.3% YoY). The company noted that operating profit tends to be low in Q1 due to NHI drug price revisions and seasonal factors.

The rate of progress toward the company's 1H earnings forecast was 49.4% for sales, 29.3% for operating profit, 29.4% for recurring profit, and 21.7% for net income. The rate of progress toward the company's full-year earnings forecast was 24.1% for sales, 11.7% for operating profit, 11.8% for recurring profit, and 8.5% for net income.

Segment results

Q1 FY03/25 results by segment were as follows.

Community Pharmacy Network

This is a new segment that integrates the former Pharmaceuticals Network business, the Dispensing Pharmacy business, and the manufacture and market pharmaceuticals business (mainly Feldsenf Pharma) previously included in Other. A digital shift business that utilizes instant messaging app LINE was added to the segment in FY03/21.

- Segment sales: JPY28.0bn (+6.3% YoY)
- Segment profit: JPY1.1bn (-1.5% YoY)

Community Pharmacy

Although the number of prescriptions filled at existing pharmacies in Q1 declined by 0.1% compared to Q1 FY03/23, which was marked by the breakout of a number of infectious diseases, the overall number of prescriptions filled at all pharmacies increased to 2,481,000 (+4.3% YoY). This growth was driven by new pharmacy openings from FY03/23, contributions from pharmacies acquired through M&A, and the impact of digital transformation (DX) initiatives, such as sending electronic prescriptions via LINE and enhanced follow-up during the medication period. Dispensing fees across all pharmacies amounted to JPY24.9bn (+5.9% YoY).

During the period under review, the company opened six community pharmacies, acquired one store, and closed or transferred six stores. As of end-June 2024, the company operated 451 community pharmacies, one in-home care plan support center, and nine cosmetics/drug stores.

Pharmaceuticals Network

Service improvements supported the increase in the number of new network affiliates. As of end-June 2024, pharmaceutical network affiliates totaled 10,178 (+422 from end-FY03/24), comprising 451 directly operated pharmacies and 9,727 affiliates. The company's target for new network affiliates for FY03/24 is 10,756, representing an increase of 1,000 from end-FY03/23. As of end-July 2024, the number of new affiliates had already reached 10,324.

Manufacture and Market Pharmaceuticals

The company offers 113 products (49 ingredients) as of end-June 2024. The number of new partner pharmacies steadily grew, with the total number of partner pharmacies reaching 5,171 (+1,529 YoY) as of end-June 2024. Sales in Q1 amounted to JPY990mn, representing 22.5% of the annual forecast of JPY4.4bn.

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. The number of new pharmacies utilizing the service steadily grew, driven by increased demand to address the NHI drug price revision in 2024 through the use of digital transformation technologies. As of end-June 2024, the number of pharmacies using the service was 5,217 (+535 from end-FY03/24).

Segment profit declined by 1.5% YoY, as newly incurred expenses related to the M&A of dispensing pharmacies in FY03/23 and higher personnel costs from salary revisions offset the increase in sales within the Community Pharmacy business and Pharmaceutical Network divisions.

Leasing and Facility-related

- Segment sales: JPY942mn (+17.8% YoY)
- Segment profit: JPY56mn (+154.5% YoY)

Operating conditions of serviced elderly housing facilities

Segment sales grew 17.8% YoY, mainly driven by an increase in construction orders.

Segment profit increased by 154.5%, attributed to the review of advertising expenses for the Wisteria serviced residence for the elderly. As of end-June 2024, 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 82.3%), while it reported an occupancy rate of 58.5% (with 48 out of 82 units occupied) for Wisteria Senri-Chuo, and an occupancy rate of 75.9% (with 88 out of 116 units occupied) for Wisteria Minami Ichijo

Meal Catering

- Segment sales: JPY586mn (-0.7% YoY)
- Segment loss: JPY2mn (versus a loss of JPY14mn in Q1 FY03/24)

Lower sales but a narrowed operating loss

Sales decreased by 0.7% due to a decline in the number of users. However, a review of the contract unit price improved the gross profit margin, which in turn narrowed the operating loss.

Other (mostly home-visit nursing care)

- Segment sales: JPY85mn (+9.0% YoY)
- Segment loss: JPY7mn (versus a loss of JPY8mn in Q1 FY03/24)

Full-year FY03/24 results (out May 10, 2024)

Overview

Full-year FY03/24 (April 2023–March 2024) earnings results

- Sales: JPY115.4bn (+5.3% YoY)
- Operating profit: JPY3.8bn (+21.2% YoY)
- Recurring profit: JPY3.8bn (+14.0% YoY)
- Net income attributable to owners of the parent: JPY1.9bn (+15.5% YoY)

Operating results and business conditions

Sales rose 5.3% YoY due to an increase in the number of prescription filled in the Community Pharmacy Network segment. The prescription unit price fell in the Community Pharmacy business owing to the impact of 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, and multiple respiratory infections were prevalent. 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 was JPY47.9bn (+4.4% YoY), with a GPM of 41.5% (-0.4pp YoY). The profit margin declined as the conclusion of transitional measures for community support system premiums drove down technical fees, which are a component of the prescription unit price and therefore a major source of income for dispensing pharmacies. SG&A expenses were JPY44.1bn (+3.1% YoY), with an SG&A ratio of 38.2% (-0.8pp YoY), reflecting efforts to improve overall productivity and control various costs, including personnel expenses. Operating profit rose 21.2% YoY, and EBITDA reached JPY7.0bn (+14.3% 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 decision to focus on pharmacy development.

The rate of progress toward the company's full-year earnings forecast was 101.4% for sales, 109.5% for operating profit, 110.9% for recurring profit, and 112.7% for net income. In the Community Pharmacy business of the Community Pharmacy Network segment, various measures proved successful, including initiatives to strengthen interpersonal services following the conclusion of transitional measures for community support system premiums, and efforts to develop new pharmacies and improve the productivity of pharmacists.

Segment results

Full-year FY03/24 results by segment were as follows.

Community Pharmacy Network

- Segment sales: JPY109.9bn (+5.3% YoY)
- Segment profit: JPY6.4bn (+9.3% 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 prescription unit price fell 0.9% YoY on an all-store basis and 0.7% YoY on an existing store basis, reflecting a decline in technical fees driven by 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 6.1% YoY on an all-store basis and 3.8% YoY on an existing store basis, 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, such as the transmission of prescriptions using LINE, also pushed up the prescription volume. As a result, medical fees (number of prescriptions × prescription unit price) came to JPY97.8bn (+5.1% YoY) on an all-store basis.

In FY03/24, the company opened 13 community pharmacies including five inside medical malls, and one drug store. As of end-March 2024, it had 450 community pharmacies, one care plan center, and nine cosmetics/drug stores.

Pharmaceuticals Network

The number of new network affiliates fell short of expectations in terms of net additions as steady new additions were offset by closures and withdrawals resulting from M&A. However, the total value of pharmaceuticals orders placed by network affiliates expanded largely in line with projections, reaching JPY618.2bn (+17.5% YoY), backed by an increase in the value of pharmaceuticals procurement by existing affiliates through the company's network. As of end-March 2024, pharmaceutical network members totaled 9,756 (+844 from end-FY03/23), comprising 450 directly operated pharmacies and 9,306 network affiliates.

Manufacture and Market Pharmaceuticals

Subsidiary Feldsenf Pharma, which handles the primary functions of this business, sold 48 active pharmaceutical ingredients (API) across 103 products as of end-March 2024. While it stopped accepting orders for some products due to the impact of shipment adjustments, the number of new partner pharmacies handling Feldsenf Pharma products increased steadily, reaching 4,998 (+1,261 YoY) as of end-March 2024. Feldsenf Pharma's sales continued to grow, reaching JPY3.2bn (+23% 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 in earnest utilizing its official LINE account. With the revision of medical fees, demand for the service has expanded in tandem with an increase in inquiries from dispensing pharmacies that are actively engaging in medical DX. As of end-March 2024, the number of registered friends (users) on the account reached 1.0mn (1.6x YoY), and the number of pharmacies using the service was 4,682 (+1,291 YoY).

Segment profit

Segment profit increased 9.3% YoY, with the profit margin rising 0.3pp YoY. Factors contributing to the improved profitability included the negative impact of the conclusion of transitional measures for community support system premiums in the Community Pharmacy business being offset by a recovery in the number of prescriptions and productivity improvements, and strong performance in the Pharmaceuticals Network business supported by growth in the number of affiliates.

Leasing and Facility-related

- Segment sales: JPY3.6bn (+3.3% YoY)
- Segment profit: JPY158mn (versus a loss of JPY92mn in FY03/23)

Operating conditions of serviced elderly housing facilities

Segment sales grew 3.3% YoY, driven by robust management fee income from properties under management and an increase in construction orders.

At end-March 2024, occupancy rates for all five properties stood at 83.0%. Three of the five properties maintained stable occupancy rates. For the remaining two, Wisteria Senri-Chuo had 51 out of 82 units occupied (occupancy rate of 62.2%), and Wisteria Minami-Ichijo had 88 out of 116 units occupied (75.9%).

Segment profit

The segment recorded a profit of JPY158mn, reversing the year-earlier loss. Contributing factors included the transfer of business development costs previously recorded in the Leasing and Facility-related segment to the Community Pharmacy Network segment, and adjustments made to staff allocations and advertising spending associated with the Wisteria serviced residence for the elderly.

Meal Catering

- Segment sales: JPY2.4bn (+3.1% YoY)
- Segment loss: JPY43mn (versus a loss of JPY65mn in 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 for food ingredients. The segment remained in the red as a result.

Other (mostly home-visit nursing care)

- Segment sales: JPY314mn (+3.3% YoY)
- Segment loss: JPY43mn (versus a loss of JPY22mn in FY03/23)

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 segment 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 a 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)

News and topics

Revision to 1H and full-year FY03/25 earnings forecast

2024-10-31

Medical System Network Co., Ltd. announced a revision to its 1H and full-year FY03/25 earnings forecast on October 31, 2024.

Revision to 1H FY03/25 earnings forecast

- Sales: JPY59.8bn (up JPY261mn from previously forecast JPY59.5bn)
- Operating profit: JPY1.0bn (down JPY573mn from JPY1.6bn)
- Recurring profit: JPY1.0bn (down JPY570mn from JPY1.6bn)
- Net income attributable to owners of the parent: JPY207mn (down JPY577mn from JPY785mn)

Revision to full-year FY03/25 earnings forecast

- Sales: JPY122.0bn (no change from the previous forecast)
- Operating profit: JPY3.0bn (down JPY1.0bn from previously forecast JPY4.0bn)
- Recurring profit: JPY3.0bn (down JPY950mn from JPY4.0bn)
- Net income attributable to owners of the parent: JPY1.3bn (down JPY750mn from 2.0bn)

Reasons for revision

The company anticipates that 1H FY03/25 sales will exceed its prior forecast. However, profits are expected to fall short due to lower-than-expected number of prescriptions filled in the Community Pharmacy business at existing stores and rising pharmaceutical procurement costs.

For the full-year forecast, while sales are projected to align with prior expectations, profit estimates have been revised downward. This adjustment reflects the 1H FY03/25 revision and ongoing uncertainties around the number of prescriptions filled in 2H. Please refer to the release for details.

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.)
July 2021	Acquired Home-visit Nursing Care Station Himawari Co., Ltd. in a absorption-type merger
Nov 2023	Acquired additional shares in PharmaShift Co., Ltd., and made it a subsidiary

Source: Shared Research based on company data (as of March 2024)

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	19
Number of directors	17
Directors' term of office under Articles of Incorporation	1 year
Chairperson of the Board of Directors	President
Number of outside directors	7
Number of independent outside directors	7
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	2
Number of independent outside members of Audit & Supervisory Board	0
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 2024)

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
The Master Trust Bank of Japan, Ltd.(trust account)	3,201,100	10.73%
S&S G.K.	2,769,100	9.28%
Yasuyuki Okinaka	2,506,000	8.40%
Jiro Akino	2,220,900	7.45%
CACEIS BANK /QUINTET LUXEMBOURG SUB AC/UCITS CUSTOMERS ACCOUNT	1,678,200	5.62%
MSIP CLIENT SECURITIES	1,093,205	3.66%
Medical System Network Employees Stochkholding Association	870,500	2.92%
Custody Bank of Japan, Ltd. (trust account)	790,100	2.65%
Inao Tajiri	783,100	2.62%
Custody Bank of Japan, Ltd. (trust account)	581,000	1.94%
SUM	16,493,205	55.32%

Source: Shared Research based on company data (as of September 30, 2024)

Employees

Segment	No. of employees	No. of temporary employees	Total
Community Pharmacy Network	3,399	560	3,959
Leasing and Facility-related	127	11	138
Meal Catering	171	225	396
Other	44	14	58
Corporate (administration)	153	14	167
Total	3,894	824	4,017

Source: Shared Research based on company data (as of September 30, 2024)
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.

Contact Details

Company name

Shared Research Inc.

Phone

+81 (0)3 5834-8787

Address

2-6-10 Kanda-Sarugakucho Chiyoda-ku Tokyo, Japan

Email

info@sharedresearch.jp

Website

https://sharedresearch.jp

Disclaimer