COMPANY RESEARCH AND ANALYSIS REPORT

Qol Holdings Co., Ltd. (Qol)

3034

Tokyo Stock Exchange Prime Market

16-Aug.-2023

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Summary

With DAIICHI SANKYO ESPHA joining the Group, the Company's business scale will grow rapidly from FY3/25

Qol Holdings Co., Ltd. (Qol) <3034> ("the Company") is a major dispensing pharmacy chain positioned at No. 2 in the number of dispensing pharmacies and No. 3 in net sales (using data from listed companies). It stands out in its operation of "One-on-one pharmacies" and deployment of "Healthcare pharmacies" through alliances with companies in other industries. In fields other than dispensing pharmacies, in addition to the CSO* Business, it also conducts the Medical Professional Referral Dispatch Business for pharmacists and other medical practitioners, and the Pharmaceutical Manufacturing Business.

* CSO stands for Contract Sales Organization and involves CMR (Contract Medical Representative) dispatch services.

1. In FY3/23, sales reached a record high

Looking at consolidated financial results for FY3/23, net sales increased 2.3% year on year (YoY) to ¥170,036mn, while operating income decreased 3.7% to ¥9,495mn. Sales in the mainstay Pharmacy Business rose due to an increase in the number of prescriptions, which reflected factors such as an increase in the number of stores, and sales also increased in the Medical Related Business, including the start of sales of COVID-19 antigen test kits and a recovery in demand for medical professional referral dispatches, which led to consecutive record high net sales. Meanwhile, operating income decreased overall for the first time in two fiscal years, reflecting a decline in profit in the Pharmacy Business as a result of lower technical fee unit prices due to revisions of drug prices and dispensing fees, along with an increase in pharmacy operation costs due to responses to COVID-19 and soaring energy prices, despite an increase in profit in the Medical Related Business. The number of stores as of the end of FY3/23 increased by 58 from the previous fiscal year-end to 892.

2. The Company forecasts to achieve growth in sales and profits in FY3/24

For FY3/24, the Company is forecasting growth in sales and profits, with net sales to increase 5.9% YoY to ¥180,000mn and operating income to increase 5.3% to ¥10,000mn. In the Pharmacy Business, although drug prices continue to decline, increases in sales and profits are forecast based on an increase in the number of prescriptions due to an increase in the number of stores, and progress on streamlining personnel costs, which had expanded due to the response to COVID-19 in the previous fiscal year. Meanwhile, in the Medical Related Business, increases in sales and profits are expected as a snap-back decline in antigen test kits should be outweighed by growth in the CSO Business and the Medical Professional Referral Dispatch Business. Regarding the number of dispensing pharmacies, the Company expects to open 20 stores organically and acquire between 30 and 50 stores through M&A. The Company has made a steady start with the organic opening of new stores, with 10 such stores already opened as of June 2. In addition, the Company has announced that it will conduct a phased acquisition of shares of DAIICHI SANKYO ESPHA CO., LTD., which is mainly engaged in authorized generic products (hereafter, "AG products"*). The Company plans to acquire 30% of the shares of DAIICHI SANKYO ESPHA on October 1, 2023, making it an equity-method affiliate, and then acquire an additional 21% of shares in April 2024, making it a consolidated subsidiary. The stock acquisition cost is ¥25.0bn, and it will be covered by borrowings from financial institutions and cash in hand. In its FY3/24 results forecast, the Company expects to record ¥700mn in share of profit in entities accounted for using equity method.

* AG products: generic drugs that, with permission from the new drug manufacturer, have the same drug substances, additives, manufacturing process, and so on as the new drug.

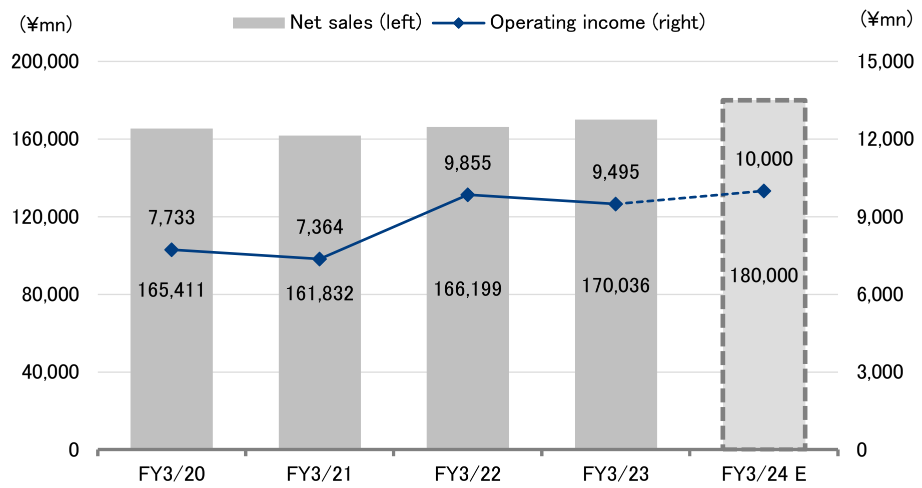
3. With DAIICHI SANKYO ESPHA joining the Group, the Company's medium-term net sales target of ¥300.0bn is now firmly within the achievable range

The Company's medium- to long-term growth strategies have remained consistent without changes. In the Pharmacy Business, it is aiming for stable growth by working on expanding scale through strategic store openings and creating value of pharmacies. In store openings, the Company is continuing at the pace of 40 to 90 stores per year including those from M&A, aiming to reach 1,000 stores at an early stage. It also intends to expand its market share by raising added value as part of efforts to strengthen its functions as a primary pharmacy for local communities, alongside efforts to improve services by leveraging IT. In the Medical Related Business, the Company will work to deepen specialization in the CSO Business and aims to increase its CMR headcount in the medium term from the current level of around 610 people to 1,000 people while developing high-value-added human resources and considering M&A. Also, in the Pharmaceutical Manufacturing Business, the Company will strive to maximize Group synergies while seeking to drive business expansion through its M&A strategy. Significant strides will be made on this front as a result of DAIICHI SANKYO ESPHA joining the Group. In terms of results for FY3/23, DAIICHI SANKYO ESPHA posted net sales of ¥78,769mn and operating income of ¥12,865mn. Simple addition of these results to the Company's FY3/24 consolidated results forecasts yields net sales of around ¥260.0bn and operating income of around ¥23.0bn. This will place the Company's medium-term targets of net sales of ¥300.0bn and operating income of ¥25.0bn firmly within the achievable range. Future developments, including the creation of synergies, will be watched closely.

Key Points

- In FY3/23, the Company updated record high sales
- In FY3/24, the Company aims to renew record-high results by reaping the benefits of new stores and M&A, as well as the recovery from COVID-19
- With DAIICHI SANKYO ESPHA joining the Group, the Company's medium-term performance targets of net sales of ¥300.0bn and operating income of ¥25.0bn are now firmly within the achievable range

Results trends



Source: Prepared by FISCO from the Company's financial results

Company profile

Under a holding company structure as a major dispensing pharmacy chain, the Company is conducting businesses on the twin axis of the Pharmacy Business and the Medical Related Business

1. History

Chairman Masaru Nakamura founded Qol Co., Ltd. in 1992. Qol Co., Ltd. steadily expanded its dispensing pharmacy network after opening the first pharmacy in Nihonbashi Kabutocho in 1993. In addition to opening its own stories, the Company has been expanding its dispensing pharmacy network through aggressive M&A and also moved into related and peripheral areas, the Company moved into the clinical trial-related business when it established PhaseOn Co., Ltd. in 2003, and established Qol Medis, Co., Ltd. in 2008 to start worker placements and dispatching services business.

Subsequently, the Company organized its businesses into two business segments, the Pharmacy Business and the BPO Business (currently, the Medical Related Business). It then changed to a holding company structure in October 2018 in order to improve management efficiency and to expand the business scope. Following this, the Company changed its corporate name to Qol Holdings Co., Ltd. as a pure holding company, and is leading the Group as a whole toward enhancing corporate governance and formulating the Group's medium- to long-term growth strategy. The Pharmacy Business is conducted by Qol Co., Ltd., and other companies that joined the Group through M&A. In the Medical Related Business, APO PLUS STATION Co., Ltd., conducts the CSO Business, mainly CMR dispatches, while Fujinaga Pharm Co., Ltd., which became as a subsidiary in August 2019, conducts the Pharmaceutical Manufacturing Business. Furthermore, as part of efforts to accelerate the growth of the Medical Professional Referral Dispatch Business for pharmacists and other medical professionals, which had been conducted by APO PLUS STATION, the Company established APO PLUS CAREER Co., Ltd. in February 2020, and transferred the business to it.

The Company is aiming to achieve business growth, while increasing the stability of earnings, by developing its businesses on the twin axis of the Pharmacy Business and the Medical Related Business. The Pharmacy Business is a business that can stably acquire earnings, but it is exposed to the risk of fluctuating earnings due to the government's medical policies (including revisions to dispensing fees once every two years). In a revision year, there may be negative factors in terms of earnings, and the strategy is to stably increase overall earnings by covering these negatives through the Medical Related Business. Looking at the breakdown by segments (FY3/23 results), the Pharmacy Business accounts for the majority at 91.2% of net sales and 88.2% of operating income; however, the Company intends to increase the share of the Medical Related Business over the medium to long term.

Pursuing an approach of "One-on-one pharmacies" and "Healthcare pharmacies" through alliances with companies in other industries to increase the number of stores while utilizing M&A

2. Pharmacy Business

(1) Business scale and positioning in the industry

The Pharmacy Business segment mainly involves the management of dispensing pharmacies. Looking at the number of stores at the end of March 2023, 872 (98%) of the 892 stores were dispensing pharmacies, while the remaining 20 were shops located within hospitals. Prescription net sales (dispensing pharmacy net sales) amounted to about 93% of the segment sales. Remaining sales came from product sales at pharmacies, convenience stores, and shops located within hospitals and sales income for health foods, hygiene items, and other products on Qol's official e-commerce website.

Regarding positioning in the dispensing pharmacy industry, Qol ranks second in number of stores among listed dispensing pharmacy chains after Ain Holdings Inc. <9627> (1,209 stores as of the end of April 2023) and third in net sales after Ain Holdings and Nihon Chouzai Co., Ltd. <3341>. Nihon Chouzai, which is third in the number of stores at 718 (as of the end of March 2023), has net sales that exceed those of the Company because it has developed many pharmacies located adjacent to hospitals, which generate strong sales.

(2) Pharmacy development strategy

A feature of the Company's pharmacy development strategy is that it conducts the business through two formats that are largely different in type. The first type is the "One-on-one pharmacies," and the second type is "Healthcare pharmacies" through business alliances with different industries such as major convenience store operator Lawson, Inc. <2651> and BIC CAMERA Inc.<3048>, and others.

"One-on-one pharmacies" is a concept that defines the fundamental stance in store operations for ordinary QOL Pharmacies. It is also the "core business" in its business model. The key point lies in the close cooperation between the prescribing medical institutions and QOL Pharmacies. Our understanding at FISCO is that the phrase "One-on-one" is used to express the pharmacies' deep, cooperative relationships with medical institutions. From the phrase "One-on-one," the tendency is to imagine a deep relationship between only one QOL Pharmacy and only one prescribing medical institution. But in fact, it seems that in many cases, one pharmacy builds deep cooperative relationships with multiple medical institutions.

In its "One-on-one pharmacies," the Company is aiming to utilize cooperation with medical institutions to realize efficient and low-cost operations, and to invest the results of this into improving services for patients. Specifically, it is aiming to create these pharmacies by adjusting store designs and functions in accordance with factors such as the departments of target prescribing medical institutions and the characteristics of each area. The funds for this are generated from the pharmacies' low-cost structures, including more efficient drug inventories, which is one of the benefits of "one-on-one" management. Based on the concept of "One-on-one pharmacies," the Company positions the creation of pharmacies that are selected by patients for having high utility value as the core of its pharmacy strategy. In addition, the concept of "One-on-one pharmacies," which essentially entails cooperation with medical institutions, can be said to be in line with the Japanese Government's Vision for Patient-centered Pharmacies, which is also an important point for the growth strategy. We at FISCO think that the Company's pharmacies will demonstrate their strength in the pharmacy authorization system for specific functions (details mentioned later), which was introduced in August 2021.

The catalyst for Qol's deployment of "Healthcare pharmacies" through alliances with companies in other industries, which is its other format, was a revision to the Pharmaceuticals Affair Law in June 2009 that allows convenience stores, drugstores, supermarkets, and other industry stores to sell OTC drugs as registered businesses. Spurred on by this, it became possible for companies to launch a dispensing pharmacy business, such as in drugstores. As an offensive measure in response to this, the Company entered into business alliances with the two aforementioned companies, and is now proceeding with this initiative.

"One-on-one pharmacies" have somewhat restricted customer scope that enables Qol to improve efficiencies in drug inventory management. "Healthcare pharmacies," meanwhile, target unspecified large number of customers in locations with heavy people flow, so-called foot-traffic pharmacies. While these sites require larger inventory investments and other outlays than the "One-on-one pharmacies," they are likely to attract more customers (and thus receive more prescriptions). Qol positions "One-on-one pharmacies" as the core model and also aims to broaden the customer base through deployment of "Healthcare pharmacies."

As a new initiative, the Company has allied with Ryohin Keikaku Co., Ltd. <7453> and started opening stores inside MUJI stores in FY3/22. Ryohin Keikaku has opened "Machi no Hokenshitsu (town infirmaries)" inside MUJI stores as a health promotion space that holds health-themed events, offers casual health consultation, and provides a full-line of services covering disease prevention and health maintenance through to pharmaceuticals in order to contribute to the healthy living of local residents. The Company opens dispensing pharmacies as a collaborating partner in this initiative.

As of the end of March 2023, there were 36 healthcare stores in alliance with Lawson, 5 inside BIC CAMERA stores, 2 inside MUJI stores, and a further 2 inside train stations.

Overall image of the pharmacy strategy

Business format	Pharmacy type	Location	Function	Opening method	Degree of focus
QOL Pharmacies	One-on-one	Urban type. Clinic-adjacent	Primary pharmacist/pharmacy function, health support function	Organic, M&A	◎
	Foot-traffic pharmacies		Primary pharmacist/pharmacy function, health support function	Organic, M&A	
	Hospital-adjacent pharmacies	Hospitals of a certain size	Primary pharmacist/pharmacy function, advanced pharmaceutical management function, health support function	Organic, M&A	○
Healthcare pharmacies	Foot-traffic pharmacies	Within shopping districts, within and near to train stations	Primary pharmacist/pharmacy function, health support function	Organic	◎

Source: Prepared by FISCO from Company materials and interviews

Looking at the number of store openings by area at the end of March 2023, Kanto leads with 382 stores (42.8% of the total volume), followed by Kansai with 141 stores (15.8%), and Koshinetsu with 111 stores (12.4%). As store openings have taken place with Tokyo as the area in which the Company was founded, there have been many openings in the Kanto area. Looking at the increases since the end of FY3/17, Kansai has had the increase with 48 stores, Tokai and Hokuriku with 27 stores, and Koshinetsu with 20 stores. These trends show that the Company has steadily increased its number of stores in the Kansai and Chubu areas. The focus areas are the Tokyo, Nagoya, and Osaka, which have a high population density. Looking at a comparison of the number of stores and population composition ratio by area, the Company has a higher ratio in Kanto, Koshinetsu, and Tohoku and a lower ratio in the other areas. The Company's priority going forward is to develop the Tokai area, centered on Aichi Prefecture in particular, where it has strong prospects for growth.

Number of stores by area and population composition comparisons

	End of FY3/17	End of FY3/22		End of FY3/23		Increase on end of FY3/17	Population composition (2020)
	Number of stores	Number of stores	Composition ratios	Number of stores	Composition ratios		
Hokkaido	10	10	1.2%	11	1.2%	1	4.1%
Tohoku	75	90	10.8%	90	10.1%	15	6.8%
Kanto	314	338	40.5%	382	42.8%	68	34.6%
Koshinetsu	91	110	13.2%	111	12.4%	20	4.0%
Tokai, Hokuriku	45	70	8.4%	72	8.1%	27	14.2%
Kansai	93	133	15.9%	141	15.8%	48	16.3%
Chugoku, Shikoku	51	48	5.8%	50	5.6%	-1	8.7%
Kyushu, Okinawa	17	35	4.2%	35	3.9%	18	11.3%
Total	696	834	100.0%	892	100.0%	196	100.0%

Note: Japan's population composition based on national census data from 2020
Source: Prepared by FISCO from Company materials

Developing the Medical Professional Referral Dispatch Business centered on CMR dispatches, and entered the Pharmaceutical Manufacturing Business through acquisition of a pharmaceutical company in 2019

3. Medical Related Business

The Medical Related Business includes the CSO Business (CMR dispatches), and the CRO* Business (clinical trials support services), which are mainly conducted by APO PLUS STATION; the Medical Professional Referral Dispatch Business (pharmacists, registered sales personnel, public health nurses, nurses, etc.) conducted by APO PLUS CAREER; the Medical-related Publishing Business conducted by Medical Qol Co., Ltd.; and the Pharmaceutical Manufacturing Business conducted by Fujinaga Pharm, which joined the Group in August 2019. Looking at the sales composition ratio, the CSO Business and CRO Business accounts for approximately 60%, while the Medical Professional Referral Dispatch Business accounts for approximately 20%, Pharmaceutical Manufacturing Business for approximately 15%, and the Medical-related Publishing Business accounts for approximately 5%.

* CRO is the abbreviation of Contract Research Organization and refers to assistance business and other services for clinical trials and other activities.

(1) CSO Business and CRO Business

The CSO Business involves recruiting and training MR and dispatching them to the contracted pharmaceutical companies. MR refers to sales representatives who provide doctors, pharmacists, and others with knowledge and information on the pharmaceuticals that are sold. In recent years, the development trend for new drugs among pharmaceutical companies has shifted from primary medicine (for treatment of lifestyle related diseases, etc.) that targets many customers (medical facilities and doctors) to specialty drugs (anti-cancer drugs, etc.) for which the target customers are limited. Accordingly, there has been an expanding movement toward reducing their in-house MR personnel and switching to CMR personnel.

In this situation, the Company has been leveraging its strengths of recruitment and training capabilities and increasing its recruitment of CMR personnel. At the end of March 2023, it had approximately 610 CMR personnel, which is an industry share of around 15%, and it holds the leading position in the industry for the number of customers as well, with 50 to 60 companies. According to the "2022 Edition MR White Paper" published by the MR Education & Accreditation Center of Japan, at the end of March 2022, there were 3,948 CMRs (increased 25 YoY), who were being utilized by 138 companies as of October 2021 for an MR outsourcing rate of 6.4%. All three metrics represent new record highs.

On the other hand, the CRO Business provides total solutions from planning through to publication for clinical trials and clinical research in the respective fields of ethical drugs, OTC drugs, food, and healthcare. The Company has strengths in clinical trials in the food field, and in the pharmaceuticals field it has experience in dermatology and ophthalmology.

(2) Medical Professional Referral Dispatch Business

This business involves referral dispatches of pharmacists, public health nurses, registered sales personnel, and others. Of these, it mainly conducts referral dispatches of pharmacists. It ranks in the top 10 for the number of dispatched pharmacists in the industry, while it also ranks in the top 3 for public health nurses. In addition, at APO PLUS CAREER, the Company provides pharmacy business succession and management support services and consulting services on health management for corporations.

(3) Pharmaceutical Manufacturing Business

Fujinaga Pharm is a pharmaceutical manufacturer established in 1941 (founded in February 1924) that mainly covers psychiatry and dermatology fields. It manufactures brand-name drugs Phenobal and Hydantol, generic-drug Fujinaga lithium carbonate, and other products. Its annual sales scale before joining the Group was around ¥1.8bn. But going forward, the policy is to establish its unique position and grow its business by increasing sales for the Group's dispensing pharmacies and strengthening manufacturing facilities.

Business trends

Except for operating income, the Company renewed consecutive record highs in FY3/23.

1. Summary of FY3/23 results

In its FY3/23 consolidated results, the Company renewed record highs for the second consecutive year at all levels of sales and profits except for operating income, with net sales increasing 2.3% YoY to ¥170,036mn, operating income decreasing 3.7% to ¥9,495mn, ordinary income increasing 0.04% to ¥10,098mn, and profit attributable to owners of parent increasing 3.0% to ¥5,656mn. Both net sales and profits at every level were lower than the Company's forecasts. This was mainly due to lower-than-expected demand for prescriptions, which primarily reflected delays in the closing of M&A deals in the Pharmacy Business as a result of the COVID-19 pandemic. Other factors included additional costs of approximately ¥0.4bn to replenish pharmacists following an increase in pharmacists who contracted COVID-19, and an increase in utility costs due to soaring energy prices.

FY3/23 results (consolidated)

(¥mn)

	FY3/22		FY3/23				
	Results	% of net sales	Company forecasts	Results	% of net sales	YoY	Compared to forecast
Net sales	166,199	-	180,000	170,036	-	2.3%	-5.5%
Gross profit	23,163	13.9%	-	23,504	13.8%	1.5%	-
SG&A expenses	13,308	8.0%	-	14,009	8.2%	5.3%	-
Operating income	9,855	5.9%	12,000	9,495	5.6%	-3.7%	-20.9%
Ordinary income	10,094	6.1%	12,000	10,098	5.9%	0.0%	-15.8%
Extraordinary income/losses	-407	-0.2%	-	-514	-0.3%	-	-
Profit attributable to owners of parent	5,489	3.3%	6,500	5,656	3.3%	3.0%	-13.0%
EBITDA*	14,588	8.8%	17,360	14,379	8.5%	-1.4%	-17.2%

* EBITDA = Operating income + Depreciation + Amortization of goodwill
Source: Prepared by FISCO from the Company's financial results and supplemental results materials

Looking at the results by business segment, in the Pharmacy Business, net sales increased 1.5% YoY to ¥155,446mn, while operating income decreased 3.1% to ¥11,499mn. The factors behind the increase in net sales were increases in the number of stores and the number of prescriptions at existing stores, which absorbed the decrease in the unit price of prescriptions due to the effects of revisions of drug prices and dispensing fees. Another factor was growth in sales other than dispensing fees, such as sales through shops and e-commerce. On the profit front, the fall in profits reflected a decline in technical fee unit prices following revisions of drug prices and dispensing fees and an increase in store operation costs, such as personnel and utility costs.

On the other hand, in the Medical Related Business, net sales increased 11.3% YoY to ¥14,993mn and operating income increased 29.0% to ¥1,534mn, marking a return to growth both in sales and profits for the first time in two fiscal years. The CSO Business continues to increase sales and profits due to expansion in demand for highly specialized CMRs, while the Medical Professional Referral Dispatch Business also saw a return to positive growth both in sales and profits, mainly due to a recovery in demand for dispatch of pharmacists. Moreover, in the Pharmaceutical Manufacturing Business, sales and profits both decreased in 1H FY3/23 due to the effects of revisions of drug prices and an increase in raw material costs. However, antigen test kits for COVID-19, for which sales were started in December 2022, contributed to results, leading to increases in both sales and profits on a full year basis.

Performance by segment

(¥mn)

	FY3/21 Results	FY3/22 Results	FY3/23		
			Results	Change	Change (%)
Pharmacy Business					
Net sales	148,778	153,164	155,446	2,282	1.5%
Segment income	9,605	11,865	11,499	-366	-3.1%
% of net sales	6.5%	7.7%	7.4%		
Medical Related Business					
Net sales	13,811	13,471	14,993	1,522	11.3%
Segment income	1,476	1,190	1,534	344	29.0%
% of net sales	10.7%	8.8%	10.2%		

* Net sales shown before deducting inter-segment transactions
Source: Prepared by FISCO from the Company's results briefing materials

Net sales reached a new record high, as an increase in the number of prescriptions absorbed a decline in the unit price of prescriptions

2. Trends in the Pharmacy Business

(1) Status of net sales at dispensing pharmacies

In the Pharmacy Business, net sales are comprised of dispensing pharmacies' dispensing pharmacy sales and product sales such as shops and e-commerce. Looking at the breakdown of net sales for FY3/23, both dispensing pharmacy sales and other sales were higher YoY, with dispensing pharmacy sales increasing 1.2% to ¥144,036mn, and other sales rising 5.1% to ¥11,410mn. Breaking down dispensing pharmacy net sales by store-opening period and format, among the Company's organic openings, sales at existing pharmacies increased 2.9% YoY, or ¥1,267mn on a monetary basis, and sales at new pharmacies rose 36.6%, or ¥186mn on a monetary basis, due partly to a higher number of new pharmacy openings compared with the previous fiscal year. For pharmacies acquired through M&A and other methods, although it is difficult to distinguish their results as they are not separated for existing pharmacies and newly opened pharmacies, sales increased 0.3% YoY, or ¥273mn on a monetary basis.

Details of dispensing pharmacy net sales by opening period and by format

(¥mn)

	FY3/22			FY3/23		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	44,116	3,181	7.8%	45,383	1,267	2.9%
Newly opened pharmacies	508	-666	-56.7%	694	186	36.6%
M&A, etc.	97,686	2,964	3.1%	97,959	273	0.3%
All pharmacies	142,311	5,479	4.0%	144,036	1,725	1.2%

Source: Prepared by FISCO from the Company's supplemental results materials

On breaking down dispensing pharmacy net sales into the number of prescriptions and the unit price of prescriptions, the number of prescriptions increased 5.5% YoY to 14,957,000 prescriptions, while the unit price of prescriptions decreased 4.1% to ¥9,629. They are affected by other factors such as the opening period and M&A. We will look at these values in detail below.

The change rate in the number of existing pharmacies, which is considered to be close to actual conditions regarding the number of prescriptions, was a YoY increase of 5.3%. Although there was still a lingering trend of people refraining from seeking treatment due to the COVID-19 pandemic in the previous fiscal year, it appears that this trend gradually subsided in FY3/23 and led to growth in existing pharmacies. Moreover, the number of prescriptions at pharmacies through M&A, etc. increased by 5.1%. The number of store acquisitions increased just over three-fold from 15 in the previous fiscal year to 48 in the fiscal year under review. Of these, 38 were stores of Power Pharmacy in Tochigi Prefecture, which became a subsidiary in January 2023. The effect of these pharmacy acquisitions on the overall number of prescriptions was minimal. Following the conversion of Power Pharmacy into a subsidiary, the Group now has more pharmacies than any other pharmacy chain in Tochigi Prefecture.

Number of prescriptions by store-opening period and format (details)

(thousands)

	FY3/22			FY3/23		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	4,027	350	9.5%	4,240	213	5.3%
Newly opened pharmacies	89	-15	-14.4%	144	55	61.8%
M&A, etc.	10,059	471	4.9%	10,572	513	5.1%
All pharmacies	14,176	807	6.0%	14,957	781	5.5%

Source: Prepared by FISCO from the Company's supplemental results materials

On the other hand, the unit price of prescriptions fell by 4.1% YoY overall, marking the second straight year of decline. This decline includes a 2.3% fall at existing pharmacies and a 4.6% fall at M&A and other pharmacies. The main factors were the impact of drug price revisions, which are now carried out every year, in addition to a decrease in dispensing fee unit prices as there was an increase in relatively low-priced prescription drugs such as antipyretics due to the COVID-19 pandemic. However, there was also a slight decrease due to the impact of dispensing fee revisions (revised once every two years) regarding the unit price of dispensing pharmacy's technical fees.

Unit price of prescriptions by store-opening period and format (details)

(¥)

	FY3/22			FY3/23		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	10,955	-177	-1.6%	10,701	-254	-2.3%
Newly opened pharmacies	5,652	-5,642	-50.0%	4,799	-853	-15.1%
M&A, etc.	9,711	-168	-1.7%	9,266	-445	-4.6%
All pharmacies	10,039	-196	-1.9%	9,629	-409	-4.1%

Source: Prepared by FISCO from the Company's supplemental results materials

The dispensing pharmacy's technical fees, which are the equivalent of the pharmacy's added value, work on a system in which points are aggregated depending on the level of achievement of predetermined standards. The fees mainly comprise a basic dispensing fee, (categorized by number of prescriptions and concentration ratio on designated medical institutions, etc.), generic drug dispensing premium (categorized by ratio of generic drugs handled), and community support system incentives (categorized by system for contribution to community healthcare, such as home and facility delivery dispensing). Of these, the generic drug dispensing premium and community support system incentives offer points that vary depending on the state of each pharmacy's initiatives, providing a point of differentiation. In the recent revision, the basic dispensing fee was changed based on the efficiency of pharmacy management; the generic drug dispensing premium's standard for the proportion of dispensing volume was increased and its evaluation method was revised; and the systems relating to contribution to community healthcare and the results-based evaluation system for the community support system incentives were revised.

The revised points categories for the basic dispensing fee have been refined from the previous five categories to six, adding an item of 32 points between 42 points, which is the highest, and 26 points. With the recent revision, for the basic fee of large-scale Group pharmacies*, pharmacies receiving over 85% of prescriptions from designated medical institutions were assigned 16 points, while those with less than 85% received 32 points. As a result, the ratio of the Company's pharmacies receiving 42 points, which was 47.3% in April 2021, decreased to 1.2% in April 2022, while the ratio of pharmacies receiving 32 points, a newly added category, was 47.1%. These changes led to the decrease in technical fee unit prices.

* The pharmacies in the same group receiving more than 0.4 million prescriptions a month, or having 300 or more pharmacies in the same group. The basic dispensing fee is computed as a set number of points from April of the current year to March of the next year, based on performance metrics such as the number of prescriptions over a one-year period, from March of the previous year to February of the current year.

The generic drug handling ratio (volume basis) rose slightly from 84.0% for the overall Group as of March 2022 to 85.6% as of March 2023, continuing to exceed the level of 80% targeted by the Ministry of Health, Labour and Welfare. The major factor in this change was the overall Group's efforts in the use of generic drugs in line with the Japanese government's policy on them. With the revision in April 2022, the condition for receiving the maximum points has been lifted from the previous condition of 85% or above to receive 28 points to the revised condition of 85% or above to receive 28 points and 90% or above to receive 30 points. The ratio of the Company's stores receiving 28 points was 64.7% as of April 2021, while the combined ratio of those receiving 28 points and 30 points was 70.2% as of April 2022. The combined ratio had increased to 76.7% as of March 2023, thereby contributing positively to the technical fee unit prices.

The community support system incentives previously had only two categories: 0 points and 38 points. After the revision, the categories were refined into four: 0 points, 17 points, 39 points, and 47 points. The ratio of the Company's stores receiving 38 points was 35.7% as of April 2021. In comparison, the ratio of the Company's stores receiving 39 points and 47 points was 36.7% (of which, pharmacies receiving 47 points were 26.4%) as of April 2022, and that ratio was 34.8% (of which, pharmacies receiving 47 points were 28.6%) as of March 2023. Moreover, as a result of promoting measures focused on the Home and Facility Delivery Dispensing Business, the ratio of the Company's stores receiving 0 points decreased from 64.3% as of April 2021 to 54.3% as of April 2022, and 50.1% as of March 2023. This decrease was a factor that contributed positively to the technical fee unit prices. Additionally, Home and Facility Delivery Dispensing Business sales appear to have increased 20% YoY to approximately ¥6.0bn.

Basic dispensing fee (percentage of store type)

Points	End of April 2021	End of April 2022	End of March 2023
42 points	47.3%	1.2%	2.5%
32 points	-	47.1%	44.6%
26 points	0.6%	0.0%	4.0%
21 points	0.0%	0.5%	0.5%
16 points	50.0%	49.1%	46.0%
9 points	2.0%	-	-
7 points	-	2.1%	2.4%
Number of pharmacies	782	807	866

Generic drug dispensing premium (percentage of store type)

Points	End of April 2021	Points	End of April 2022	End of March 2023
28 points	64.7%	30 points	18.7%	33.6%
22 points	18.7%	28 points	51.5%	43.1%
15 points	6.8%	21 points	16.9%	13.6%
0 points	9.8%	0 points	12.9%	9.7%
Number of pharmacies	782		807	866

Community support system incentives (percentage of store type)

Points	End of April 2021	Points	End of April 2022	End of March 2023
38 points	35.7%	47 points	26.4%	28.6%
		39 points	10.3%	6.2%
		17 points	9.0%	15.0%
0 points	64.3%	0 points	54.3%	50.1%
Number of pharmacies	782		807	866

Source: Prepared by FISCO from the Company's results briefing materials

(2) Store openings and closures and M&A status

The number of stores at the end of March 2023 stood at 892, an increase of 58 stores from the end of the previous fiscal year. The Company opened a total of 70 stores, including 20 stores opened organically, 48 acquired through M&A, 1 collaborative store opened with BIC CAMERA, and 1 shop. It closed 12 stores. One of the newly opened stores was a collaborative store with Ryohin Keikaku. In April 2022, the Company opened this store within the "Machi no Hokenshitsu" of MUJI Hiroshima Alpark.

Store openings and closures status

		FY3/22				FY3/23			
		Opened		Closed	End of fiscal year	Opened		Closed	End of fiscal year
QOL Pharmacies		Organic openings	15	6	769	Organic openings	20	8	829
		Through M&A	15			Through M&A	48		
New format	Lawson		0	2	36		0	0	36
	BIC CAMERA		0	0	5		1	1	5
	Within train stations		0	0	2		0	0	2
Shops			1	0	22		1	3	20
Total			31	8	834		70	12	892

Source: Prepared by FISCO from the Company's financial results and supplemental results materials

CMR dispatches, the Medical Professional Referral Dispatch Business, and the Pharmaceutical Manufacturing Business all achieve higher sales and profits

3. Trends in the Medical Related Business

Within the Medical Related Business, the mainstay CSO Business reported higher sales and profits, achieving record-high net sales. CMR dispatch began to rebound from 2H FY3/22, and the number of CMR dispatches increased from approximately 600 to around 610. With an increase in new specialty drugs that require a high degree of specialization in fields such as oncology and central nervous system disorders, the Company focused on nurturing CMRs in these specialized fields, which has led to an increase in the average unit price and was one factor behind the increases in sales and profits.

In the Medical Professional Referral Dispatch Business, net sales returned to positive growth, up 20% YoY. Operating income also rebounded sharply, tripling from the previous fiscal year. Looking at the main factors behind these increases, since 2H FY3/22, dispatches of pharmacists and registered sales personnel for drugstores have resumed a recovery trend, along with the continued expansion of dispatch demand for industrial physicians and health professionals against the backdrop of an increase in the number of companies implementing health management.

In the Pharmaceutical Manufacturing Business, sales and profits decreased due to the impacts of drug price revisions and soaring raw material costs in 1H. However, the Company started sales of Tegaruna® stick SARS-CoV-2 Ag, a COVID-19 antigen test kit, in December 2022. It sold approximately 760,000 units of the test kit, with these sales contributing to increases in sales and profits on a full year basis.

In FY3/24, the Company aims to continue delivering record-high business performance by strengthening activities in the Home and Facility Delivery Dispensing Business.

4. FY3/24 outlook

The financial results outlook for FY3/24 calls for the Company to deliver record-high business performance, with net sales to increase 5.9% YoY to ¥180,000mn, operating income to increase 5.3% to ¥10,000mn, ordinary income to increase 6.0% to ¥10,700mn, and profit attributable to owners of parent to increase 9.6% to ¥6,200mn. Both the Pharmacy Business and the Medical Related Business are expected to record increases in sales and profits. As a result of the phased acquisition of shares of DAIICHI SANKYO ESPHA, which was announced on May 16, 2023, the Company expects to record ¥700mn in share of profit in entities accounted for using equity method as non-operating income (details covered later). Capital investment is forecast to decrease substantially from ¥4,510mn in the previous fiscal year to ¥986mn. That said, capital investment included ¥2.0bn in land acquisition costs for stores in the previous fiscal year. Depreciation and amortization of goodwill will increase by a combined ¥620mn. However, the effect of increased sales, and the absence of the cost of additional pharmacists (approximately ¥0.4bn) needed to sustain store operations during the COVID-19 pandemic, which pushed up costs in the previous fiscal year, will contribute positively to profits.

In the outlook for 1H results, net sales are forecast to increase 3.8% YoY, while operating income is forecast to decrease by 13.0%. Profits are expected to decrease because in the Pharmacy Business, the Company expects the unit price of dispensing pharmacy's technical fees, which is directly linked to profits, to decline following the end of a transitional measure* for community support system incentives at the end of the previous fiscal year. By strengthening activities in the Home and Facility Delivery Dispensing Business, the Company expects community support system incentives to recover in 2H FY3/24.

* As a result of revisions to dispensing fees in April 2022, when calculating community support system incentives, stores eligible for basic dispensing fee 3-c (32 points) were previously deemed to be eligible for basic dispensing fee 1 (42 points) through March 31, 2023, and their incentives were calculated as 47 points or 39 points. However, from April 1, their incentives will be calculated under basic dispensing fee 3-c, so the incentives of these stores will be reduced to 39 points or 17 points. In addition, as a special measure from April to December 2023, stores eligible for the generic drug dispensing premium that satisfy certain conditions may compute their scores with either 1 point or 3 points added on to their community support system incentives.

FY3/24 outlook

(¥mn)

	FY3/23		FY3/24				
	Full year results	% of net sales	1H forecasts	YoY	Full year forecasts	% of net sales	YoY
Net sales	170,036	-	85,600	3.8%	180,000	-	5.9%
Operating income	9,495	5.6%	3,500	-13.0%	10,000	5.6%	5.3%
Ordinary income	10,098	5.9%	3,500	-16.2%	10,700	5.9%	6.0%
Profit attributable to owners of parent	5,656	3.3%	1,800	-23.9%	6,200	3.4%	9.6%
EBITDA	14,379	8.5%			15,504	8.6%	7.8%
Capital investment	4,510	-			986	-	-78.1%
Depreciation	1,680	-			1,991	-	18.5%
Amortization of goodwill	3,204	-			3,513	-	9.7%
Earnings per share (yen)	152.96		48.68		167.67		

Source: Prepared by FISCO from the Company's financial results, supplemental results materials, and releases

(1) Pharmacy Business

The Pharmacy Business is expected to record increases in both sales and profits. In FY3/24, the forecast for new store openings, an indicator of performance, is for 20 organic openings and 30 to 50 openings through M&A. Looking at actual store openings and closures through June 2, 2023, the Company opened 10 stores organically and acquired 2 stores through M&A, while closing 2 stores. This brought the total number of stores to 902 stores, an increase of 10 stores compared to the end of the previous fiscal year. As the dispensing pharmacy market continues to face a challenging business environment, major companies are expected to continue to undertake consolidation measures. The Company also plans to advance its M&A strategy while carefully examining M&A deals.

The number of prescriptions, which is a key precondition for business forecasts, is expected to increase by roughly 5% YoY, due partly to growth in the number of stores. As for the unit price of prescriptions, dispensing fee unit prices are forecast to decrease by around 2%, but this decline should be mostly offset by maintaining or improving the unit price of dispensing pharmacy's technical fees. The most important point is that the Company's success will depend on how it restores the community support system incentives, which will decrease when transitional measures end. Stores that had received 47 points or 39 points in the previous fiscal year will see their scores reduced to 39 or 17 points. For this reason, the Company plans to maintain or improve the community support system incentives by strengthening measures in the Home and Facility Delivery Dispensing Business and related areas, with a view to converting stores that currently have a calculated score of 0 points into those that can obtain 17 or 39 points. The Company aims to convert around half of the stores that have a calculated score of 0 points, which accounted for 50.1% of all stores as of March 2023, to stores that can receive incentives. If this target is achieved, FISCO believes that the Company can maintain the average unit price of community support system incentives on par with the previous fiscal year. Meanwhile, the Company should be able to increase the average unit price of the generic drug dispensing premium by roughly several percentage points by strengthening its activities. In addition, the Company expects to be able to maintain the basic dispensing fee for existing stores at mostly the same level as in the previous fiscal year.

In other net sales, the Company expects to drive growth in e-commerce sales, convenience store product sales, and OTC pharmaceutical sales. In April 2023, through a collaboration with Suntory Wellness Ltd., the Company started sales of six Suntory Wellness health food brands, which had previously been offered only via mail-order sales, at Qol stores. Additionally, the Company and Suntory Wellness will hold regular study sessions attended by the Company's pharmacists and Suntory Wellness' researchers to share knowledge with one another. These study sessions will help to enhance the Company's role as a community health-support pharmacy.

(2) Medical Related Business

In the Medical Related Business, although lower sales and profits are forecast in the Pharmaceutical Manufacturing Business due to a snap-back decline in COVID-19 antigen test kits, this decline is expected to be covered by revenue growth in the CSO Business and the Medical Professional Referral Dispatch Business, leading to projected increases in sales and profits overall. Although a certain level of demand for antigen test kits is expected for companies and schools, and sales of antigen test kits could grow in phases when the number of COVID-19 infections is increasing, the Company has incorporated a conservative outlook for such antigen test kits in its forecast. In the CSO Business, steady growth is anticipated as demand for CMRs remains firm.

In the Medical Professional Referral Dispatch Business, APO PLUS CAREER has announced that it newly acquired the shares of Oncall Inc. and made it a subsidiary in April 2023. Oncall is developing a medical personnel matching platform business for spot projects and a network-based medical checkup business. As a startup established in 2019, Oncall will have a negligible impact on business results. However, Oncall is experiencing steady growth, with the number of medical facilities adopting its platform surpassing 400. The addition of Oncall to the lineup as a solution that covers numerous demands related to workers on the medical frontlines will pave the way for the Company to further grow its business scale.

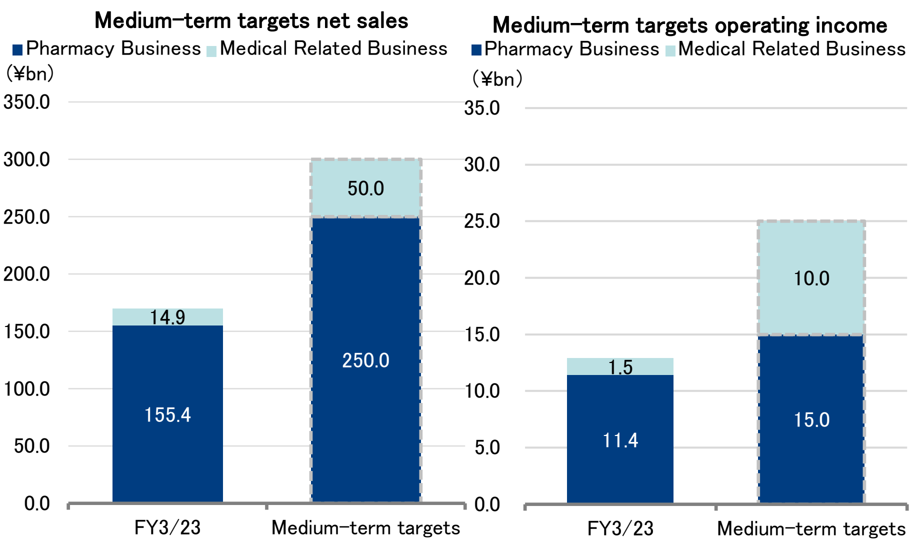
Medium- to long-term growth strategy and progress

With DAIICHI SANKYO ESPHA joining the Group, the Company's medium-term performance targets of net sales of ¥300.0bn and operating income of ¥25.0bn are now firmly within the achievable range

1. Medium-term performance targets and DAIICHI SANKYO ESPHA joining the Group

The Company's medium-term targets and growth strategies to achieve them have remained consistent and unchanged. The medium-term performance targets are net sales of ¥300.0bn and operating income of ¥25.0bn. By business segment, the target for the Pharmacy Business is net sales of ¥250.0bn, 1.6 times more than FY3/23 and operating income of ¥15.0bn, 1.3 times, and the target for the Medical Related Business is net sales of ¥50.0bn, 3.3 times greater than FY3/23 and operating income of ¥10.0bn, 6.5 times.

Medium-term targets and ideal business portfolio



Source: Prepared by FISCO from the Company's results briefing materials

Of these targets, the Company will surpass its targets for the Medical Related Business all at once as a result of DAIICHI SANKYO ESPHA joining the Group as announced in May 2023. It can be said that the Company's overall business performance targets are now firmly within the achievable range. DAIICHI SANKYO ESPHA is a fabless manufacturer focused on planning and sales. It was established by Daiichi Sankyo Company, Limited <4568> in 2010 to enter the generic drugs market. DAIICHI SANKYO ESPHA stands out for having a sales composition in which AG products account for approximately 75% of net sales and for having the top market share in Japan in terms of sales value. DAIICHI SANKYO ESPHA's market share stood at approximately 26% in FY3/23. In terms of sales items, DAIICHI SANKYO ESPHA has entered into licensing agreements for the development and sales of AG products with not only Daiichi Sankyo, but also multiple other pharmaceutical companies, and it has developed products based on these agreements. It currently sells 18 items. In FY3/23, DAIICHI SANKYO ESPHA reported outstanding performance with increasing sales and profits, due in part to a supply shortage of generic drugs with which it competes. Its business performance is expected to continue growing steadily as its sales item range expands. Daiichi Sankyo now sees business portfolio optimization as a key theme of its medium-term management plan. The divestment of DAIICHI SANKYO ESPHA appears to have been undertaken as part of this concept.

Results and management indicators of DAIICHI SANKYO ESPHA

(¥mn)

	FY3/21	FY3/22	FY3/23
Net sales	60,159	64,382	78,769
Operating income	10,698	10,879	12,865
Ordinary income	10,706	10,880	12,897
Net profit	7,398	7,520	8,934
Net assets	17,431	17,554	18,982
Total assets	36,024	37,431	46,466

	FY3/21	FY3/22	FY3/23
Equity ratio	48.4%	46.9%	40.9%
Operating income margin	17.8%	16.9%	16.3%
ROE	-	28.7%	33.0%
ROA	-	29.6%	30.7%

Source: Prepared by FISCO from the Company's publicly disclosed materials

The Company plans to acquire 30% of DAIICHI SANKYO ESPHA's shares and make it an equity-method affiliate on October 1, 2023. The Company will then acquire an additional 21% of its shares and make it a consolidated subsidiary on April 1, 2024. The Company will cover the stock acquisition value of ¥25.0bn with borrowings from financial institutions and cash in hand. In FY3/24, the Company expects to record ¥700mn in share of profit in entities accounted for using equity method. This amount includes amortization of goodwill. Both companies will hold discussions on the remaining 49% of shares. In the future, the Company is also considering making DAIICHI SANKYO ESPHA a wholly owned subsidiary.

By sharing their expertise, both companies will develop high-valued-added drugs and drugs centered on AG products that address customer needs. In addition, the two companies will consider developing new businesses through the integration of their operations. The Company is expected to grow dramatically as a comprehensive healthcare company that combines the Pharmacy Business, which is expected to deliver steady profit growth, and the Medical Related Business, which offers high earnings potential.

Overview of the Group's growth strategy

Source: The Company's results briefing materials

In the Pharmacy Business, the Company will focus mainly on expanding the number of stores and strengthening Home and Facility Delivery Dispensing Business, as well as strengthening differentiation through promotion of DX and earning capability

2. Pharmacy Business growth strategy and progress

In the Pharmacy Business, the Company is aiming for growth through the basic strategy of expanding scale through strategic store openings and creating value of pharmacies.

(1) Expanding scale through strategic store openings

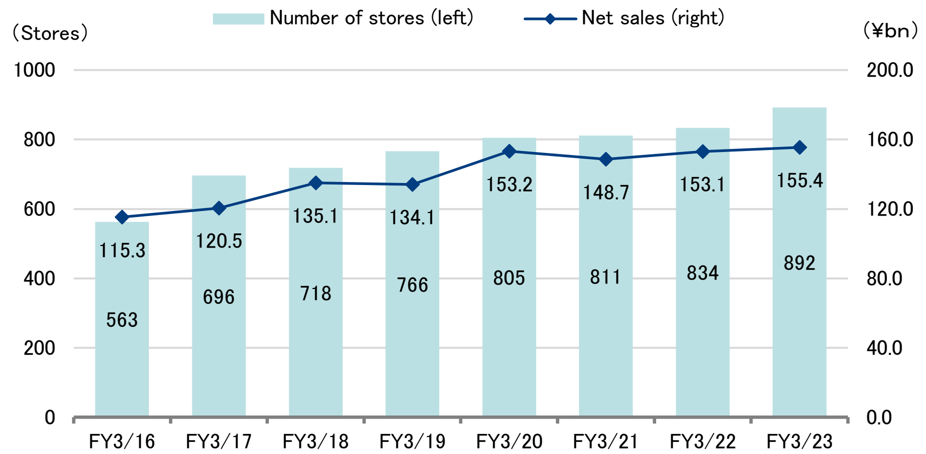
Regarding the number of stores, the Company's target for the time being is to have 1,000 stores though 10 to 20 organic openings yearly and by acquiring 30 to 70 stores annually through M&A. Initially, this achievement was targeted for FY3/23, but as the COVID-19 pandemic has slowed the pace of M&A, the Company is on track to achieve its aim by about FY3/25 if maintaining the current pace (or earlier if it is possible to achieve a large-scale M&A). The Company will target openings for areas with large populations, such as the three major metropolitan areas and efficiently expand the number of stores through dominant openings. Similarly for M&A, its policy is to move ahead in main urban areas where it is easy to collaborate with communities.

As for the store format, it continues to open "One-on-one pharmacies" that are its strength and target the same model in M&A. The number of "Healthcare pharmacies" through alliances with companies in other industries was 45 as of March 31, 2023. Breaking this down, 36 were collaborative stores with Lawson, 5 were pharmacies within BIC CAMERA stores, 2 were pharmacies within MUJI stores and 2 were pharmacies within train stations. Among these, due to the improved recognition of the mainstay collaborative stores with Lawson, profitability is also improving. Going forward, the Company will focus on these as a differentiation strategy during the expansion of the Home and Facility Delivery Dispensing Business.

In other strategic store openings, the Company's policy is to bolster openings of pharmacies specialized for Home and Facility Delivery Dispensing Business, aiming to provide the enhancement of community healthcare called for by the arrival of the super-aging society. Currently, the Company operates a total of 15 such stores, comprising 5 stores with a focus on Home and Facility Delivery Dispensing Business and 10 that specialize in it. The Company will expand the number to 50 stores over the coming years. Within a 16 km radius, which is the condition for medical service fees for pharmaceutical management in home medical care, the Company is expected to have stable sales through agreements with multiple institutions, such as nursing care facilities. Costs are higher in the initial stage of opening such stores because they require slightly larger initial investments than regular stores, such as providing dedicated shelves for at-home and in-facility patients. However, the unit price for prescriptions is around 1.5 times higher (approximately ¥9,500) on average since the medical service fee for pharmaceutical management in home medical care* is added. This means that stores become highly profitable if they can secure a number of contracting facilities.

* Medical service fees for pharmaceutical management in home medical care are ¥6,500 for one patient in a single building, ¥3,200 for two to nine patients, and ¥2,900 for ten or more patients (up to four times a month per patient; eight times a month (twice a week) for patients with terminal malignant tumors, etc.). There is also an additional ¥150 home visit drug dispensing premium.

Trends in the number of stores at the fiscal year-end and net sales of Pharmacy Business

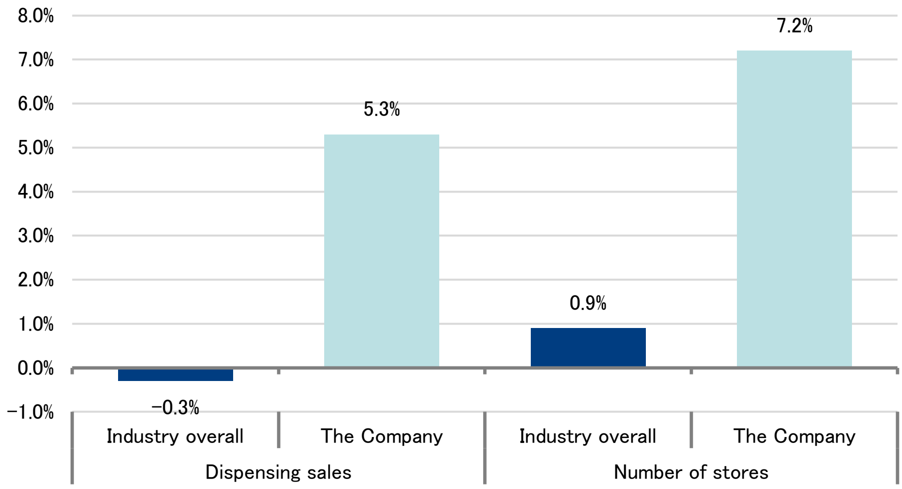


Source: Prepared by FISCO from the Company's results briefing materials

In the dispensing pharmacy industry, in addition to the lifting of the ban on online drug administration guidance in 2020 and the introduction of the authorization system for specific functions in August 2021, electronic prescriptions began operation in 2023. The provision of services using IT is expected to play an increasingly crucial role in pharmacy management. For example, major companies are working to retain customers through the usage of LINE mini-apps. On the other hand, building such systems will require capital capabilities above a certain level, and this is one factor supporting the view that the industry will increasingly become an oligopoly dominated by major corporations. Furthermore, there are approximately 60,000 dispensing pharmacies nationwide, with a market scale of approximately ¥7.7tn in fiscal 2021. Compared to fiscal 2015 (market scale ¥7.8tn, number of pharmacies 58,000), the market scale has effectively topped out due to the impact of reducing drug prices, while the number of pharmacies is increasing, albeit slightly, partly due to the opening of drugstores, leading to a more competitive environment.

In this environment, major dispensing pharmacies continue sales growth through expanding the number of stores by organic openings and M&A. The Company is one such company, and the CAGR from FY3/16 to FY3/22 shows dispensing pharmacy sales grew 5.3% and the number of stores by 7.2%, which significantly exceeds the growth rate of the industry as a whole (dispensing pharmacy sales -0.3%, number of pharmacies 0.9%). Currently, the total sales of the 10 leading companies in the dispensing pharmacy market are around ¥1.4tn, which converts to a market share of only approximately 19%. Considering that the top 10 companies in the drugstore industry currently have a share of more than 70%, it is highly likely that the major players in the dispensing pharmacy industry will proceed to form an oligopoly going forward. The Company's strategy of expanding store openings, both organically and through M&A, makes sense and FISCO believe it is possible for the Company to achieve sustainable growth through the medium-term expansion of store numbers. The Company judges whether or not to conduct an M&A based on strict in-house standards, including the scales of sales, whether or not synergetic effects will be generated, and the investment recovery period.

FY3/16–FY3/22 CAGR



* Number of Qol stores excludes the number of shops
Source: Prepared by FISCO from the Ministry of Health, Labour and Welfare's "Trends of Medical Prescription Fees (Computerized Data) in FY2020"

(2) Creating value of pharmacies

As its measures for creating value of pharmacies, the Company has been creating pharmacies that offer high quality sought by the public. For example, as of November 2022, the Company has 157 authorized health-support pharmacies, which can not only function as primary pharmacies for local communities, but also provide various health-related consultations on matters such as OTC drugs, nursing care, and diet and nutrition. Under the pharmacy authorization system for specific functions introduced in August 2021, the Company has 154 community cooperative pharmacies*1 and 10 pharmacies in cooperation with specialized medical institutions*2 (As of May 31, 2023). With the arrival of a super-aging society, this system can be viewed as an initiative to establish a comprehensive community care system to facilitate the implementation of the healthcare and nursing care system. Although the system has not yet affected profits, it may impact the calculation of dispensing pharmacy's technical fees when dispensing fees are revised. For this reason, the Company will continue working to receive authorization. In the future, the Company seeks to have all pharmacies authorized as either a community cooperative pharmacy or a pharmacy in cooperation with specialized medical institutions.

*1 Pharmacies that can respond to hospital admissions and discharges and home medical care in coordination with other medical provider facilities.
*2 Pharmacies that can respond to specialized pharmaceutical management for cancer and other diseases in coordination with other medical provider facilities.

Also in FY3/24, the Company is taking measures based on the priority measures of strengthening the Home and Facility Delivery Dispensing Business and promoting DX. These markets still account for only a small share of around several percent of the overall dispensing market, but from 2025 onward, as the baby boomer generation reaches the age of 75, demand is expected to grow further for at-home medical and nursing care services, and the home and facility delivery dispensing pharmacy market is also expected to continue a period of high growth. Looking ahead, the Company's policy is to focus on developing facilities, such as nursing care facilities, and providing services to individual homes. The sales target for the Home and Facility Delivery Dispensing Business is ¥10.0bn in FY3/24, and the Company is forecasting a 25% increase in the number of contracted nursing care facilities compared to April 2021.

Meanwhile, on the other priority measure, promoting DX, the Company is working not only to streamline operations inside pharmacies through the utilization of IT (including the introduction of automated checkout machines). It is also working to retain customers by expanding the development and provision of various services which lead to greater convenience for customers by utilizing its LINE official account. Specifically, in April 2022, the Company launched an advanced reservation prescription service and is also steadily expanding services such as same-day delivery functions, online medicine administration guidance and an automatic data link function with prescription records, etc., as part of efforts to increase user convenience. As a result of these initiatives, the number of registered users of the Company's official LINE account surpassed 140,000 as of the end of May 2023, which is two times greater than the level half a year ago.

CMR dispatches is focusing on the pursuit of specialization and expanding market share, the Medical Professional Referral Dispatch Business is expanding areas, and the Pharmaceutical Manufacturing Business is aiming for high growth by utilizing Group synergies

3. Medical Related Business growth strategy and progress

The Company calls for deepening specialization and maximizing Group synergies as a growth strategy in the Medical Related Business with a policy of expanding sales scale and raising profitability.

(1) CSO Business

The current understanding of the CMR market in the CSO Business is that the main focus of new drugs shifted from primary medicine (drugs for treatment of lifestyle related diseases, etc.) to specialty drugs (anti-cancer drugs, etc.). Amid that shift, the trend of pharmaceutical companies reducing their MR personnel is expected to continue. Meanwhile, demand is growing for highly specialized MR and MR with high IT literacy, and demand for highly specialized CMRs is expected to be solid in such an environment.

In fact, according to the “2022 Edition MR White Paper,” the number of MR personnel in Japan peaked at 65,000 in fiscal 2013 and continues on a decreasing trend, reaching 51,000 in fiscal 2021. On the other hand, according to the “2022 Summary of the CSO Business in Japan” by the Japan Contract Sales Organization Association, the number of working CMRs peaked at 4,148 people in 2014 and declined to 3,110 in 2018, but has since reverted to increasing and in 2022 was 3,647 people. CMRs accounted for 5.0% of all MRs in 2018, and the ratio rose to the highest level on record at 7.0% in 2022. In the US, which is an advanced country for CMRs, the CMR ratio is 11.2%, while in the UK it is 14.0%, both in the 10% range. Considering this, there appears to be ample potential for the CMR ratio to increase further in Japan going forward. Nevertheless, considering that there are around 6,500 CMRs among the US population of 58,000 MRs, there is not as much room to increase in terms of absolute numbers. In this context, the Company’s growth strategy is to increase its industry share through the recruitment and training of highly specialized CMR personnel, for whom there is significant demand.

Specifically, the Company is aiming to increase the number of CMR personnel from the current approximately 610 to 1,000 people and lift its industry share from approximately 15% currently to over 20%. One advantage of the Company’s CSO Business is that it boasts the best staff formation in the industry, with 20 people who conduct MR training. It has a robust educational curriculum that broadly covers everything from basic areas to advanced specialties. The Company’s expertise in training CMRs in specialized fields centered on oncology, inflammatory bowel disease, and central nervous system diseases can be considered a strength. The Company’s policy is to also focus on recruitment and training of staff from other industries.

(2) Medical Professional Referral Dispatch Business

In the Medical Professional Referral Dispatch Business, in addition to expanding dispatch services for medical professionals such as pharmacists, public health nurses and registered sales personnel, the Company is seeking to expand its service lineup through such means as consulting for business succession for pharmacies, consulting for matters related to health management for corporations, and converting Oncall Inc. into a subsidiary. In conjunction with these measures, the Company intends to expand the scale of its business.

(3) Pharmaceutical Manufacturing Business

In FY3/25, the Company's scale of business is expected to expand all at once as a result of DAIICHI SANKYO ESPHA joining the Group. Meanwhile, the strategy for Fujinaga Pharm is to expand its business scale by continuing to develop pharmaceuticals in niche fields. In the future, Fujinaga Pharm will seek to expand into areas such as outsourced manufacturing services while ramping up its facilities. Fujinaga Pharm has collaborated with DAIICHI SANKYO ESPHA on co-promotion activities, but does not have a manufacturing relationship with it.

Income statement and main indicators

(¥mn)

	FY3/19	FY3/20	FY3/21	FY3/22	FY3/23
Net sales	144,783	165,411	161,832	166,199	170,036
YoY	-0.5%	14.2%	-2.2%	2.7%	2.3%
Gross profit	17,863	21,094	21,102	23,163	23,504
Gross margin	12.3%	12.8%	13.0%	13.9%	13.8%
SG&A expenses	10,812	13,361	13,737	13,308	14,009
SG&A expense ratio	7.5%	8.1%	8.5%	8.0%	8.2%
Operating income	7,050	7,733	7,364	9,855	9,495
YoY	-22.4%	9.7%	-4.8%	33.8%	-3.7%
Operating margin	4.9%	4.7%	4.6%	5.9%	5.6%
Ordinary income	7,208	8,024	7,403	10,094	10,098
YoY	-22.8%	11.3%	-7.7%	36.4%	0.0%
Profit attributable to owners of parent	3,908	4,067	3,365	5,489	5,656
YoY	-21.6%	4.1%	-17.3%	63.1%	3.0%
Earnings per share (¥)	101.73	107.23	89.55	149.51	152.96
Dividend per share (¥)	28.00	28.00	28.00	28.00	32.00
Book value per share (¥)	1,006.55	1,074.57	1,124.31	1,189.70	1,314.69

Source: Prepared by FISCO from the Company's financial results and supplemental results materials

Simplified balance sheet

(¥mn)

	End of FY3/20	End of FY3/21	End of FY3/22	End of FY3/23	Change
Current assets	45,881	45,499	42,296	44,214	1,917
Cash and deposits	15,802	19,648	16,685	18,770	2,084
Notes and accounts receivable- trade, and contract assets	22,862	18,231	17,382	16,951	-431
Inventories	5,224	4,854	5,582	5,286	-296
Noncurrent assets	56,976	55,062	53,682	57,689	4,006
Property, plant and equipment	13,055	12,730	12,846	16,108	3,261
Intangible assets	36,642	34,938	33,238	33,790	552
Investments and other assets	7,278	7,393	7,598	7,791	192
Deferred assets	14	9	4	1	-3
Total assets	102,872	100,571	95,984	101,905	5,920
Current liabilities	38,730	38,709	35,460	36,330	869
Noncurrent liabilities	23,139	20,026	16,642	16,719	76
Total liabilities	61,870	58,736	52,103	53,049	945
Interest-bearing debt	32,650	29,721	23,282	22,750	-532
Total net assets	41,001	41,834	43,881	48,856	4,974

Source: Prepared by FISCO from the Company's financial results and supplemental results materials

Cash flow and management indicators

(¥mn)

	FY3/20	FY3/21	FY3/22	FY3/23
Cash flow from operating activities	4,468	12,912	10,112	11,662
Cash flow from investing activities	-8,670	-3,065	-3,087	-7,013
Free cash flow	-4,201	9,846	7,025	4,648
Cash flow from financing activities	-225	-6,114	-10,006	-2,569
Cash and cash equivalents at the end of the period	15,766	19,498	16,516	18,596
Equity ratio	39.4%	40.9%	45.7%	47.9%
Interest-bearing debt ratio	80.6%	72.2%	53.1%	46.6%
ROIC	7.3%	7.1%	10.2%	9.2%
ROE	10.3%	8.2%	12.9%	12.2%
ROA	8.1%	7.3%	10.3%	10.2%

Source: Prepared by FISCO from the Company's financial results and supplemental results materials

Returns to shareholders and SDGs initiatives

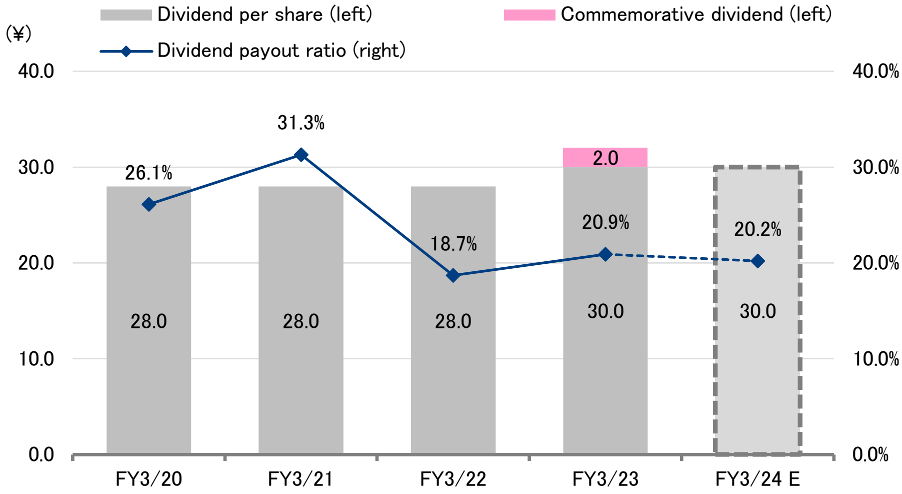
Basic policy is to stable returns to shareholders, as well as introducing shareholder benefits program

1. Shareholder return policy

Its basic policy is to pay stable return of profits to shareholders while also giving consideration to internal reserves for future business development and reinforcement of its management foundation. It does not set an official payout ratio or other standards on dividend. Also, in order to execute a flexible capital policy, the Company considers acquisitions of treasury shares when necessary. Based on this basic policy, in FY3/23, the Company paid a dividend per share of ¥32.0 (dividend payout ratio of 20.9%), an increase of ¥4.0 per share compared to the previous fiscal year. In conjunction with the increase in its internal reserves, the Company increased its ordinary dividend by ¥2.0 per share and added to this a commemorative dividend of ¥2.0 per share to mark the 30th anniversary of its foundation. In FY3/24, the Company plans to maintain the dividend level from the previous fiscal year, with an ordinary dividend of ¥30.0 per share (dividend payout ratio of 20.2%). While the commemorative dividend will be absent, the Company's policy is to allocate funds to growth investments such as the acquisition of shares of DAIICHI SANKYO ESPHA.

The Company has also introduced a shareholder benefits program. Shareholders registered at the end of March in each year are eligible for the program. Looking at the example of shareholders holding 1 unit of 100 shares, they receive a catalog gift worth ¥3,000 if they have held the shares for less than 1 year, and worth ¥5,000 if held for 1 year or longer. On calculating the investment yield which combines the dividend and shareholder benefits based on the closing share price on June 2 (¥1,670), it is 3.6% if the shares were held for less than 1 year and 4.8% if held for 1 year or longer.

Dividend per share and dividend payout ratio



Source: Prepared by FISCO from the Company's financial results

Content of shareholder benefits

Sustained ownership period	Number of shares owned	
	100-499 shares	500 shares or more
Less than a year	Catalog gifts worth ¥3,000	Catalog gifts worth ¥5,000
One year or longer	Catalog gifts worth ¥5,000	Catalog gifts worth ¥7,000

Source: Prepared by FISCO from the Company's website

2. Initiatives for SDGs

Regarding initiatives for SDGs, the Company established a Sustainability Committee in May 2022 as an advisory body to the Board of Directors to strengthen activities related to the Group's sustainability. The Company plans to move ahead on such activities as sustainability trend surveys, proposals for sustainability-related management strategies, identification and review of important issues (materiality), monitoring of progress status and evaluation of achievement status.

Moreover, in December 2022, the Company announced its endorsement of the Task Force on Climate-related Financial Disclosures (TCFD). Additionally, in February 2023, the Company prepared a publication called Value Report 2022 for the first time. This report summarizes the Company's position on sustainability and the current state of sustainability activities, among other matters. Value Report 2022 can be viewed from the Company's website. Furthermore, a cross-divisional team made up of executives, middle-tier employees, and young employees was created to develop goals to be achieved in 2030 and 2050. The team is advancing discussions on its awareness of current conditions and the Company's ideal profile for the future based on the team members' diverse array of values and ideas.

As examples of sustainability initiatives, the entire Group is conducting a store greening campaign for store beautification and to promote SDGs. In addition, it has concluded a partnership agreement with the Japan Inclusive Football Federation to support inclusive football associations and soccer teams through lectures and dietary and nutritional consultation given by sports pharmacists with highly advanced specialist knowledge and registered dieticians. Moreover, the Company established Qol Assist Co., Ltd. in 2009, the industry's first special subsidiary with the objective of promoting employment for people with disabilities, and currently more than 50 employees are active in the company, centered on people with severe disabilities engaged in home-based employment.

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