COMPANY RESEARCH AND ANALYSIS REPORT

Qol Holdings Co., Ltd. (Qol)

3034

Tokyo Stock Exchange Prime Market

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Contents

Summary

Consolidation of DAIICHI SANKYO ESPHA to drive major expansion in earnings

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). In fields other than dispensing pharmacies, the Company also operates the CSO*1 Business, a Medical Professional Referral Dispatch Business, and the Pharmaceutical Manufacturing Business. In October 2023, the Company acquired 30% of the shares of DAIICHI SANKYO ESPHA CO., LTD., which is mainly engaged in authorized generic products (hereafter, "AG products"*2), making it an equity-method affiliate. The Company then acquired an additional 21% of shares in April 2024 and made it a wholly owned consolidated subsidiary. The Company plans to make DAIICHI SANKYO ESPHA a wholly owned subsidiary in a few years. The stock acquisition cost is ¥25.0bn, which will be covered by borrowings from financial institutions and cash in hand.

*1 CSO stands for Contract Sales Organization and involves CMR (Contract Medical Representative) dispatch services.
*2 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.

1. Profits declined in FY3/24, but net sales reached record high

FY3/24 consolidated net sales increased 5.9% year on year (YoY) to ¥180,052mn and operating income declined 12.3% YoY to ¥8,324mn. Net sales reached a record high for the third consecutive year, supported by steady sales growth of 6.3% YoY in the mainstay Pharmacy Business. However, profits in the Pharmacy Business contracted 6.7%, mainly reflecting deterioration in the purchasing margin and a decrease in the technical fee unit price due to the end of transitional measures for the community support system premium. Profits also declined in the Medical Related Business, falling 25.9% YoY on weaker profitability at a pharmaceutical manufacturing subsidiary.

2. Company forecasts steep rise in FY3/25 net sales and profits, partly on M&A

For FY3/25, the Company forecasts strong growth in both sales and profits, with consolidated net sales up 50.0% YoY to ¥270,000mn and operating income up 80.2% to ¥15,000mn. It expects growth in existing businesses and the consolidation of DAIICHI SANKYO ESPHA to drive growth, with the new subsidiary projected to lift sales by ¥82.5bn and operating income by ¥7.0bn. In the Pharmacy Business, the Company forecasts sales will increase roughly 5% YoY and operating income will rise approximately 10%, supported by new store openings, including those acquired through M&A, and stepped up efforts to secure community support system premiums. It also sees sales and profits increasing in the CSO Business and the Medical Professional Referral Dispatch Business.

3. Targeting operating income of ¥24.0bn in FY3/27

The Company's medium-term three-year performance targets are net sales of ¥307.2bn and operating income of ¥24.0bn in FY3/27. In the Pharmacy Business, it is targeting annualized sales growth of 4% or higher through new store openings and M&A, while also improving profitability by strengthening dispensing pharmacy functions as primary pharmacies for local communities and implementing digital transformation (DX). In the Pharmaceutical Manufacturing Business, it is aiming for sales of ¥100.0bn and operating income of ¥12.0bn at DAIICHI SANKYO ESPHA. The goal is to increase earnings by launching three to four new authorized generic (AG) products each year, and by improving the cost of sales ratio and reviewing SG&A expenses from scratch. In the Medical Related Business, the Company is targeting annualized organic sales growth of 10%, supported by strong demand for human resources. By expanding all three businesses, the Company aims to help realize a sustainable society as a Comprehensive Healthcare Company covering R&D of pharmaceuticals to manufacture and sales, medical professional services and dispensing pharmacies.

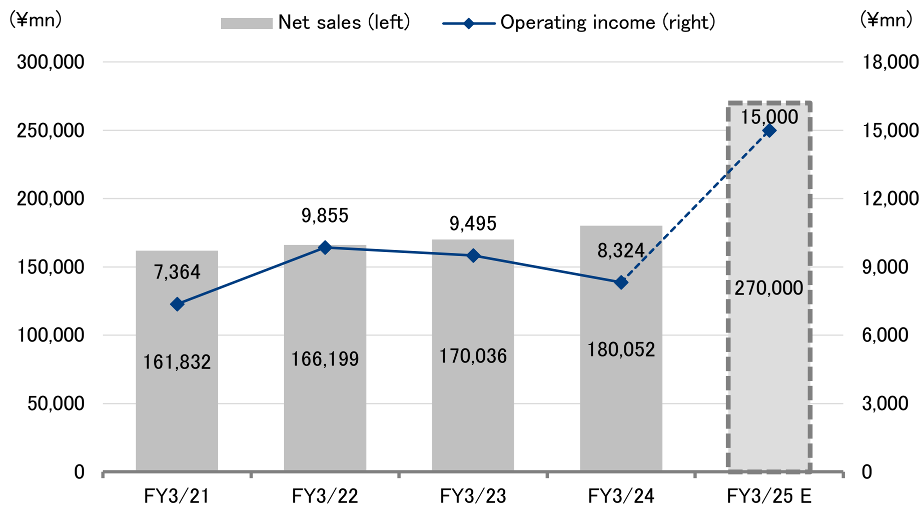
4. Segment classification changed from FY3/25

Effective from 1Q FY3/25, the Company has changed its reporting segments to better reflect actual business activities. Its previous two business segments, the Pharmacy Business and the Medical Related Business, have been reclassified as the Pharmacy Business, the BPO Contracting Businesses and the Pharmaceutical Manufacturing Business. The Pharmaceutical Manufacturing Business (Fujinaga Pharm Co., Ltd.) was part of the Medical Related Business under the previous segment classification, but under the new classification, it has become the Pharmaceutical Manufacturing Business along with DAIICHI SANKYO ESPHA, which became a consolidated subsidiary from 1Q FY3/25.

Key Points

- Profits declined in FY3/24 due to increase in cost of sales ratio, but net sales reached record high
- On track for sharply higher record earnings in FY3/25 on consolidation of DAIICHI SANKYO ESPHA
- Targeting net sales of ¥307.2bn and operating income of ¥24.0bn in FY3/27 as a Comprehensive Healthcare Company by expanding all three businesses
- Reporting segment classification changed from 1Q FY3/25

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

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 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. In April 2023, APO PLUS CAREER acquired all of the shares of Oncall Inc., which develops and operates a spot work-type medical professional matching platform, making it a subsidiary.

In October 2023 the Company acquired a 30% stake in DAIICHI SANKYO ESPHA, a generic drug manufacturing and sales subsidiary of Daiichi Sankyo Company, Limited <4568>, making it an equity method affiliate. In April 2024 it acquired an additional 21% stake, making it a consolidated subsidiary. The Company plans to convert it to a wholly owned subsidiary in a few years, with further share purchases to be funded by borrowings and cash in hand.

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 (FY3/24 results), the Pharmacy Business accounts for the majority at 91.7% of net sales and 90.4% of operating income. DAIICHI SANKYO ESPHA will become a consolidated subsidiary from FY3/25, which is expected to create a significant change in the breakdown.

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 mainly operates dispensing pharmacies. As of the end of March 2024, the business had a total of 920 stores, of which, 898 (approximately 98%) were dispensing pharmacies and the remaining 22 were shops located in hospitals. Prescription net sales (dispensing pharmacy net sales) account for around 93% of segment sales. Remaining sales are generated by products sold through pharmacies, convenience stores and shops located in hospitals, and by sales from health foods, hygiene items and other products via 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> (1,221 stores as of the end of January 2024) 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 742 (as of June 1, 2024), 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>, BIC CAMERA Inc. <3048>, Ryohin Keikaku Co., Ltd. <7453>, 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. Under the pharmacy authorization system that was introduced in August 2021, two categories were established: community cooperative pharmacies and pharmacies in cooperation with specialized medical institutions. Among these, the community cooperative pharmacies are expected to play an important role in the national project of building a comprehensive community care system. The Company has therefore adopted a policy of working proactively to receive authorization.*

* As of the end of March 2024, the Company had received authorization for 174 community cooperative pharmacies (pharmacies that can respond to hospital admissions and discharges and home medical care in coordination with other medical provider facilities) and 11 pharmacies in cooperation with specialized medical institutions (pharmacies that can respond to specialized pharmaceutical management for cancer and other diseases in coordination with other medical provider facilities).

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, 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." Also, the Company has allied with Ryohin Keikaku and started opening stores inside MUJI stores in FY3/22. Ryohin Keikaku opened a "Community Health Center" 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 2024, 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 2024, Kanto leads with 391 stores (42.5% of total number), followed by Kansai with 145 store (15.8%) and Koshinetsu with 113 store (12.3%), with the three areas accounting for over 70% in total. The Kanto area has many stores, as the Company was founded in Tokyo and focused on openings in the area (Tochigi Prefecture has more Group stores than any other prefecture). However, in the last few years, the number of stores has also been steadily increasing in the Kansai, Kyushu and Okinawa areas, due mainly to M&A.

Number of stores by area and population composition comparisons

	End of FY3/20 Number of stores	End of FY3/23 Number of stores	End of FY3/24		Increase on end of FY3/20	Population composition (2023)
			Number of stores	Composition ratios		
Hokkaido	10	11	11	1.2%	1	4.1%
Tohoku	85	90	89	9.7%	4	6.7%
Kanto	326	382	391	42.5%	65	35.0%
Koshinetsu	109	111	113	12.3%	4	4.0%
Tokai, Hokuriku	67	72	73	7.9%	6	14.1%
Kansai	132	141	145	15.8%	13	16.3%
Chugoku, Shikoku	49	50	49	5.3%	0	8.6%
Kyushu, Okinawa	27	35	49	5.3%	22	11.3%
Total	805	892	920	100.0%	115	100.0%

Note: Japan's population composition based on data as of 2023
Source: Prepared by FISCO from the Company's supplemental results materials and the Ministry of Internal Affairs and Communications' Population Estimates (2023)

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

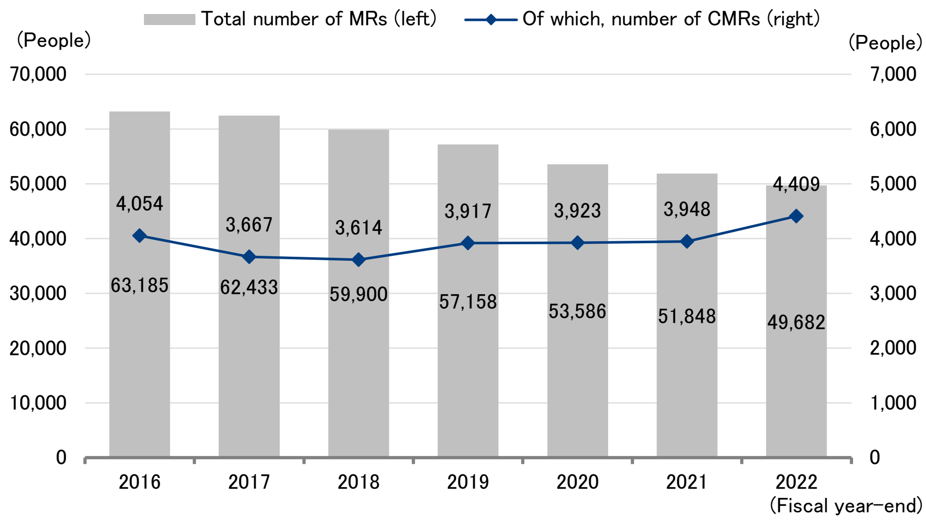
The Medical Related Business includes the CSO Business (CMR dispatches), and the CRO* Business (clinical trials support services), which are mainly conducted by APO PLUS STATION; the Medical Professional Referral Dispatch Business (pharmacists, registered sales personnel, public health nurses, nurses, 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. Looking at the sales composition ratio in the FY3/24 results, 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 10%, and the Medical-related Publishing Business accounts for just under 10%.

* 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 fact, according to the 2023 MR White Paper published by the MR Education & Accreditation Center of Japan, at the end of FY22, there were 49,682 MRs (down 2,166 YoY), representing a ninth consecutive year of decreases. However, the number of CMRs was 4,409 (up 461 YoY), increasing for a fourth consecutive year to reach a new record high. In this situation, the Company has been leveraging its recruiting and training capabilities to increase CMR personnel, reaching approximately 620 CMR personnel as of the end of March 2024, which is an industry share of around 14%, while holding the leading position in the industry for the number of customers as well, with around 50 to 60 companies.

Number of MRs and CMRs in Japan



Source: Prepared by FISCO from the MR Education & Accreditation Center of Japan, “2023 MR White Paper”

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, functional food, and healthcare products. The Company has strengths in clinical trials in the food field, and also 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 the psychiatry and dermatology fields. It primarily manufactures brand-name drugs Phenobal and Hydantol and generic drug Fujinaga lithium carbonate for sleep disorders, depression and other indications.

Business trends

Profits declined in FY3/24 due to an increase in the cost of sales ratio, but net sales reached a record high

1. Summary of FY3/24 results

In its FY3/24 consolidated results, the Company recorded higher sales with lower profits, with net sales increasing 5.9% YoY to ¥180,052mn, operating income decreasing 12.3% to ¥8,324mn, ordinary income decreasing 8.3% to ¥9,256mn, and profit attributable to owners of parent decreasing 13.7% to ¥4,880mn. Demand recovered in both the Pharmacy Business and the Medical Related Business as the novel coronavirus pandemic (hereinafter, the COVID-19 pandemic) subsided, driving net sales to a record high for the third consecutive fiscal year, and almost in line with the Company's forecast. However, profits declined due to deterioration in the purchasing margin and the end of transitional measures for the community support system premium in the Pharmacy Business, and drug price revisions, higher raw material costs and weaker sales of COVID-19 antigen test kits in the Pharmaceutical Manufacturing Business. Profits missed the Company's forecasts, mainly reflecting the deterioration in the purchasing margin and a shortfall in the number of pharmacies receiving the community support system premium in the Pharmacy Business, and higher-than-expected raw material costs in the Pharmaceutical Manufacturing Business.

FY3/24 results (consolidated)

(¥mn)

	FY3/23		FY3/24				
	Results	% of net sales	Company forecast	Results	% of net sales	YoY	Compared to forecast
Net sales	170,036	-	180,000	180,052	-	5.9%	0.0%
Gross profit	23,504	13.8%	-	23,249	12.9%	-1.1%	-
SG&A expenses	14,009	8.2%	-	14,925	8.3%	6.5%	-
Operating income	9,495	5.6%	10,000	8,324	4.6%	-12.3%	-16.8%
Ordinary income	10,098	5.9%	10,700	9,256	5.1%	-8.3%	-13.5%
Extraordinary income/losses	-514	-0.3%	-	-396	-0.2%	-	-
Profit attributable to owners of parent	5,656	3.3%	6,200	4,880	2.7%	-13.7%	-21.3%
EBITDA*	14,379	8.5%	15,504	13,566	7.5%	-5.7%	-12.5%

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

Performance by segment

(¥mn)

	FY3/23		FY3/24	
	Results	% change	Results	% change
Pharmacy Business				
Net sales	155,370	1.5%	165,099	6.3%
Segment income	11,499	-3.1%	10,730	-6.7%
% of net sales	7.4%		6.5%	
Medical Related Business				
Net sales	14,665	12.0%	14,952	2.0%
Segment income	1,534	28.9%	1,136	-25.9%
% of net sales	10.5%		7.6%	

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

Looking at results by business segment, the Pharmacy Business recorded net sales of ¥165,099mn, up 6.3% YoY, and operating income of ¥10,730mn, down 6.7%. The operating margin was 6.5%, down 0.9 percentage points. Net sales in the business continued to rise YoY, with a recovery in the number of prescriptions at existing stores, new store openings and M&A offsetting a decline in the unit price of prescriptions caused by drug price revisions. Profits declined due to deterioration in the purchasing margin for pharmaceuticals and a drop in the technical fee unit price after the end of transitional measures for the community support system premium. Amid a continued shortage of generic drugs, price negotiations with pharmaceutical wholesalers resulted in higher-than-expected purchase prices, with the resulting deterioration in margins having a particularly large impact on profits. Recently, there has been a trend, especially among foreign pharmaceutical companies, to limit supplies of single products to only one pharmaceutical wholesaler, making it harder for the Company to negotiate discounts with wholesalers.

The Medical Related Business reported net sales of ¥14,952mn, up 2.0% YoY, and operating income of ¥1,136mn, down 25.9%. Sales and profits increased in the CSO Business on solid demand for CMR, while the Medical Professional Referral Dispatch Business also performed well, posting double-digit sales and profit growth, supported by a recovery in temporary staffing demand for pharmacists and other roles as the COVID-19 pandemic subsided. In the Pharmaceutical Manufacturing Business, sales and profits declined, mainly due to drug price revisions and higher pharmaceutical raw material costs. A drop in sales of COVID-19 antigen test kits, launched in December 2022, also weighed on profits.

Sales continue to rise, with growth in the number of prescriptions offsetting a drop in prescription unit price

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' sales and product sales through channels such as shops and e-commerce. Looking at the breakdown of net sales for FY3/24, both dispensing pharmacy net sales and other net sales were higher YoY, with dispensing pharmacy net sales increasing 6.5% to ¥153,428mn and other net sales increasing 3.0% to ¥11,671mn. Breaking down dispensing pharmacy net sales by store-opening period and format, among the Company's organic openings, sales at existing pharmacies increased 8.6%, or ¥3,894mn on a monetary basis, and sales at new stores (excluding shops) increased 46.3% YoY, or ¥321mn on a monetary basis, due to the opening of 16 new stores. Also, for pharmacies acquired through M&As, etc., combined net sales for existing stores and new stores increased 5.3%, or ¥5,175mn on a monetary basis.

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

(¥mn)

	FY3/23			FY3/24		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	45,383	1,267	2.9%	49,277	3,894	8.6%
Newly opened pharmacies	694	186	36.6%	1,015	321	46.3%
M&A, etc.	97,959	273	0.3%	103,134	5,175	5.3%
All pharmacies	144,036	1,725	1.2%	153,428	9,392	6.5%

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 10.1% YoY to 16,467,000 prescriptions, while the unit price of prescriptions decreased 3.2% to ¥9,317. 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 10.2%. Although there was still a lingering trend of people refraining from seeking treatment due to the COVID-19 in the previous fiscal year, the number of visits to doctors increased following easing of restrictions on patients at medical institutions after the May 2023 reclassification of COVID-19 from a Class II to a Class V—equivalent to seasonal influenza—under the Act on the Prevention of Infectious Diseases and Medical Care for Patients with Infectious Diseases, leading to an increase in the number of prescriptions. Moreover, the number of prescriptions at pharmacies through M&A, etc., increased by 8.5%. The number of newly acquired stores through M&A was only 17, but the addition of growth in existing stores and 59 stores acquired in 2H FY3/23 were also a factor in the increase.

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

(thousands)

	FY3/23			FY3/24		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	4,240	213	5.3%	4,671	431	10.2%
Newly opened pharmacies	144	55	61.8%	322	178	123.6%
M&A, etc.	10,572	513	5.1%	11,473	901	8.5%
All pharmacies	14,957	781	5.5%	16,467	1,510	10.1%

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

The unit price of prescriptions fell by 3.2% YoY overall, marking a third straight year of decline. This decline includes a 1.4% fall at existing pharmacies and a 3.0% fall at M&A pharmacies. These declines reflect the impacts of a decrease in the unit price of dispensing fees, which is now revised every year, as well as a slight decrease in the dispensing pharmacy's technical fee unit prices due to the end of a transitional measure for community support system premium.

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

(¥)

	FY3/23			FY3/24		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	10,701	-254	-2.3%	10,549	-152	-1.4%
Newly opened pharmacies	4,799	-853	-15.1%	3,149	-1,650	-34.4%
M&A, etc.	9,266	-445	-4.6%	8,989	-277	-3.0%
All pharmacies	9,629	-409	-4.1%	9,317	-312	-3.2%

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 premium (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 premium offer points that vary depending on the state of each pharmacy's initiatives, providing a point of differentiation. Dispensing fees are revised every second year. In the revision of April 2022, 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 premium were revised. All dispensing pharmacies are promoting measures to clear the standards indicated in the revision and receive points.

Looking at the status of the number of stores that received points by points received in FY3/24, with regard to basic dispensing fees there were no significant changes to be seen in the composition ratio of pharmacies that acquired points. On the other hand, with regard to the generic drug handling ratio (volume basis), the ratio of stores that acquired the maximum 30 point allocation increased significantly from 33.6% as of March 2023 to 48.4% as of March 2024, making a positive contribution in terms of technical fee unit prices. The generic drug handling ratio for the Group overall continued to increase, rising from 85.6% in March 2023 to 88.0% in March 2024, and continued to exceed the 80% target set by the Ministry of Health, Labour and Welfare. Even amid an ongoing supply shortage of generic drugs and pressure from pharmaceutical wholesalers in purchasing negotiations, it appears that Groupwide efforts to implement measures in line with national policy have been effective.

With regard to community support system premium, pharmacies that received 47 points or 39 points in FY3/23 were downgraded to 39 points or 17 points following the end of a transitional measure in March 2023*, which was a negative factor for the dispensing pharmacy's technical fee unit prices. The composition ratio of pharmacies that received 47 points fell sharply from 28.6% in March 2023 to 1.0% in March 2024, and the ratio for pharmacies that received 39 points increased from 6.2% to 22.6%, while that of pharmacies that received 17 points increased from 15.0% to 30.7%. The Company's policy for responding to the end of transitional measures was to offset the negative impact by reducing the compositional ratio of pharmacies that received 0 points from 50.1% in March 2023 to around 30% in March 2024, and to increase the compositional ratio of pharmacies that received 17 points or higher. However, efforts to control the placement of pharmacists and so forth have been ineffective, with the ratio of pharmacies that received 0 points standing at 45.7% as of March 2024. Assuming a constant number of prescriptions per pharmacy, the number of community support system incentive points per pharmacy was calculated to decrease from 18.4 points in March 2023 to 14.5 points in March 2024. Since each point is worth ¥10, this represents a factor causing a ¥39 decrease in the unit price of prescriptions. This, multiplied by the number of prescriptions, can be seen as the profit decrease factor due to the end of the transitional measure. Using the same method to calculate the points for the basic dispensing fee and for the generic drug dispensing premium, combined points totaled 64.5 as of March 2024, down from 67.2 points as of March 2023, resulting in an estimated ¥27 decline in the unit price of prescriptions.

* With the revision of dispensing fees in April 2022, some pharmacies were shifted from "Basic dispensing fee 1" (42 points) to the newly established "Basic dispensing fee 3-c" (pharmacies in the same group receiving more than 0.4 million prescriptions a month, or having 300 or more pharmacies in the same group, basic dispensing fee 32 points). As a transitional measure, these pharmacies were deemed to be "Basic dispensing fee 1" pharmacies as before until March 2023, and were able to receive 39 points or 47 points depending on the number of home dispensing services performed and the status of afterhours, late-night, and holiday service. However, from April 2023, their incentives are calculated at 17 points or 39 points, the standard for "Basic dispensing fee 3-c" pharmacies. In addition, as a special measure from April to December 2023, pharmacies 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 premium.

Basic dispensing fee
(percentage of store type)

Points	End of September 2022	End of March 2023	End of September 2023	End of March 2024
42 points	1.2%	2.5%	1.3%	1.8%
32 points	47.1%	44.6%	47.2%	46.0%
26 points	0.0%	0.5%	0.0%	0.6%
21 points	0.5%	4.0%	0.6%	0.0%
16 points	48.7%	46.0%	48.2%	48.9%
9 points	2.5%	-	-	-
7 points	-	2.4%	2.7%	2.7%
Number of pharmacies	810	866	890	895

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

Generic drug dispensing premium
(percentage of store type)

Points	End of September 2022	End of March 2023	End of September 2023	End of March 2024
30 points	27.9%	33.6%	39.0%	48.4%
28 points	46.5%	43.1%	39.8%	35.3%
21 points	15.0%	13.6%	12.6%	9.5%
0 points	10.6%	9.7%	8.7%	6.8%
Number of pharmacies	810	866	890	895

Community support system premium
(percentage of store type)

Points	End of September 2022	End of March 2023	End of September 2023	End of March 2024
47 points	28.2%	28.6%	0.7%	1.0%
39 points	8.6%	6.2%	15.3%	22.6%
17 points	13.1%	15.0%	34.5%	30.7%
0 points	50.1%	50.1%	49.6%	45.7%
Number of pharmacies	810	866	890	895

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 2024 stood at 920, an increase of 28 stores from the end of the previous fiscal year. The Company opened a total of 35 stores, including 16 stores opened organically (excluding shops), 17 acquired through M&A, and 2 shops. The Company closed 7 stores. In the previous fiscal year, it opened a total of 70 stores, including 20 stores opened organically, 48 stores acquired through M&A, 1 store opened inside BIC CAMERA, and 1 shop, with 12 stores closed. While organic store openings were within the range of the initial plan (10-20 stores), stores opened through M&A fell short of target (30-70 stores), as some M&A deals were delayed until FY3/25.

Store openings and closures status

		FY3/23				FY3/24			
		Opened		Closed	End of 4Q	Opened		Closed	End of FY3/24
QOL Pharmacies		Organic openings	20	8	829	Organic openings	16	7	855
		Through M&A	48			Through M&A	17		
New format	Lawson		0	0	36		0	0	36
	BIC CAMERA		1	1	5		0	0	5
	Within train stations		0	0	2		0	0	2
Shops			1	3	20		2	0	22
Total			70	12	892		35	7	920

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

The CSO Business and the Medical Professional Referral Dispatch Business are performing favorably

3. Trends in the Medical Related Business

In the Medical Related Business, the mainstay CSO business reported higher sales and profits on strong inquiries for CMRs from pharmaceutical manufacturing companies. There is a continuing trend among pharmaceutical manufacturers to utilize CMRs and reduce their own MR personnel as a cost-cutting measure. As the Company has the largest number of transactions with companies in the industry, it has seen brisk inquiry activity, particularly in the oncology field. While CMR recruitment and training is slightly behind schedule, the number of CMRs increased to around 620 from approximately 610 at the end of the previous fiscal year. The CRO Business also performed well, receiving project orders from food manufacturers.

In the Medical Professional Referral Dispatch Business, sales and profits also increased, rising roughly 20% due to continued recovery in demand for pharmacists and registered sales personnel for drugstores since 2H FY3/22, and rising demand for industrial physicians and health professionals amid wider adoption of health and productivity management by companies, leading to an increase in the number of contracts. Moreover, while still small in scale, short-term spot-type medical professional introduction services provided by Oncall, which became a subsidiary in April 2023, also performed well.

However, in the Pharmaceutical Manufacturing Business, sales and profits declined in existing businesses due to the impact of drug price revisions, high raw material costs and factory maintenance costs. Demand for the COVID-19 antigen test kit, launched in December 2022, also moderated as the COVID-19 pandemic subsided.

On track for sharply higher record earnings in FY3/25 on consolidation of DAIICHI SANKYO ESPHA

4. FY3/25 outlook

For FY3/25, the Company forecasts sharply higher record earnings, with consolidated net sales up 50.0% YoY to ¥270,000mn, operating income up 80.2% to ¥15,000mn, ordinary income up 64.2% to ¥15,200mn, and profit attributable to owners of parent up 16.8% to ¥5,700mn. In addition to growth in existing businesses, it expects the consolidation of DAIICHI SANKYO ESPHA in April 2024 to lift earnings. For DAIICHI SANKYO ESPHA, the Company forecasts sales of ¥82.5bn, operating income of ¥7.0bn and net income of ¥4,800mn. It assumes amortization of goodwill will reduce operating income by around several hundred million yen, and minority interests in income (49% minority interests) will reduce profit attributable to owners of parent by ¥2,350mn. Even with these factors, we think the Company's consolidated forecasts look conservative. As this is DAIICHI SANKYO ESPHA's first fiscal year as a consolidated subsidiary, we think the Company has adopted cautious forecasts to take into account various risks.

Effective from 1Q FY3/25, the Company has changed its reporting segments to better reflect actual business activities. Its previous two business segments, the Pharmacy Business and the Medical Related Business, have been reclassified as the Pharmacy Business, the BPO Contracting Businesses and the Pharmaceutical Manufacturing Business. The Pharmaceutical Manufacturing Business (Fujinaga Pharm Co., Ltd.) was part of the Medical Related Business under the previous segment classification, but under the new classification, it has become the Pharmaceutical Manufacturing Business along with DAIICHI SANKYO ESPHA, which became a consolidated subsidiary from 1Q FY3/25.

FY3/25 outlook

(¥mn)

	FY3/24		FY3/25		
	Full year results	% of net sales	Full year forecast	% of net sales	YoY
Net sales	180,052	-	270,000	-	50.0%
Operating income	8,324	4.6%	15,000	5.6%	80.2%
Ordinary income	9,256	5.1%	15,200	5.6%	64.2%
Profit attributable to owners of parent	4,880	2.7%	5,700	2.1%	16.8%
EBITDA*	13,566	7.5%	21,500	8.0%	59.0%
Depreciation	1,848	-	2,164	-	17.0%
Amortization of goodwill	3,393	-	4,403	-	29.8%
Earnings per share (yen)	131.11		153.13		

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

(1) Pharmacy Business

In the Pharmacy Business, the Company appears to be forecasting sales growth of around 5% YoY and operating income growth of approximately 10%. It assumes 16 organic store openings (annual sales of ¥3.0bn) and 30-40 store openings through M&A (annual sales of ¥6.5bn). The Company is making steady progress towards these targets. As of May 2024, it had opened 9 stores organically and acquired 18 stores through M&A (including its first stores to be opened in Yamanashi Prefecture), and in July 2024 it decided to acquire 8 stores in the Tokyo metropolitan area.

The number of prescriptions, an indicator of sales performance, is forecast to rise several percent YoY, supported by growth in the number of existing stores and the impact of new store openings and M&A. The unit price of prescriptions is also expected to increase slightly. Although drug price revisions in April 2024 are expected to marginally push down the unit price of dispensing fees, the Company aims to increase the unit price of dispensing pharmacy technical fees, leading to additional points from the dispensing fee revisions that took effect from June 2024. It also forecasts an improvement in profit margins due to the increase in the unit price of technical fees, which feeds directly into profits. Although the Company raised pay for pharmacists by 4-5%, it expects this to be offset by the 3-point YoY increase in the basic dispensing fee implemented in the latest revisions.

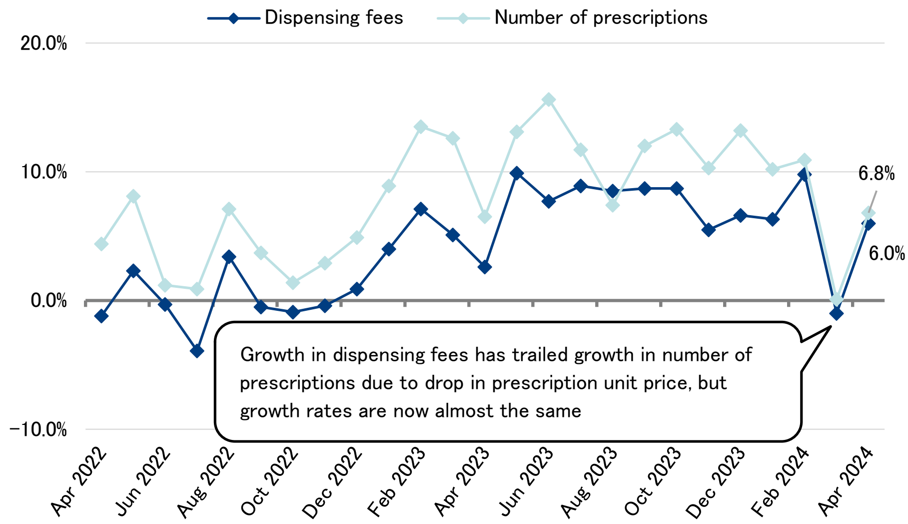
In the latest dispensing fee revisions, the basic dispensing fee was raised in response to higher wages for medical personnel, and an additional 4 points were included for companies that establish systems for implementing medical DX (including My Number Card* usage records and electronic prescription systems). Also, the number of additional points for reinforcing cooperation with medical institutions to respond to emerging infectious diseases and to supply medicines in the event of disasters was increased from 2 points to 5 points. However, the number of additional points for community support systems was reduced by 7 points, and requirements designed to further strengthen dispensing pharmacy functions as primary pharmacies for local communities, including home dispensing, are now more detailed, with new items added. The Company expects the impact of the reduction in additional points for community support systems to be limited, as a high percentage of its stores received 0 points for this category (45.7% in FY3/24), and it says any impact is likely to be offset by efforts to further reduce the percentage of zero-point stores and by increases in additional points in other categories. It plans to reduce the percentage of zero-point stores to 25% by March 2025 by redeploying staff.

* My Number Card: An Individual Number Card

Regarding medical DX initiatives, 310 stores supported electronic prescriptions as of the end of April 2024 and it plans to roll out electronic prescription systems to all stores by March 2025. The Company also has one of the highest usage rates nationwide for My Number Cards as a substitute for health insurance cards. Additionally, the Company is working to improve pharmacist productivity by automating the prescription entry process with the introduction of AI-OCR, and it is aiming to lift customer service levels by introducing automatic checkouts to reduce payment wait times. The Company also offers a range of services via its official LINE account, such as delivery of pre-booked prescriptions and online medicine administration guidance. As of the end of April 2024, the LINE account had more than 280,000 registered members. Repeat usage rates are high for these services and the Company plans to continue focusing on measures in this space to retain customers.

The Pharmacy Business made a solid start to FY3/25, with April 2024 dispensing fees up 6.0% YoY and the number of prescriptions up 6.8%. The unit price of prescriptions also appears to have nearly bottomed, with almost no impact from the drug price revisions in April. The next point to watch is how dispensing fee revisions, that took effect in June, will impact the unit price of prescriptions.

Dispensing fees and number of prescriptions (YoY, all stores)



Source: Prepared by FISCO from the Company's press releases

(2) BPO Contracting Businesses (former Medical Related Business)

From FY3/25, disclosures for the BPO Contracting Businesses exclude the Pharmaceutical Manufacturing Business. In the CSO Business, the Company aims to increase sales and profits by stepping up recruitment and training of CMRs, especially in the oncology field where demand is strong. The goal is to increase the number of CMRs to 750 (1.2x) by the end of FY3/25. In the Medical Professional Referral Dispatch Business, the Company forecasts continued double-digit growth in sales and profits in FY3/25, with personnel inquiries apparently still at a high level, especially for drugstore staff.

(3) Pharmaceutical Manufacturing Business

In the Pharmaceutical Manufacturing Business, the Company assumes another year of flat sales YoY at Fujinaga Pharm in FY3/25, but it sees profits declining on higher raw material costs amid continued yen weakness. However, the impact on consolidated earnings is likely to be negligible, as sales in the business are only around ¥1.0-1.9bn.

For DAIICHI SANKYO ESPHA, it forecasts net sales of ¥82.5bn (up 14% YoY) and operating income of ¥7.0bn (up 9%). In FY3/24, sales declined 8% YoY to ¥72.3bn and operating income fell 50% to ¥6.4bn, well below the Company's expectations. Sales were hit by the delayed launch of two new products until FY3/25, while profits were mainly affected by an increase in the cost of sales ratio and higher-than-expected SG&A expenses due to costs associated with becoming a subsidiary (costs for system integration and new offices, etc.)

In FY3/25, drug price reductions are set to impact earnings, but the company plans to launch new products, as well as the two delayed products from FY3/24. It expects these new products to support double-digit sales growth. In addition, in terms of measures to improve the cost of sales ratio, the company is revising its pricing policy for each product, negotiating with domestic CMOs and reviewing its wholesale policy and distribution expenses. It is also working to improve profitability by reviewing all SG&A expenses from scratch. Although profit margins will decline in FY3/25 due to the drug price revisions, it expects profitability to improve from FY3/26 on the back of these measures.

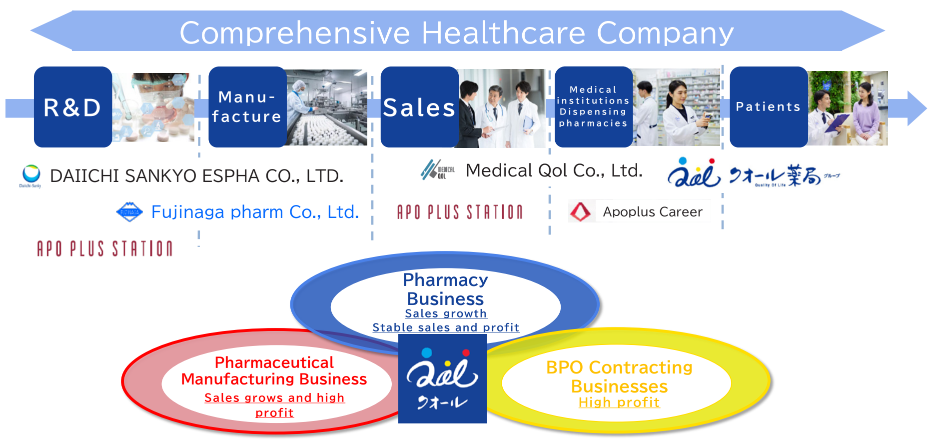
Medium-term performance targets and growth strategy

Targeting net sales of ¥307.2bn and operating income of ¥24.0bn in FY3/27 as a Comprehensive Healthcare Company by expanding all three businesses

1. Medium-term performance targets

The Company has announced its medium-term performance targets for the three years through FY3/27. It aims to achieve sustainable growth while strengthening its management base as a Comprehensive Healthcare Company covering pharmaceutical R&D (APO PLUS STATION), manufacturing and sales (DAIICHI SANKYO ESPHA, Fujinaga Pharm), medical professional services (APO PLUS STATION, Oncall), and dispensing pharmacies (Qol).

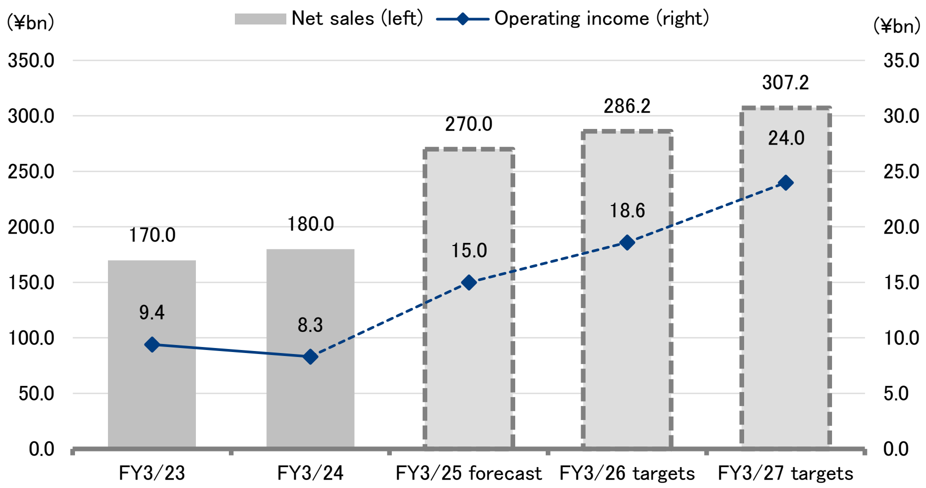
Overview of Group growth strategy



Source: Source: The Company's results briefing materials

The Company targets net sales of ¥307.2bn and operating income of ¥24.0bn in FY3/27. That equates to annualized growth of 6.7% for net sales and growth of 26.5% for operating income compared with FY3/25 forecasts. The goal is to expand earnings and lift profitability in each business by enhancing Group synergies. Under its previous three-year targets, the Company was aiming for net sales of ¥300.0bn and operating income of ¥25.0bn in FY3/26, so it has effectively pushed back its targets by one year, mainly due to revised forecasts for DAIICHI SANKYO ESPHA based on its performance in FY3/24. The pace of growth in the Pharmacy Business and the BPO Contracting Businesses are largely in line the previous medium-term performance targets.

Medium-term performance targets



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

Looking at FY3/27 performance targets by business segment, the Company forecasts FY3/27 net sales of ¥187.1bn and operating income of ¥11.6bn in the Pharmacy Business. It is aiming for annualized net sales growth of 4% or higher and an improvement in profitability in the order of ¥4.0bn by lifting quality. In the BPO Contracting Businesses, the Company its targeting annualized net sales and profit growth of 10% through organic growth. It has also factored in a boost from M&A of ¥1.6bn for net sales and ¥160mn of operating income. Overall targets for FY3/27 are net sales of ¥20.5bn and operating income of ¥2.6bn. In the Pharmaceutical Manufacturing Business, the Company is aiming for net sales of ¥103.1bn and operating income of ¥12.6bn driven by growth at DAIICHI SANKYO ESPHA. An increase in the share of earnings from the highly profitable DAIICHI SANKYO ESPHA business is seen lifting the operating margin from 5.6% in FY3/25 (forecast) to 7.8% in FY3/27.

In the two years starting from FY3/25, consolidated operating income is forecast to increase ¥9.0bn, with 60% of this growth coming from the Pharmaceutical Manufacturing Business. DAIICHI SANKYO ESPHA therefore holds the key to achieving the new targets, with the company's performance trends likely to be watched closely. The ongoing shortage of generic drugs in Japan over the last few years has raised prospects of realignment in the sector. However, as Japan's third-largest generic drug supplier by sales, DAIICHI SANKYO ESPHA is unlikely to be negatively impacted.

Medium-term performance targets

(¥bn)

		FY3/25 forecast	FY3/26 targets	FY3/27 targets	Targets
Pharmacy Business	Net sales	173.0	179.9	187.1	CAGR of 4% or higher Productivity of 7% or higher (¥4.0bn scale)
	Operating income	8.5	10.1	11.6	
	% of net sales	4.9%	5.6%	6.2%	
BPO Contracting Businesses	Net sales	15.7	17.6	20.5	Organic annualized growth of 10% Sales 1.5x vs FY3/24, including boost from M&A
	Operating income	2.0	2.2	2.6	
	% of net sales	12.7%	12.5%	12.7%	
Pharmaceutical Manufacturing Business	Net sales	84.8	92.2	103.1	(DAIICHI SANKYO ESPHA)
	Operating income	6.9	8.9	12.6	Return operating income to FY3/23 level (¥12.0bn)
	% of net sales	8.1%	9.7%	12.2%	Lift operating margin from 9% in FY3/24 to 12%
Total	Net sales	270.0	286.2	307.2	
	Operating income	15.0	18.6	24.0	
	% of net sales	5.6%	6.5%	7.8%	

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

Targeting steady growth in the Pharmacy Business by expanding store openings and adding value, including DX-driven services

2. Growth strategy by business

(1) Pharmacy Business

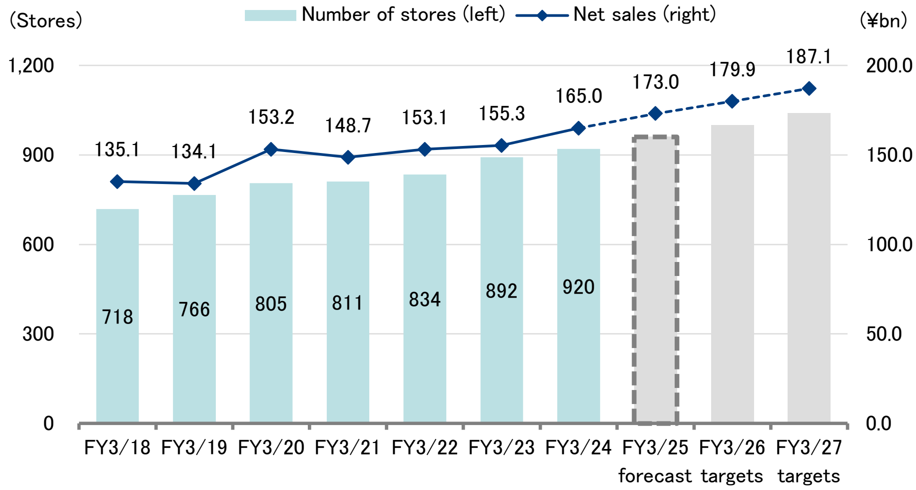
In the Pharmacy Business, the Company's growth strategy is unchanged, aiming for steady growth through the basic strategy of expanding scale through strategic store openings and creating value of pharmacies.

a) Expanding scale through aggressive M&A and store openings

The Company plans to continue opening 10 to 20 stores organically per year and securing 30 to 40 stores per year through M&A. The Company will target openings for areas with large populations, such as the three major metropolitan areas, efficiently expanding the number of stores through dominant openings and developing stores that can be expected to deliver high earnings. Similarly for M&A, its policy is to move ahead in main urban areas where it is easy to collaborate with communities.

In other strategic store openings, the Company intends 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 10 such stores, and 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 business operators of 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. As a strategy for acquiring contracting facilities, since 2022 the Company has held medical and nursing care collaboration meeting with companies operating nursing care facilities and companies providing at-home medical care, and the Company's strategy is therefore to promote this initiative even further to expand the number of contracts.

* 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 or ¥500 home visit drug dispensing premium (depending on other criteria such as the supply of narcotic drugs for medicinal use, sterile dispensing, or pediatric home dispensing, etc.)

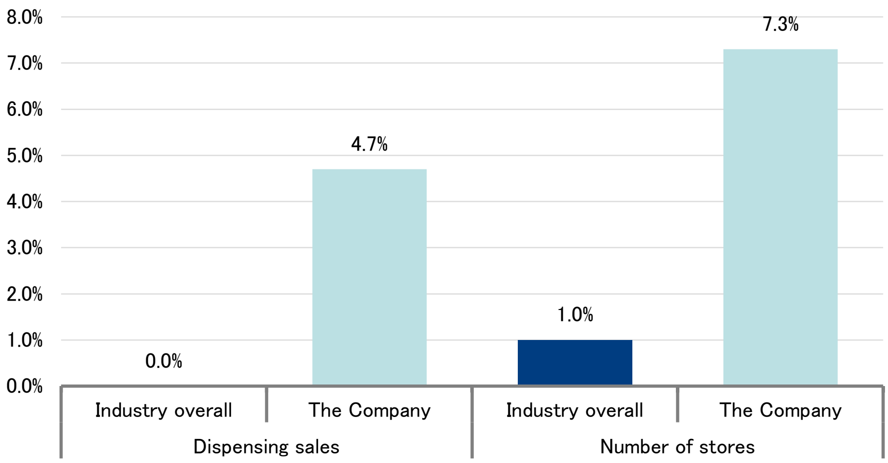


Source: Prepared by FISCO from the Company's results briefing materials

The number of dispensing pharmacies has been gradually increasing to around 62,000 at the end of FY2022 due to expansion of drugstore openings over the past few years. Meanwhile, although dispensing pharmacy fees, which correspond to sales, for FY2022 increased by 1.7% YoY to ¥7.8tn, increasing for a second consecutive year, they remain level with FY2015 due to the impact of decreased drug prices. We at FISCO recognize that this constitutes an adverse competitive environment for dispensing pharmacies. In this situation, following the lifting of the ban on online drug administration guidance in 2020, 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. In addition, building such systems will require capital capabilities, and this is one factor supporting the view that the industry will tend to become an oligopoly dominated by major corporations.

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 FY3/23 shows dispensing pharmacy sales grew 4.7% and the number of stores by 7.3%, which significantly exceeds the growth rate of the industry as a whole (dispensing pharmacy sales 0.0%, number of pharmacies 1.0%). Currently, the total sales of the 10 leading companies in the dispensing pharmacy market are around ¥1.3tn, which converts to a market share of only approximately 16%. Considering that the top 10 companies in the drugstore industry currently have a share of around 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 believes it is possible for the Company to achieve sustainable growth through the expansion of store numbers, even if the market scale continues to be effectively topped out going forward. 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–FY3/23 CAGR



Source: Prepared by FISCO from the Company's supplemental results materials and the Ministry of Health, Labour and Welfare's materials

b) Improvements in both earnings and costs

As a strategy for increasing profitability, the Company will continue to increase the number of prescriptions and its technical fees at existing pharmacies, undertake a rigorous review of productivity, and work to review costs from scratch. In its efforts to increase the number of prescriptions, the Company is strengthening its initiatives for health-support pharmacies that 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. Since launching an advanced reservation prescription service in April 2022 via its official LINE account, the Company has been steadily rolling out a range of other new services to retain customers. These include same-day delivery functions, online medicine administration guidance, an automatic data link function with prescription records, and a mobile order system that allows customers to complete everything from prescription acceptance to payment using their smartphones.

As measures to increase technical fee unit prices, the Company is working to strengthen the Home and Facility Delivery Dispensing Business. Although home dispensing still accounts for only a few percent of the total dispensing market, demand for home dispensing is expected to expand further after 2025, when the baby boomer generation reaches the age of 75. This was also one of the key themes in the 2024 dispensing fee revisions. While these initiatives are being promoted for facilities, the Company also plans to develop links with hospitals and community care managers to develop the market for individual homes.

Moreover, in measures to increase productivity, the Company will continue optimal placement of pharmacists as well as streamlining operations inside pharmacies through the utilization of IT (including the introduction of AI-OCR and automated checkout machines). Through these initiatives, the Company expects to achieve profitability improvement effects in the order of ¥4.0bn by FY3/27. To build new sources of earnings outside dispensing fees, the Company also plans to focus on developing new businesses in the areas of health and preventive medicine through collaboration with a major food manufacturer, and an in-store digital signage business.

(2) BPO Contracting Businesses (former Medical Related Business)

In the BPO Contracting Businesses, the Company is targeting annualized growth of 10%, driven by organic growth in each subsidiary and supported by M&A in peripheral business areas with potential synergies. APO PLUS STATION will focus on developing human resources in the CSO Business for specialist fields such as oncology, where demand is strong, aiming to build a workforce of 1,000 CMRs. APO PLUS STATION also plans to grow its CRO Business by focusing on contract testing for major food manufacturers.

APO PLUS CAREER aims to expand its business partners by expanding its coverage of medical roles beyond pharmacists to include medical clerical roles, industrial physicians, physicians, and nurses, and has aims to grow sales by responding to diverse needs among customer corporations, including through collaboration with its subsidiary, Oncall.

(3) Pharmaceutical Manufacturing Business

DAIICHI SANKYO ESPHA is a fabless manufacturer focused on planning and sales and was established by Daiichi Sankyo in 2010 to enter the generic drugs market. It is Japan's third-largest supplier of generic drugs by sales and held the top share for AG products in FY3/23 with roughly 26% of the market. AG products make up around 75% of net sales. It has entered into licensing agreements for the development and sale of AG products with not only Daiichi Sankyo, but also multiple other pharmaceutical companies, and it currently sells 18 items.

The three-year goal is to return operating income to the level achieved in FY3/23. The company is targeting annualized sales growth of over 10% by launching three to four AG products per year. It also aims to raise the operating margin from 8.9% in FY3/24 to 12%, although that will fall short of the 16.3% margin achieved in FY3/23.

Expected Group synergies are likely to include expanded sales functions. DAIICHI SANKYO ESPHA currently has around 200 MR sales personnel, with the potential to use an additional 60 sales staff at Fujinaga Pharm and CMR personnel at APO PLUS STATION to boost sales functions. Moreover, as synergies in the development field, the Company has the potential to strengthen its development capabilities through coordination with Fujinaga Pharm, as well as reflect feedback received from patients, pharmacists and doctors via its dispensing pharmacies in product development. This latter point in particular is seen by FISCO as a significant benefit for development, as it increases the potential for developing generic products with better adherence* than brand-name drugs.

* Adherence: This refers to the sufficient understanding of patients regarding the treatment method for a disorder, adequate acceptance of the administration method and types of drug before implementing and continuing treatment.

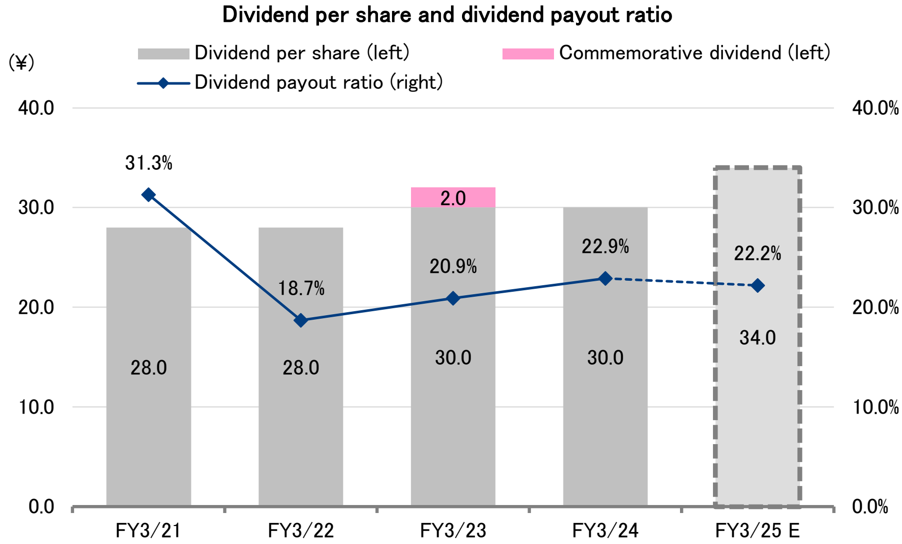
Returns to shareholders and SDGs initiatives

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

1. Shareholder return policy

The Company's 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 FY3/24, the Company maintained the dividend level from the previous fiscal year, with an ordinary dividend of ¥30.0 per share (dividend payout ratio of 22.9%). For FY3/25, it plans to raise the dividend by ¥4.0 YoY to ¥34.0 (22.2%).

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 per unit which combines the dividend and shareholder benefits based on the closing share price on May 30 (¥1,448), it is 4.4% if the shares were held for less than 1 year and 5.8% if held for 1 year or longer.



* FY3/23 includes a 30th founding anniversary commemorative dividend of ¥2.0.
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, the Company prepared a publication called Value Report 2023 (published in January 2024). This report summarizes the Company's position on sustainability and the current state of sustainability activities and targets, among other matters. Value Report 2023 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.

2030/2050 targets

Indicator	Target year	Target value	Measures announced in FY3/23
Group's overall CO_2 emissions	2050	100% reduction	Introduce LED lighting in stores, EVs and solar power
Shopping bag usage rate	2030	8% or less	Reduce use of plastic shopping bags
	2050	5% or less	
Disposal rate	2030	1.7%	Reduce product disposal rate
Ratio of female managers	2030	50% (Department manager or above + pharmacy manager + head supervisor)	Establish system that enables women to retain roles after life events, reduce long working hours, increase productivity
Paid leave usage rate	2025	70%	Ensure 100% of employees use five days of paid leave, systemize store shifts, reduce long working hours, increase productivity
	2030	90%	

Source: Prepared by FISCO from Company's Value Report 2023

As one of its sustainability initiatives, the Company worked to meet the needs of local residents affected by the Noto Peninsula earthquake in January 2024. The Company rapidly opened a temporary store in an evacuation shelter to replace the Qol Notocho Pharmacy, which was damaged in the earthquake, and it responded to individual customers by delivering prescriptions and providing medication guidance at evacuation shelters after regular dispensing operations were suspended at some stores due to water outages.

Income statement and main indicators

(¥mn)

	FY3/20	FY3/21	FY3/22	FY3/23	FY3/24	FY3/25 E
Net sales	165,411	161,832	166,199	170,036	180,052	270,000
YoY	14.2%	-2.2%	2.7%	2.3%	5.9%	50.0%
Gross profit	21,094	21,102	23,163	23,504	23,249	
Gross margin	12.8%	13.0%	13.9%	13.8%	12.9%	
SG&A expenses	13,361	13,737	13,308	14,009	14,925	
SG&A expense ratio	8.1%	8.5%	8.0%	8.2%	8.3%	
Operating income	7,733	7,364	9,855	9,495	8,324	15,000
YoY	9.7%	-4.8%	33.8%	-3.7%	-12.3%	80.2%
Operating margin	4.7%	4.6%	5.9%	5.6%	4.6%	5.6%
Ordinary income	8,024	7,403	10,094	10,098	9,256	15,200
YoY	11.3%	-7.7%	36.4%	0.0%	-8.3%	64.2%
Profit attributable to owners of parent	4,067	3,365	5,489	5,656	4,880	5,700
YoY	4.1%	-17.3%	63.1%	3.0%	-13.7%	16.8%
Earnings per share (¥)	107.23	89.55	149.51	152.96	131.11	153.13
Book value per share (¥)	1,074.57	1,124.31	1,189.70	1,314.69	1,414.43	
Dividend per share (¥)	28.00	28.00	28.00	32.00	30.00	34.00

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

Simplified balance sheet

(¥mn)

	End of FY3/21	End of FY3/22	End of FY3/23	End of FY3/24	Change
Current assets	45,499	42,296	44,214	52,690	8,476
Cash and deposits	19,648	16,685	18,770	27,282	8,512
Notes and accounts receivable-trade, and contract assets	18,231	17,382	16,951	16,909	-41
Inventories	4,854	5,582	5,286	5,171	-114
Noncurrent assets	55,062	53,682	57,689	65,089	7,399
Property, plant and equipment	12,730	12,846	16,108	16,281	173
Intangible assets	34,938	33,238	33,790	33,136	-654
Investments and other assets	7,393	7,598	7,791	15,670	7,879
Total assets	100,571	95,984	101,905	117,779	15,874
Current liabilities	38,709	35,460	36,330	38,823	2,493
Noncurrent liabilities	20,026	16,642	16,719	26,118	9,399
Total liabilities	58,736	52,103	53,049	64,941	11,892
Interest-bearing debt	29,729	23,290	22,983	31,882	8,899
Total net assets	41,834	43,881	48,856	52,837	3,981

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

Cash flow and management indicators

(¥mn)

	FY3/21	FY3/22	FY3/23	FY3/24
Cash flows from operating activities	12,912	10,112	11,662	13,533
Cash flows from investing activities	-3,065	-3,087	-7,013	-13,155
Free cash flow	9,846	7,025	4,648	377
Cash flows from financing activities	-6,114	-10,006	-2,569	7,969
Cash and cash equivalents at the end of the period	19,498	16,516	18,596	26,944
Equity ratio	40.9%	45.7%	47.9%	44.8%
Interest-bearing debt ratio	71.1%	53.1%	47.0%	60.3%
ROIC	7.1%	10.2%	9.2%	6.8%
ROE	8.2%	12.9%	12.2%	9.6%
ROA	7.3%	10.3%	10.2%	8.4%

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

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