COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Corp.

9729

Tokyo Stock Exchange Prime Market

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This report is a translation of the Japanese-language version report issued on July 24, 2024.

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Contents

Summary

Record-high net sales in FY3/24, with operating profit turning into an increase. Aims for further expansion of business foundation by implementing aggressive growth investments

TOKAI Corp. <9729> (hereafter "TOKAI" or "the Company") has the three main segments of Healthcare Services, Pharmacy Services, and Environmental Services. TOKAI aims to progress continuously as a comprehensive health-care company catering to a super-aging society, utilizing its strengths in both the medical care and nursing care business fields.

1. Overview of FY3/24 results

In the FY3/24 consolidated results, net sales increased 6.2% year on year (YoY) to ¥138,222mn and operating profit was up 2.9% to ¥8,082mn, exceeding the Company's forecast (net sales of ¥135,609mn, operating profit of ¥7,437mn). Net sales increased in all business segments, posting a record high overall. Operating profit rose for the first time in two fiscal years. Profit of the Healthcare Services segment declined due to increases in startup costs and depreciation of the Saitama Plant, which began operation in October 2023. However, profit of the Pharmacy Services segment turned up as a result of a rise in the number of prescriptions and the unit price for technical fees, while profit increased in the Environmental Services segment, due in part to the integration effect of merging with two group companies in the Leasekin Business.

2. Outlook for FY3/25

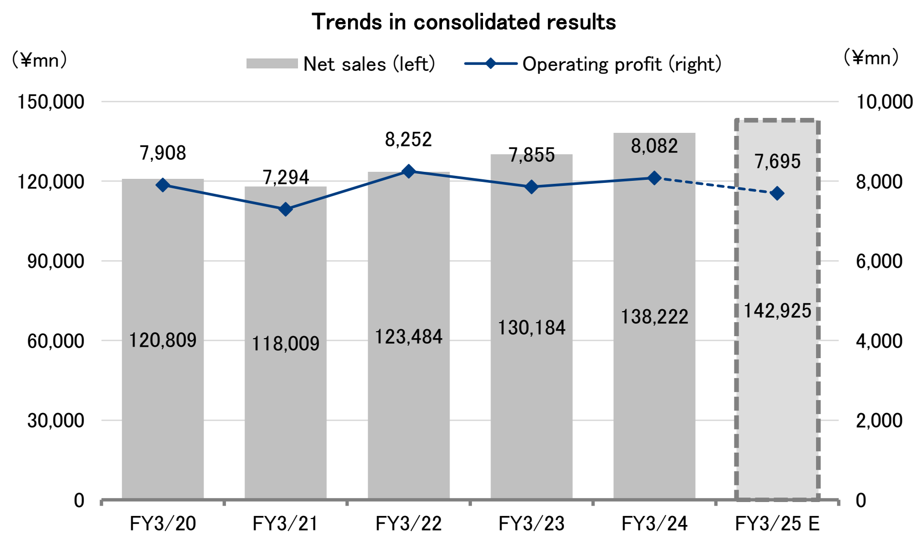
The Company's full-year FY3/25 consolidated results forecast calls for a 3.4% YoY increase in net sales to ¥142,925mn and 4.8% decline in operating profit to ¥7,695mn. A net sales increase is forecast in all segments, but higher depreciation is expected to weigh on operating profit. The Company announced in June 2024 that it had concluded a share transfer agreement relating to the acquisition of the rehabilitation day service, drugstore, and other businesses of Mikjapan.co.,Ltd., but has not factored any impact of this into its earnings plan. The addition of Mikjapan's rehabilitation day service business with 33 facilities nationwide makes it possible to provide a combination of services to elderly people living at home and will further expand the Company's Elderly Care Equipment Business (rental and sales of elderly care equipment), which is a core business. Synergy effects are also expected from the acquisition of Mikjapan's drugstore business, which will likely boost the product sales functions of Tanpopo Pharmacy stores in the Pharmacy Services segment.

3. Management initiatives with awareness of cost of capital and share price

The Company aims to increase ROE to the 8% level by focusing on improving profitability and achieve a PBR above 1.0 as soon as possible by strengthening IR activities to resolve the information gap and announcing a medium- to long-term growth strategy. It plans to announce an overview and numerical management targets of its next medium-term management plan in November 2024. The Company's shareholder returns policy is based on a dividend payout ratio of 35%, and the dividend for FY3/25 is forecast to be unchanged from FY3/24 at ¥58.0 per share. A dividend increase is expected if the dividend payout ratio were to drop below 35% as a result of earnings growth. The Company repurchased 140mn shares for ¥2.9bn in May 2024, which brings the total return ratio in FY3/25 to slightly under 90%.

Key Points

- Record-high net sales in FY3/24, with sales increasing in all three main business segments, operating profit turning into an increase
- FY3/25 earnings plan calls for slight profit decline without factoring in M&A effect, but upward trend in net sales to continue
- For medium-term management plan, likely to undershoot profit target, but exceed net sales target
- Working to improve PBR by improving profitability and capital efficiency and expanding information dissemination



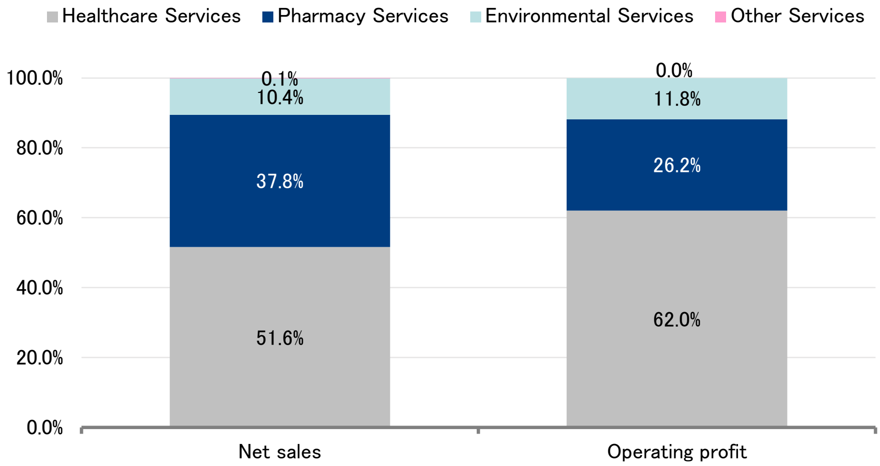
Source: Prepared by FISCO from the Company's financial results

Business overview

TOKAI's earnings pillar is the healthcare business that combines Healthcare Services and Pharmacy Services

The Company, whose headquarters is in Gifu Prefecture, conducts businesses on the axis of three business segments: Healthcare Services, Pharmacy Services, and Environmental Services. By segment, Healthcare Services provides the majority of net sales and operating profit, followed by Pharmacy Services and Environmental Services.

Percentage of results by business segment (FY3/24)



Note: Operating profit figure is the percentage of segment profit total
Source: Prepared by FISCO from the Company's financial results

1. Healthcare Services

Healthcare Services include Hospital Business (medical-related consignment services such as linen supply, nursing assistance, and distribution management for medical institutions and nursing care facilities), Bedding and Linen Supply Business (bedding and linen supply services for lodging facilities such as hotels), Elderly Care Equipment Business (rental and sales of elderly care equipment), Food Supply Business (for medical institutions and nursing care facilities), Cleaning Equipment Manufacturing Business, and Aqua Clara Business (sub-franchising Aqua Clara), which delivers water to homes.

In this segment, Hospital Business and Bedding and Linen Supply Business provide 50% to 60% of net sales. Linen supply services to hospitals, nursing facilities, and lodging facilities are provided in the Tohoku, Kanto, Chubu, Kansai, Chugoku, and Shikoku areas of Japan. The Company is the second largest provider of these services to hospitals and nursing care facilities in Japan, after industry-leader Watakyu Seimoa Corporation. A key strength of the Company's Hospital Business is the ability to provide a one-stop source of medical-related services, including linen supplies, nursing assistance, and distribution management within hospitals.

The Elderly Care Equipment Business, which contributes more than 30% of this segment's net sales, involves the rental and sales of elderly care equipment, such as electric beds and wheelchairs, based on the Long-Term Care Insurance System. At the end of March 2024, Elderly Care Equipment Business were provided from Tohoku to Kyushu, covering metropolitan areas where the population of the elderly is expected to grow, with a sales network included 88 branches or offices (including 14 non-consolidated subsidiaries' bases), and 7 maintenance centers. TOKAI's market share in this business varies by region. In Shikoku, it is relatively high at around 30%. In the three metropolitan areas of Greater Tokyo, Greater Osaka and Greater Nagoya, it is about 5-10%, leaving room to expand its presence. Although competitors include FRANCE BED HOLDINGS CO., LTD. <7840> and a subsidiary of Panasonic Holdings Corporation <6752> (Panasonic AGE-FREE Co., Ltd.), the Company is seen as being the top in direct rental sales. The Company works closely with care managers in each region to provide highly tailored services, apart from other actions such as aiming to utilize its relationships with medical institutions and building a route to receive patients discharged from them, thereby increasing user numbers. Through this sales strategy, it continues to grow at a rate higher than the market as a whole. Moreover, by working to increase its share in regions utilizing M&A and other measures, it is aiming to establish a position as having the No. 1 market share in each region.

2. Pharmacy Services

In the Pharmacy Services segment, consolidated subsidiary Tanpopo Pharmacy Co, Ltd., operates dispensing pharmacies in Tokai, Hokuriku, Kansai, and Shikoku areas. It was operating 154 pharmacies at the end of March 2024. Expanding the number of stores through organic growth in principle and specializing in opening stores in front of large hospitals, it has promoted a strategy of raising management efficiency and maintaining high earnings. In recent years, in the Japanese government's Vision for Patient-centered Pharmacies, dispensing pharmacies are being required more than ever before to function as local communities' family pharmacies. So, the Company's policy is to diversify the formats of the pharmacies that it opens and to improve their functions as local communities' family pharmacies, and also to contribute to medical care in local communities by training highly specialized pharmacists.

3. Environmental Services

The Environmental Services segment mainly consists of the Leasekin Business and Cleaning Business. In the Leasekin Business, which accounts for more than 60% of net sales, the Company handles the Leasekin service, franchising the sale and rental of mops, mats, and other environment beautification products mainly to offices, stores, and homes under the Leasekin brand. The Leasekin service has about 900 franchisees nationwide, including regional head offices and agencies. In this service, TOKAI ranks second in Japan, after DUSKIN CO., LTD. <4665>. Over the past few years, it has focused on products peripheral to toilets in order to differentiate itself. In the cleaning business, which accounts for more than 30% of net sales, the Company provides cleaning and management services on a consignment basis to buildings, and in recent years, it has focused on provision of advanced cleaning services to medical institutions with the intent to prevent infections. Cleaning at medical institutions and nursing care facilities already generates about 70% of sales. This segment also engages in the electricity sales business through solar power generation.

4. Other Services

Other Services include the provision of management information by the consolidated subsidiary Japan Intelligence Mart.

Results Trends

Record-high net sales in FY3/24, with sales increasing in all three main business segments, operating profit turning into an increase

1. Overview of FY3/24 results

In the FY3/24 consolidated results, net sales increased 6.2% YoY to ¥138,222mn, operating profit was up 2.9% to ¥8,082mn, ordinary profit rose 5.3% to ¥8,505mn, and profit attributable to owners of parent fell 4.8% to ¥5,810mn. All these results exceeded the Company's forecast. Net sales increased in all business segments, posting a record high overall. Operating profit and ordinary profit rose for the first time in two fiscal years, because improved productivity and price revisions of services provided absorbed increases in materials costs and one-off expenses associated with the startup of the Saitama Plant. However, profit attributable to owners of parent declined due to the dropout of a ¥1,079mn extraordinary gain from the sale of real estate recorded in FY3/23. Although non-operating profit/loss improved by ¥197mn, this was mainly due to the dropout of a ¥170mn bad debt expenses and ¥110mn transfer to provision of allowance for doubtful accounts, which were recorded as non-operating expenses in FY3/23.

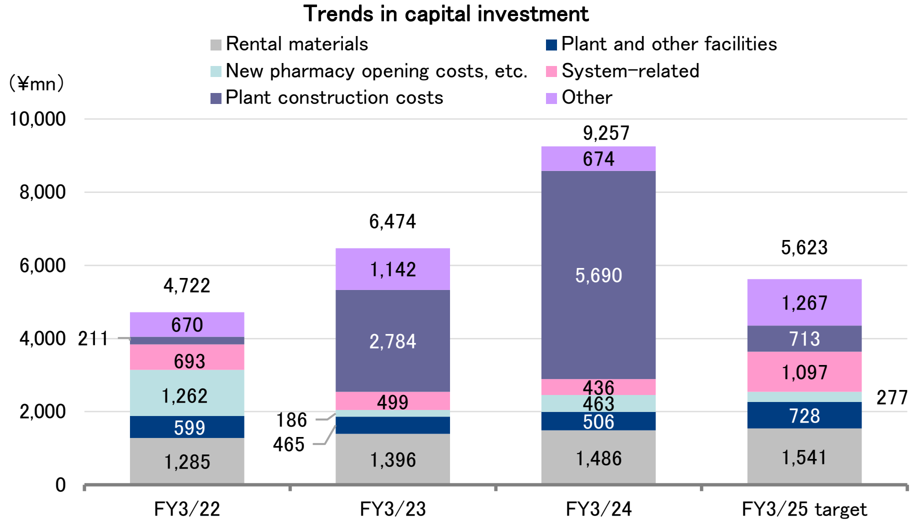
FY3/24 consolidated results

(¥mn)

	FY3/23		FY3/24				
	Results	Vs. sales	Forecasts	Results	Vs. sales	YoY	Vs. plan
Net sales	130,184	-	135,609	138,222	-	6.2%	1.9%
Cost of sales	98,266	75.5%	-	104,585	75.7%	6.4%	-
SG&A expenses	24,063	18.5%	-	25,554	18.5%	6.2%	-
Operating profit	7,855	6.0%	7,437	8,082	5.8%	2.9%	8.7%
Ordinary profit	8,080	6.2%	7,804	8,505	6.2%	5.3%	9.0%
Extraordinary loss	859	-	-	-75	-	-	-
Profit attributable to owners of parent	6,106	4.7%	5,121	5,810	4.2%	-4.8%	13.5%

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

Capital investment increased by ¥2,782mn YoY to a record-high ¥9,257mn in FY3/24. Increases were mainly in the cost of building plants to ¥5,690mn (up ¥2,888mn), cost of opening dispensing pharmacies to ¥463mn (up ¥277mn), and purchase costs of rental materials to ¥1,486mn (up ¥90mn). System-related investment totaled ¥436mn (down ¥63mn), decreasing slightly due to delays in the development schedule of the core system. The increased costs of building plants were for the Saitama Plant, which began operation in October 2023, as well as the approximately ¥900mn construction cost of the Kyushu Maintenance Center in Saga Prefecture scheduled to start operation in summer 2024 (total investment: ¥1.4bn) and ¥1.1bn rebuilding cost of the Leasekin plant of subsidiary DOJINSHA Co., Ltd. Depreciation increased by ¥406mn to ¥4,596mn due to increased capital investment. Capital investment is expected to decrease in FY3/25 to ¥5,623mn as major investments run their course, but depreciation is forecast to reach peak level in recent years at ¥5,182mn.



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

The Saitama Plant has hospital linen laundry facilities and elderly care equipment maintenance center functions. It is the core plant for the Kanto area. The Elderly Care Equipment Business targets an 80% increase in rental sales in the Kanto area in 10 years. The new maintenance center provides the capacity for the expansion in scale of the business. The new maintenance center is equipped with automated conveyors and AUTOLATER vertical transfer systems to improve business efficiency by reducing the need for manpower. The hospital linen laundry facility also saves labor by installing the latest equipment supplied by subsidiary Purex, requiring a work force 20% smaller than the previous facility (Yokohama Plant). With the addition of solar power generation, waste heat and wastewater recycling equipment, and energy-efficient air conditioners that use well water as a refrigerant that reduce energy costs,* the facilities of the Saitama Plant are expected to improve productivity by around 40%. This equates to a 17% reduction in CO_2 emissions, making the Saitama Plant a likely driver of the Company's medium-term earnings expansion as a cutting-edge environment-friendly plant. The previous plant is continuing to operate as the NEXSURG laundry facility.

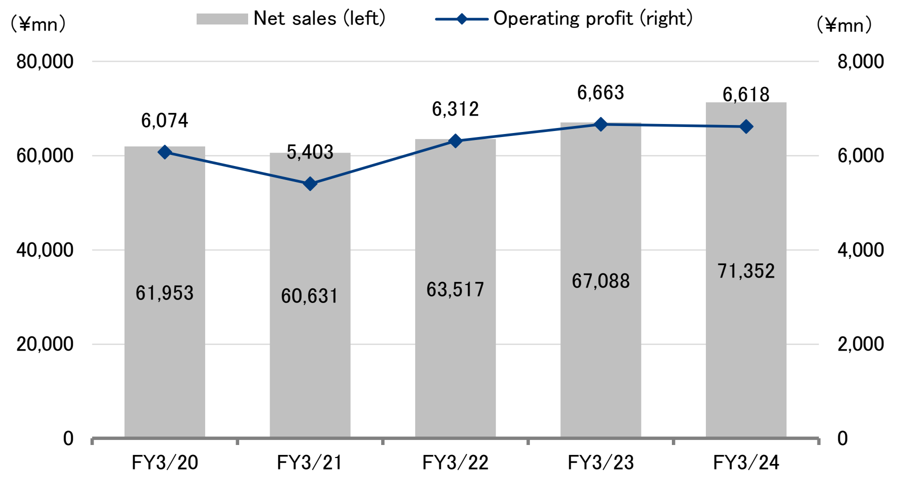
* Improvements of 10% per unit of fuel consumption rate, 5% in electricity consumption rate, and 20% in water consumption rate are expected as a result of actions such as installing highly efficient boilers and solar panels, large washing machines that save water, installing various waste heat and wastewater recycling facilities and an energy-efficient air conditioning system that uses well water as a refrigerant.

Recovery in Linen Supply Business for hotels and Cleaning Equipment Manufacturing Business; Pharmacy Services also post net sales and profit growth

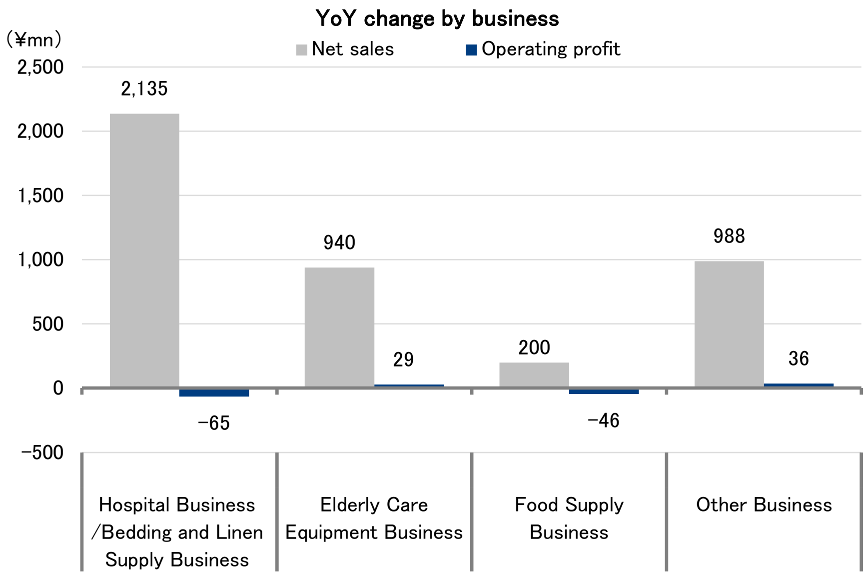
2. Results trends by business segment

(1) Healthcare Services

In Healthcare Services, net sales increased 6.4% YoY to ¥71,352mn and operating profit fell 0.7% to ¥6,618mn. Net sales showed a steady increase in the core Hospital Business, Bedding and Linen Supply Business and Elderly Care Equipment Business, as well as recovering sharply in the Cleaning Equipment Manufacturing Business to post a record high for the second year in a row. However, profit declined due to an increase in one-time expenses (real estate acquisition taxes, etc.) and depreciation associated with the operation of the Saitama Plant (including the Maintenance Center), with costs increasing ¥461mn in total. Worsening profitability of the Food Supply business was also a negative factor for profit.



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



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

a) Hospital Business, Bedding and Linen Supply Business

In this segment, net sales increased by ¥2,135mn YoY while operating profit was down by ¥65mn. The main contributing factors for sales growth were as follows. Rental revenue from lodging facilities such as hotels grew 15.0% YoY due to the recovery of tourism demand and price hike effect. The Company also won new contracts for its strategic item hospitalization/residency set*1, with sales increasing 11.9%, while sales of NEXSURG*2 also rose a steady 4.8%. In particular, sales of hotel linen supply exceeded the FY3/20 level before the COVID-19 pandemic. The number of linen supply beds in hospitals and nursing care facilities also increased a solid 1.8% YoY, because the Company won new contracts with private nursing care facilities and others. Although net sales growth was a positive factor for profit, negative factors totaled ¥326mn because of the abovementioned one-time expenses and depreciation associated with the operation of the Saitama Plant.

*1 Hospitalization/residency set: A service providing a set of commodities rented at a fixed daily charge when people are hospitalized or enter a nursing care facility, including towels, day wear, sleepwear (pajamas), underwear, toothbrush, and body soap.
*2 NEXSURG: A surgical linen reuse system that TOKAI pioneered and commercialized. The key advantages of this system are that it offers lower medical waste disposal costs and environmental impact than those of regular disposable offerings.

b) Elderly Care Equipment Business

The Elderly Care Equipment Business posted a YoY net sales increase of ¥940mn and operating profit increase of ¥29mn. Although the rate of direct rental sales growth slowed slightly YoY from 7.6% to 5.4% in FY3/24 due to an increase in the number of users who moved to hospitals and nursing care facilities after the COVID-19 pandemic wound down, sales appear to continue to grow faster than the market as a whole and the number of users continues to grow. The segment posted profit growth due to the sale growth effect despite the startup of the Saitama Maintenance Center adding ¥133mn to costs. Regarding M&A, in September 2023, the Company acquired all shares in Carecrest, a welfare equipment rental company based in Mie Prefecture and made it a non-consolidated subsidiary. Carecrest has annual sales of around ¥500mn and five business sites in Mie Prefecture versus TOKAI's one. The acquisition will enable TOKAI to increase its market share in Mie Prefecture. In December 2023, the Company also made WITH COMPANY LIMITED a non-consolidated subsidiary. WITH operates seven business sites in Osaka and Yokohama.

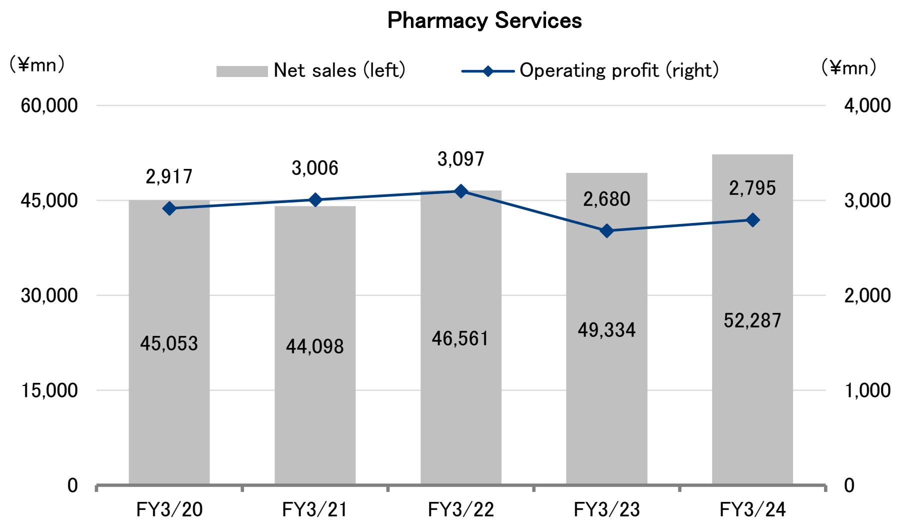
c) Food Supply and Other Business

In Food Supply Services, net sales increased by ¥200mn YoY, but operating profit fell by ¥46mn. Net sales rose for the first time in two fiscal years as a result of winning new consignment contracts and a price increase, but profit fell, because sales growth was not enough to cover increases in food prices and personnel expenses.

In Other Services (mainly cleaning equipment manufacturing), net sales were up by ¥988mn and operating profit rose by ¥36mn. Sales of cleaning equipment at subsidiary Purex Co., Ltd. recovered a sharp 65.5% amid a rebound in linen supply demand due to the rise in occupancy rates of hotels, etc., making a large contribution to net sales growth of the Healthcare Services segment.

(2) Pharmacy Services

Pharmacy Services posted a 6.0% YoY increase in net sales to ¥52,287mn and 4.3% rise in operating profit to ¥2,795mn. Net sales rose three fiscal years in a row to mark a record high due to increases in the number of prescriptions and prescription unit price, which were boosted by the new store effect (including stores opened in FY3/23). Operating profit also turned up for the first time in two fiscal years, with increases in the number of prescriptions and the unit price for technical fees absorbing the cost of opening stores. The Company opened 7 stores and closed 2 stores to bring the total to 154, up by 5 from the end of the previous fiscal year.



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

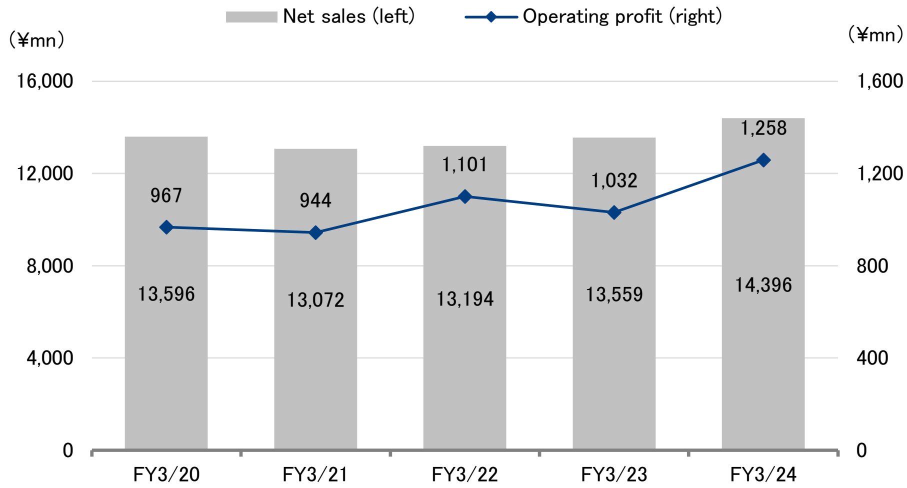
Breaking down factors contributing to net sales growth, sales from drug fees increased by ¥2,472mn and sales from technical fees went up by ¥499mn. The number of prescriptions rose 4.5% YoY and the prescription unit price increased 1.5%. Both the drug fee and technical fee components of the prescription unit price increased YoY. Although the drug fee was negatively impacted by the NHI drug reimbursement price revision, increased demand for anticancer drugs (with high unit prices) compensated. Initiatives for at-home dispensing services, offered by 92% of the Company's pharmacies, and strengthening family pharmacy functions through collaboration with medical institutions and nursing care/welfare facilities made a positive contribution to the technical fee. Specific initiatives to strengthen family pharmacy functions are training specialist pharmacists (increase their number from 58 at end-September 2023 to 132 at end-March 2024) and increase the number of stores with pharmacy certification (stores with community cooperating pharmacy certification from 48 to 55 and stores with health support pharmacy certification from 11 to 14 over the same period).

Factors affecting operating profit were as follows. Positive effects were increased sales from technical fees (¥499mn) and from drug fees (¥12mn), which absorbed the ¥396mn rise in store expenses. Increased sales from drug fees made a limited contribution to profit growth due in part to higher drug purchase costs associated with the supply shortage of generic drugs and other factors.

(3) Environmental Services

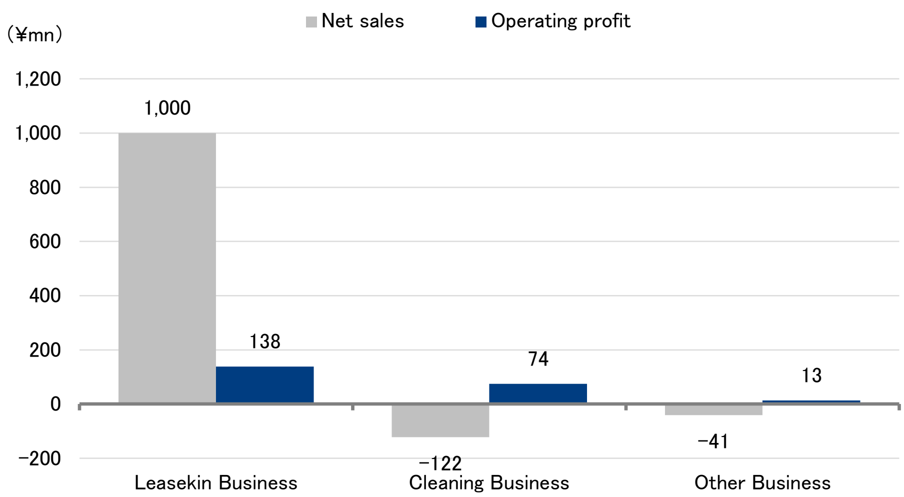
In Environmental Services, net sales increased 6.2% YoY to ¥14,396mn and operating profit increased 21.9% YoY to ¥1,258mn. These were record highs, for the first time in five years for net sales and two years for operating profit.

Environmental Services



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

YoY change by business



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

In the Leasekin Business, net sales were up by ¥1,000mn YoY and operating profit rose ¥138mn. The Company went ahead with an absorption-type merger with one non-consolidated subsidiary* and one consolidated subsidiary in April 2023 to centralize management resources and improve business efficiency, which played a big part in net sales and profit growth. Sales of toilet-related products, which the Company has been focusing on in recent years, grew a brisk 11.3% YoY and contributed to net sales growth. Sales of products that help to keep toilet areas clean such as the sterilevice uric scale adhesion prevention device were strong amid the ongoing labor shortage.

* RENTEX Co., Ltd., which was established in July 2021 after the business was split off by Hakuyosha Company, Ltd. <9731>, had shares acquired and was made TOKAI's non-consolidated subsidiary.

The Cleaning Business recorded a ¥122mn decline in net sales YoY, but a ¥74mn increase in operating profit. The main reason for the net sales decline was the end of contracted work for COVID-19 wards. The dropout of startup expenses for new business sites (booked as a one-off expense a year ago) and higher productivity as a result of improving production processes contributed to profit growth.

Property, plant and equipment increased sharply on construction of new plant; strong financial soundness reflected in equity ratio over 70%

3. Financial condition and management indicators

The Company's financial condition as of the end of FY3/24 was as follows. Total assets increased ¥4,140mn from the end of the previous fiscal year to ¥114,926mn. The main change factors were, in current assets, a ¥1,913mn increase in notes and accounts receivable – trade offset against a ¥5,084mn decrease in cash and deposits for capital expenditure. In non-current assets, there were increases of ¥4,735mn property, plant and equipment and ¥2,417mn in investment securities.

Total liabilities decreased by ¥425mn to ¥28,137mn compared to the end of FY3/23. There were increases of ¥725mn in accounts payable – other and ¥400mn in deferred tax liabilities against decreases of ¥1,357mn in notes and accounts payable – trade and ¥523mn in interest-bearing debt. Total net assets increased ¥4,565mn to ¥86,789mn. The reason for the increase was recording ¥5,810mn in profit attributable to owners of parent and ¥996mn in valuation difference on available-for-sale securities offset against ¥2,254mn in expenses for payment of dividends.

Turning to management indicators, the equity ratio remains at a high level of 75.0%, rising 1.3 percentage points due to increased share capital, although net cash (cash and deposits – interest-bearing debt) decreased by ¥4,561mn due to major capital investment. The interest-bearing debt ratio is also at a low level of 2.7%. These ratios indicate that the Company is very financially sound. Its business model has a stable earnings structure and the Company can be considered to have built a strong financial base, with rental businesses such as linen supply, elder care equipment rental, and Leasekin as the mainstay, which is one of its strengths.

Consolidated balance sheet

(¥mn)

	End-FY3/21	End-FY3/22	End-FY3/23	End-FY3/24	Change
Current assets	58,769	59,748	62,628	59,601	-3,026
(Cash and deposits)	35,148	35,794	36,070	30,985	-5,085
(Inventories)	5,646	4,635	5,424	5,545	121
Non-current assets	43,411	46,151	48,157	55,324	7,167
Total assets	102,180	105,900	110,785	114,926	4,140
Total liabilities	28,302	28,381	28,562	28,137	-425
(Interest-bearing debt)	3,876	3,398	2,876	2,352	-523
Total net assets	73,878	77,519	82,223	86,789	4,565
(Stability)					
Equity ratio	71.8%	72.7%	73.7%	75.0%	1.3pt
Interest-bearing debt ratio	5.3%	4.4%	3.5%	2.7%	-0.8pt
Net cash	31,272	32,396	33,194	28,633	-4,561
(Profitability)					
ROA	8.1%	8.5%	7.5%	7.5%	0.0pt
ROE	7.7%	7.7%	7.7%	6.9%	-0.8pt
Operating profit margin	6.2%	6.7%	6.0%	5.8%	-0.2pt

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

Business Outlook

Forecasts slightly lower profit on continued net sales growth in FY3/25 without factoring M&A effect into earnings plan

1. Outlook for FY3/25

For the FY3/25 consolidated results outlook, the Company forecasts an increase in net sales by 3.4% YoY to ¥142,925mn, a decrease in operating profit by 4.8% to ¥7,695mn, a decrease in ordinary profit by 3.6% to ¥8,195mn, and a decrease in profit attributable to owners of parent by 4.0% to ¥5,578mn. The Company looks for an increase in net sales for the fourth consecutive year, with net sales up in all three segments. Although a profit decline is forecast due to decreases in Pharmacy Services and Environmental Services, operating profit before depreciation and amortization is projected to increase a modest 1.6% YoY, mainly due to a ¥586mn YoY rise in depreciation as a result of major capital investment in FY3/24. The FY3/25 capital investment plan totals ¥5,623mn, breaking down into ¥1,541mn for the purchase of rental materials, ¥1,441mn for plant-related investment, ¥1,097mn for the core system upgrade and Pharmacy Services departments' system investment, and ¥277mn in expenses for opening new dispensing pharmacies.

Consolidated outlook for FY3/25

(¥mn)

	FY3/24		FY3/25		
	Results	Vs. sales	Forecasts	Vs. sales	YoY
Net sales	138,222	-	142,925	-	3.4%
Operating profit	8,082	5.8%	7,695	5.4%	-4.8%
Ordinary profit	8,505	6.2%	8,195	5.7%	-3.6%
Profit attributable to owners of parent	5,810	4.2%	5,578	3.9%	-4.0%
EBITDA*	12,762	9.2%	12,877	9.0%	1.6%
Earnings per share (¥)	165.05		158.51		

* EBITDA=operating profit + depreciation + amortization of goodwill
Amortization of goodwill in FY3/24 estimated by FISCO based on the most recent results
Source: Prepared by FISCO from the Company's financial results

The Company announced in June 2024 that it had concluded a share transfer agreement relating to the acquisition of the rehabilitation day service, drugstore, and other businesses of Mikjapan. Its consolidated subsidiary Tanpopo Pharmacy acquired shares in mikjapan Co., Ltd., a new company established to take over these businesses, but the Company has not factored the impact of the acquisition into its earnings plan. Mikjapan operates drugstores (12 directly managed stores and some franchise stores), dispensing pharmacies (three directly managed stores located in drugstores) and 33 rehabilitation-type daycare service facilities mainly in the Kansai area, as well as an e-commerce business. Taking over Mikjapan's businesses to create synergies with the Company's Elderly Care Equipment Business and dispensing pharmacies is expected to enhance its corporate value as a comprehensive healthcare company. In its core Elderly Care Equipment Business in particular, the addition of a day service specializing in rehabilitation makes it possible to provide a combination of services to improve users' QOL and functional recovery. As a result, synergies are expected from strengthening product sales functions at Tanpopo Pharmacy stores through the drugstore business, enhancing the Group's procurement capabilities of various product items, mutual utilization of management resources and use of e-commerce infrastructure.

Forecasts continued net sales growth in all three segments in FY3/25

2. Outlook by business segment

Results outlook by business segment

(¥mn)

Net sales by business	FY3/21	FY3/22	FY3/23	FY3/24	FY3/25 forecast	YoY
Healthcare Services	60,631	63,517	67,088	71,352	74,230	4.0%
Pharmacy Services	44,098	46,561	49,334	52,287	53,974	3.2%
Environmental Services	13,072	13,194	13,559	14,396	14,534	1.0%
Other Services	206	211	202	185	185	-0.0%
Total	118,009	123,484	130,184	138,222	142,925	3.4%

Operating profit by business	FY3/21	FY3/22	FY3/23	FY3/24	FY3/25 forecast	YoY
Healthcare Services	5,403	6,312	6,663	6,618	6,688	1.1%
Pharmacy Services	3,006	3,097	2,680	2,795	2,530	-9.4%
Environmental Services	944	1,101	1,032	1,258	1,147	-8.9%
Other Services	31	34	16	0	-2	-
Elimination of internal transactions	-2,091	-2,294	-2,538	-2,590	-2,669	-
Total	7,294	8,252	7,855	8,081	7,695	-4.8%

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

(1) Healthcare Services

In Healthcare Services, the Company forecasts an increase of 4.0% YoY in net sales to ¥74,230mn and an increase of 1.1% in operating profit to ¥6,688mn.

The Company forecasts a ¥1,285mn increase YoY in net sales of Hospital Business and Bedding and Linen Supply Business in FY3/25, but it forecast a ¥234mn decrease in operating profit. Drivers of net sales growth are hotel linen supply (up 4.3% YoY), hospitalization/residency set (up 9.4%), and NEXSURG (up 7.7%). Although NEXSURG sales were slow in FY3/24, they are expected to pick up again in FY3/25 due to the increased number of surgeries as the COVID-19 pandemic waned. A profit decline is forecast, however, due to the full-year impact of depreciation on the Saitama Plant, which began operations in October 2024.

The Company forecasts increases of ¥1,045mn in net sales and ¥183mn in operating profit in the Elderly Care Equipment Business. There appears to be minimal impact of 2024 NHI nursing care fee revisions, with the Company expecting a similar rate of net sales growth as in FY3/24 on an increase in new users and higher profit due to the sales growth effect. In FY3/25, the Company plans to open new sales offices in Tokyo and Kyushu, and the Kyushu Maintenance Center under construction in Saga Prefecture is scheduled to begin operation in summer 2024. Its maintenance center in Kagawa Prefecture currently supplies products to the five business sites in Kyushu (Kitakyushu, Fukuoka, Kumamoto, Nagasaki, and Isahaya). The new maintenance center in Kyushu will improve logistics efficiency and establish a structure that supplies products quickly so that the Company can expand its local market share.

Food Supply Services looks for increases of ¥150mn in net sales and ¥22mn in operating profit. The Company targets higher net sales and profit by focusing on attracting new consignment contracts and revising transaction prices. In Other Businesses, the Company forecasts YoY increases of ¥397mn in net sales and ¥98mn in operating profit on the back of continued strong orders for labor-saving equipment in the Cleaning Equipment Manufacturing Business.

(2) Pharmacy Services

In Pharmacy Services, the Company forecasts a 3.2% YoY increase in net sales to ¥53,974mn and a 9.4% decrease in operating profit to ¥2,530mn. The Company plans to open eight pharmacies, of which one in a medical mall and three in front of hospitals have been confirmed.

For net sales, the Company looks for an increase in the number of prescriptions with some contribution from the eight pharmacies opening in FY3/25 offset against a small decrease in the prescription unit price. An average 1% cut in the drug fee unit price is expected in the spring 2024 NHI drug price reviews and the unit price for technical fees will also be affected by an across-the-board 7-point reduction in the community support system incentives and a 2-point or 4-point reduction in the special basic dispensing fee applied to on-site pharmacies (the Company has 15 such pharmacies). Although the basic dispensing fee was raised by 3 points in all categories, this will mostly be canceled out by an increase in pharmacists' pay. Thus, the Company seeks to strengthen initiatives to earn incentives for promoting medical DX* and other incentive categories to minimize the negative impact. It is also focused on the utilization and spread of its LINE Mini App to retain and increase the number of users through improved patient convenience as a way to raise the number of prescriptions. The number of registered patients has increased steadily since the Mini App was launched in August 2022, reaching 140,000 in March 2024 which accounts for around 17% of all patients visiting its pharmacies.

* Four points are added for pharmacies that meet criteria such being capable of handling electronic prescriptions and track record of using My Number Insurance Cards

Although the effect of a lower prescription unit price is absorbed by the increase in the number of prescriptions, other negative factors for profit include a rise in depreciation and management and maintenance costs associated with system investment for promoting DX, and higher rent due to opening new pharmacies. The Company has factored in the outlook for a continued shortage of generic drugs in its drug fee profit forecast.

(3) Environmental Services

In Environmental Services, the Company forecasts a 1.0% YoY increase in net sales to ¥14,534mn and an 8.9% decrease in operating profit to ¥1,147mn.

In the Leasekin Business, the Company forecasts an increase of ¥69mn YoY in net sales and a decrease of ¥44mn in operating profit. A continued increase in net sales is expected due to growth in sales of toilet-related products for which there is robust demand, but a ¥96mn rise in depreciation associated with the new DOJINSHA plant and molds for the production of new products are negative factors for profit.

Forecasts for the Cleaning Business are an increase of ¥51mn YoY in net sales and a decrease of ¥86mn in operating profit. The Company forecasts an increase in net sales as a result of winning new contracts with medical facilities, but also an increase in personnel expenses to start a new foreign elderly care staffing agency business and train specialist personnel in the operating room preparation operations services business*, and one-time expenses to mark a subsidiary's anniversary event as negative factors for profit. The foreign elderly care staffing agency business refers personnel educated in Indonesia with specialist skills, with the first referrals to an elderly care facility confirmed for September 2024. The Company plans to help resolve the labor shortage in the healthcare and elderly care businesses in Japan by taking advantage of its Group network.

* Trained and educated staff provide pre- and post-operative cleaning and surgical equipment setup instead of hospital staff, which helps increase operating room utilization rates.

For medium-term management plan, likely to undershoot profit target, but exceed net sales target

3. Progress on the medium-term management plan

In May 2021, the Company announced “Challenge for the new stage!,” a four-year medium-term management plan from FY3/22 to FY3/25. Lifestyles are changing greatly due to COVID-19, but even in this situation, it aims for growth as a corporate group that solves societal problems in the “medical care,” “nursing care,” and “environment” business areas and contributes to the realization of a sustainable society. Progress on the numerical management targets is as follows.

(1) Progress on the numerical management targets

The numerical management targets for FY3/25, the plan’s final fiscal year, are net sales of ¥140.0bn and operating profit of ¥9.5bn. The Company expects to surpass its initial net sales target, but currently projects approximately ¥1.8bn shortfall in operating profit, with an operating profit margin of 5.4%, lower than the target 6.8%.

Numerical management targets

(¥mn)

	FY3/21	FY3/25	
		Initial target	Plan
Net sales	118,009	140,000	142,925
Healthcare Services	60,631	71,000	74,230
Pharmacy Services	44,098	54,000	53,974
Environmental Services	13,072	14,800	14,534
Other Services	206	200	185
Operating profit	7,294	9,500	7,695
Operating profit margin	6.2%	6.8%	5.4%

Source: Prepared by FISCO from the Company’s medium-term management plan

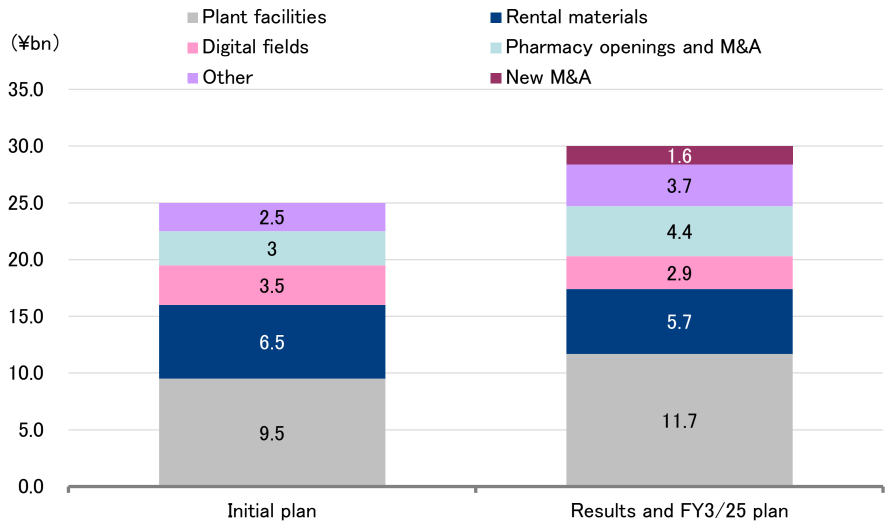
Looking at factors contributing to the difference between each segment’s initial net sales target and plan, net sales are forecast to exceed the initial forecast in Healthcare Services due to brisk performance of the Hospital Business and rental sales in the Elderly Care Business and a sharp recovery of hotel linen supply. Net sales are expected to be close to the initial target for Pharmacy Services despite the impact of a temporary drop in the number of prescriptions during the COVID-19 pandemic. In Environmental Services, net sales are likely to undershoot the initial target despite the robust growth of the Leasekin Business from the M&A effect, because the Company deferred its plan to expand the Cleaning Business into the Kansai area, instead focusing on high value-added services like the operating room preparation operations services in existing areas.

The main factors contributing to the operating profit undershoot include larger-than-expected increases in energy costs and material procurement costs after formulating the medium-term management plan (approximately ¥500mn impact) and depreciation exceeding the initial plan due to the rising construction cost of the Saitama Plant (approximately ¥140mn impact). In Pharmacy Services, the number of prescriptions and the unit price for technical fees were lower than expected, and drug purchase costs went up, including system investment-related depreciation and maintenance and management expenses (approximately ¥720mn impact). Companywide expenses such as IT security-related system investment, education and training expenses for DX promotion, M&A, and sustainability-related consulting expenses were also greater than expected.

(2) Growth investment plan and its progress

The Company was planning to make a total of ¥25.0bn in growth investments during the period of its medium-term management plan, but the total is likely to surpass ¥28.0bn, including planned spending in FY3/25. The total is over ¥30.0bn if M&A expenses in FY3/25 (such as the acquisition of Mikjapan businesses) are included. Consequently, the Company's growth investments will be more than ¥5.0bn more than the initial plan. Looking at the difference between spending and initial plan by category, plant-related investment is ¥2.2bn more than the initial plan at ¥11.7bn, pharmacy openings and M&A (excluding Mikjapan) and new business-related investments are ¥1.4bn more at ¥4.4bn, and other investments are ¥1.2bn more at ¥3.7bn.

Total growth investments in FY3/22–FY3/25



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

Working to improve PBR by improving profitability and capital efficiency and expanding information dissemination

4. Measures to improve profitability and capital efficiency, and initiatives to resolve the information gap

As the Tokyo Stock Exchange has asked companies whose shares are trading at PBRs below 1.0 to take action to improve their performance, the Company recognizes the need to work on increasing its ROE and improving its PBR through information dissemination. TOKAI's shares have traded at a PBR range of 0.8–0.9 in the past few years. The Company has announced a course of action, breaking down PBR into ROE and PER with plans to increase both to lift PBR.

(1) Initiatives to improve profitability and capital efficiency

TOKAI's ROE has been trending around the 7% mark since FY3/19. The Company understands that its cost of shareholder capital is in the 7% range, and aims to raise it above 8% as soon as possible. Its initiatives to improve ROE break down into profitability improvement and capital policy.

For profitability improvement, the Company plans to expand existing businesses and make them more profitable, as well as establish new, profitable businesses and proceed with M&A. For capital policy, it will set an ROE target and improve capital efficiency by disclosing its stance on growth investments, shareholder returns (share buybacks and dividends) and cash allocation going forward. In TOKAI's next medium-term management plan, the Company plans a balanced allocation of cash flow from operating activities and cash on hand to growth investments and shareholder returns. It plans aggressive capital investment to support business growth and growth investments that will lead to increased earnings opportunities with an awareness of capital efficiency. For shareholder returns, the Company will flexibly consider share buybacks while seeking to strike a balance between stable dividends and growth investments.

(2) Resolve the information gap

With regard to PER, which is determined by the market's valuation of the Company, TOKAI must ensure investors understand its strengths and growth strategy. To this end, it will communicate appropriate information to clearly state what its growth drivers and medium- to long-term growth strategies are, and communicate appropriate information regarding progress to enhance dialogue with investors. The Company also plans to improve disclosure of non-financial as well as financial information. It published its first integrated report in March 2024, which can be viewed on its website. In addition, TOKAI intends to strengthen its IR initiatives further by increasing English-language disclosure, holding factory tours for analysts and institutional investors, and distributing articles of IR presentations to deepen investors' understanding of the Company and lower their risk awareness.

One of its main business risks is the impact of government policy changes (such as NHI medical fee and nursing care fee revisions) on its earnings. We can say that these risks are carried by the whole industry, and differences in profitability between companies reflect how each company responds to the change. Thus, medical and nursing care fee revisions provide an opportunity for the Company to expand its market share. FISCO sees potential for stable earnings growth in the medium to long term for the following reasons. Demand for its core businesses (Healthcare Services and Pharmacy Services) will increase in Japan's aging society, and the Company's rental-based business model centered on Healthcare Services and Environmental Services has a highly stable profit structure. With its strong financial condition, the Company also has potential to pursue an M&A strategy to expand its existing business and diversify into peripheral business areas. We think PBR will improve when the stock market gains a deeper understanding of these factors.

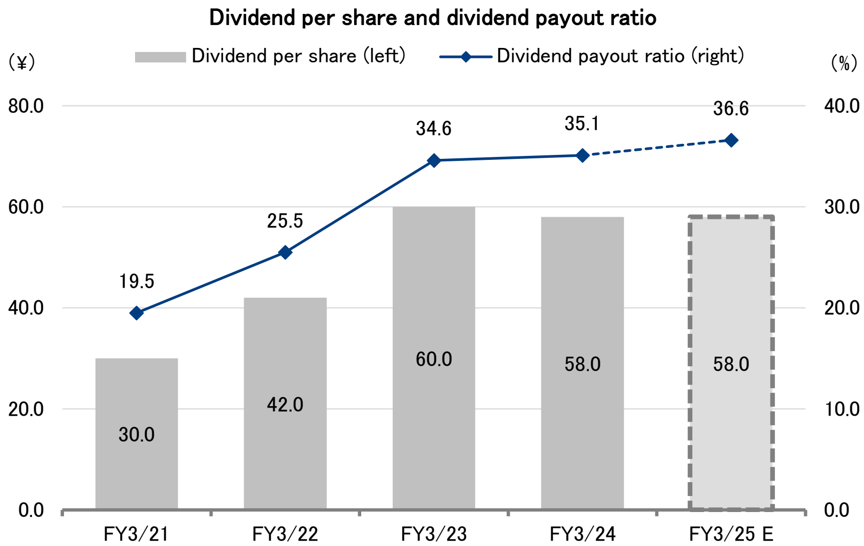
TOKAI plans to incorporate its growth strategy based on initiatives to enhance corporate value in its next three-year medium-term management plan. It intends to announce basic principles (long-term vision, aspirations, and group strategy), growth strategies and direction of specific initiatives for each business segment, and a general framework for cash allocation during the next medium-erm management plan period in November 2024 and more detailed content in May 2025.

Shareholder return policy

Policy to pay dividends with targeted consolidated dividend payout ratio of 35%

Regarding its shareholder returns policy, the Company raised its target for the dividend payout ratio from 25% to 35% from FY3/23 for further enhancement of shareholder returns based on the status of capital. The FY3/24 dividend per share decreased by ¥2.0 per share from the previous fiscal year to ¥58.0 per share (dividend payout ratio of 35.1%) due to a decrease in profit attributable to owners of parent after having recorded extraordinary income in the previous fiscal year. The same dividend per share of ¥58.0 (dividend payout ratio of 36.6%) is forecast for FY3/25. If profit growth continues going forward and the dividend payout ratio falls below 35%, dividend increases can be expected.

In May 2024, the Company went ahead with a share buyback, acquiring 1.4mn shares (4.0% of outstanding shares excluding treasury stock) for ¥2.9bn. It appears that the share buyback was conducted after being approached by a number of financial institutions regarding the sale of cross-shareholdings. The total return ratio (based on the total of dividends and share buybacks) is forecast to be slightly below 90% in FY3/25.



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