COMPANY RESEARCH AND ANALYSIS REPORT

TOKAI Corp.

9729

Tokyo Stock Exchange Prime Market

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FISCO Ltd.

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Summary

FY3/24 results show steady progress; new Saitama Plant begins operation as core plant in Kanto area

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 1H FY3/24 results

In the 1H FY3/24 consolidated results (April-September 2023), net sales increased 5.9% year on year (YoY) to ¥67,865mn and operating profit was up 3.3% to ¥3,684mn. Net sales increased in all business segments, posting a record high overall. Operating 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 personnel expenses and one-off expenses associated with the startup of the Saitama Plant. TOKAI has not disclosed the 1H company plan, but we think progress is mostly on track.

2. Forecasts of FY3/24

The Company's full-year FY3/24 consolidated results forecast is unchanged, calling for a 4.2% YoY increase in net sales to ¥135,609mn and 5.3% decline in operating profit to ¥7,437mn. A profit decline is forecast despite the outlook for sales growth in all segments due to greater rental demand and other factors because of expense increases such as the startup cost and depreciation of the Saitama Plant, which began operation in October 2023, and materials costs, and personnel expenses to push the business forward. That being said, the rate of operating profit decline may be smaller than expected due to solid progress with revisions to prices for providing services and efforts to improve productivity, and delays with some investments (such as system-related upgrade and opening Tanpopo pharmacies). The Saitama Plant–the new core plant for the Kanto area–has hospital linen laundry facility and elderly care equipment maintenance center functions. The hospital linen laundry function will be relocated in stages from the Yokohama Plant, to be completed by the end of FY3/24. The latest facilities at the Saitama Plant will improve productivity by around 40%. The Company is also working to save manpower at the elderly care equipment maintenance center, which will be a key facility to promote growth of rental revenue in the Kanto area. The Company expects the new plant to contribute toward earnings expansion in FY3/25 and beyond.

3. Progress on the medium-term management plan

The Company's four-year medium-term management plan, "Challenge for the New Stage!," which started in FY3/22, sets numerical management targets for FY3/25 of net sales of ¥140.0bn and operating profit of ¥9.5bn. While the net sales target appears achievable, the hurdle to achieving the operating profit target is somewhat higher than when the plan was formulated due to increased cost factors such as higher energy prices, tight supply of pharmaceuticals, and higher personnel expenses. The Company will expand its market share in existing businesses and promote operational efficiency through digital transformation (DX), while also responding to medical-fee revisions and nursing care fee revisions due for spring 2024 and will aim to achieve its targets. We at FISCO expect stable earnings growth to continue over the medium- to long-term because of the Company's strength in providing services in both healthcare and elderly care, where demand is likely to grow in an aging society.

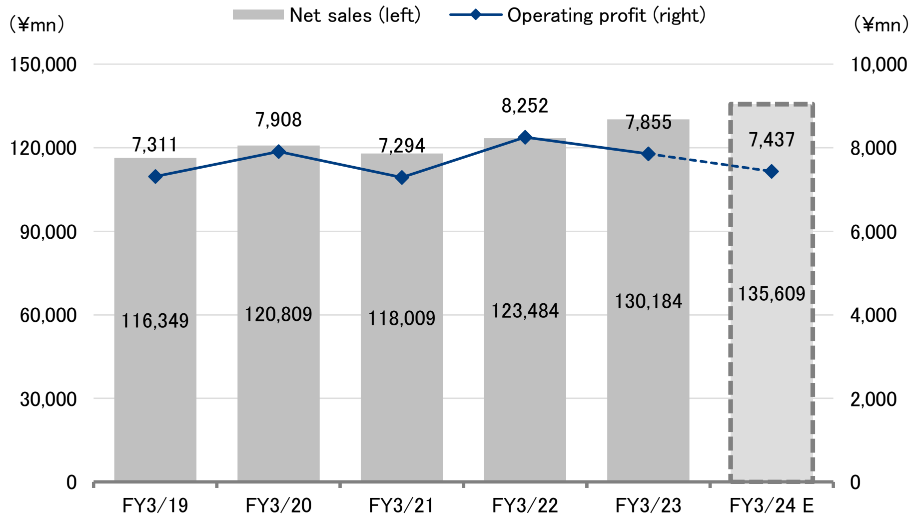
4. Shareholder return policy

For its shareholder return policy, starting in FY3/23, the Company raised its consolidated dividend payout ratio, which is a guideline for shareholder returns, to 35% from 25% to strengthen shareholder returns further. The Company forecasts dividend per share of ¥51.0 (dividend payout ratio of 35.1%) in FY3/24, a decrease of ¥9.0 from FY3/23 because it expects an ultimate decline in profit due to the dropout of extraordinary income recorded in FY3/23. However, a dividend increase can be expected if the dividend payout ratio were to drop below 35% going forward. The Company will also flexibly and appropriately consider share buybacks depending on the level of its stock price.

Key Points

- Record-high net sales in 1H FY3/24, with sales increasing in all business segments
- Profit decline on higher sales forecast for full-year FY3/24, but rate of profit decline may contract due to steady progress in 1H
- Steady progress with growth strategies in Healthcare Services, Pharmacy Services, and Environmental Services; heightened growth potential after new Saitama Plant begins operation
- Working to improve PBR by improving profitability and capital efficiency and expanding information dissemination

Trends in consolidated results



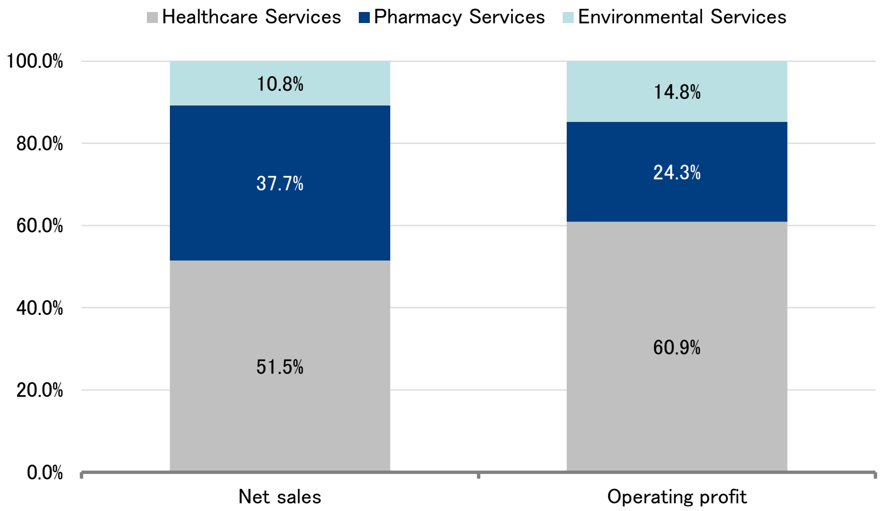
Source: Prepared by FISCO from the Company's financial results

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 (1H FY3/24)



Note: Operating profit is presented prior to elimination of internal transactions and includes Other Services, which is not presented.
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 September 2023, 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 81 branches or offices, and 7 maintenance centers (including 7 non-consolidated subsidiaries' bases). 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 152 pharmacies at the end of September 2023. 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. It handles the Leasekin service of 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 1,000 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, it 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% to 80% 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

Increased net sales in all segments to renew record high consolidated net sales in 1H FY3/24

1. Overview of 1H FY3/24 results

In the 1H FY3/24 consolidated results , net sales increased 5.9% YoY to ¥67,865mn, operating profit was up 3.3% to ¥3,684mn, ordinary profit rose 4.0% to ¥3,869mn, and profit attributable to owners of parent fell 16.1% to ¥2,626mn. Results were mostly in line with 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 personnel expenses 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. TOKAI has not disclosed the 1H company plan, but we think progress was mostly on track.

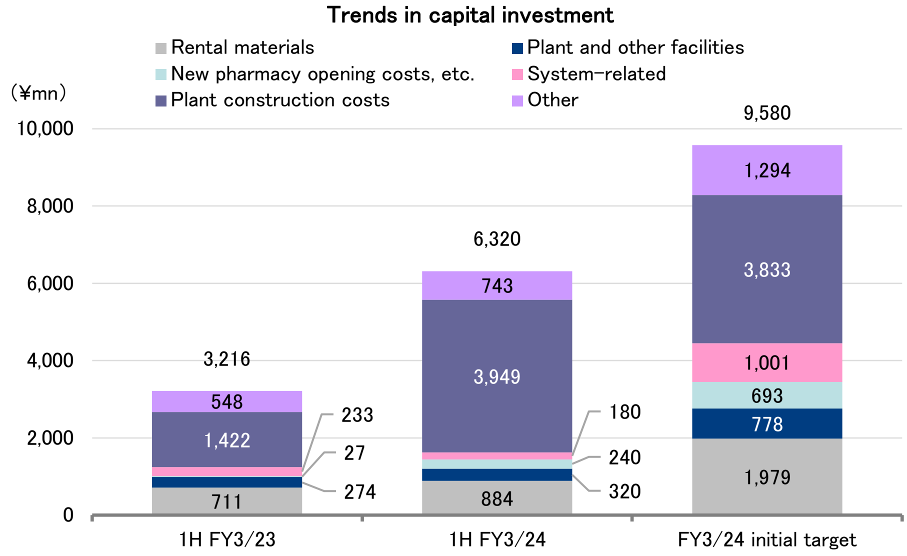
1H FY3/24 consolidated results

(¥mn)

	1H FY3/23		1H FY3/24		YoY	
	Results	Vs. sales	Results	Vs. sales	Change rate	Change
Net sales	64,091	-	67,865	-	5.9%	3,773
Cost of sales	48,583	75.8%	51,401	75.7%	5.8%	2,818
SG&A expenses	11,940	18.6%	12,778	18.8%	7.0%	838
Operating profit	3,567	5.6%	3,684	5.4%	3.3%	117
Ordinary profit	3,720	5.8%	3,869	5.7%	4.0%	148
Extraordinary loss	974	-	-40	-	-	-1,014
Profit attributable to owners of parent	3,130	4.9%	2,626	3.9%	-16.1%	-503

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

Capital investment roughly doubled YoY to ¥6,320mn in 1H FY3/24 versus ¥3,103mn in 1H FY3/23. Increases were mainly in the costs of building the Saitama Plant to ¥3,949mn (up ¥2,527mn), purchasing rental materials to ¥884mn (up ¥173mn), and opening dispensing pharmacies to ¥240mn (up ¥213mn). System-related investment totaled ¥180mn (down ¥53mn), making slow progress toward the full-year plan of ¥1,001mn due to delays in the development schedule of the core system. Depreciation increased slightly YoY, up ¥47mn to ¥2,136mn. However, the full-year forecast is ¥4,929mn (up ¥740mn), because depreciation associated with the new Saitama Plant will be recorded from 3Q.



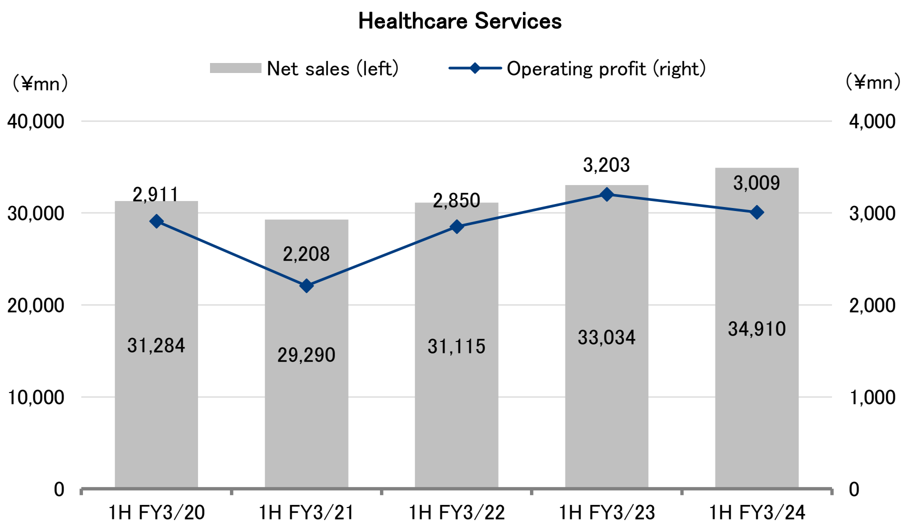
Source: Prepared by FISCO from the Company's results briefing materials

Sales and profit grew in Pharmacy Services and Environmental Services, while profit decreased in Healthcare Services due to new plant construction, despite strong sales

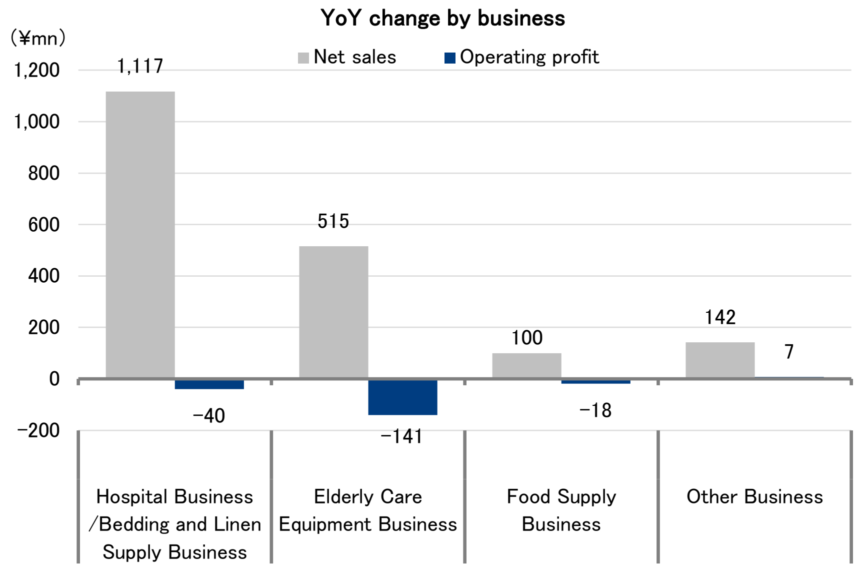
2. Results trends by business segment

(1) Healthcare Services

In Healthcare Services, net sales increased 5.7% YoY to ¥34,910mn and operating profit fell 6.1% to ¥3,009mn. Net sales showed a steady increase in the core Hospital Business and Bedding and Linen Supply Business, and the Elderly Care Equipment Business to mark a record high. However, profit declined due to increased materials costs and personnel expenses as well as booking a one-off expense (real estate acquisition taxes, etc.) of ¥142mn associated with the startup of the new plant.



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 ¥1,117mn YoY while operating profit was down by ¥40mn. Sales to temporary medical facilities declined after the downgrading of COVID-19 from equivalent to Class 2 to Class 5 under Japan's Infectious Disease Control Law in May 2023. However, the Company won new contracts with hospitals and nursing care facilities, resulting in a 1.7% increase in the number of linen supply beds. Rental revenue from lodging facilities such as hotels grew 18.2% YoY due to the recovery of tourism demand and price hike effect, recovering close to pre-pandemic levels and contributing to net sales growth. The Company also won new contracts for its strategic item hospitalization/residency set*1, maintaining brisk sales growth at 11.2% YoY, while sales of NEXSURG*2 also rose a steady 5.5%.

*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.

Operating profit declined due to increased expenses despite the sales growth effect. The cost of materials such as white coats and curtains increased, and the Company recorded a ¥48mn one-off expense associated with the startup of the new plant. Excluding one-off expenses, the Company would have secured an increase in profit.

b) Elderly Care Equipment Business

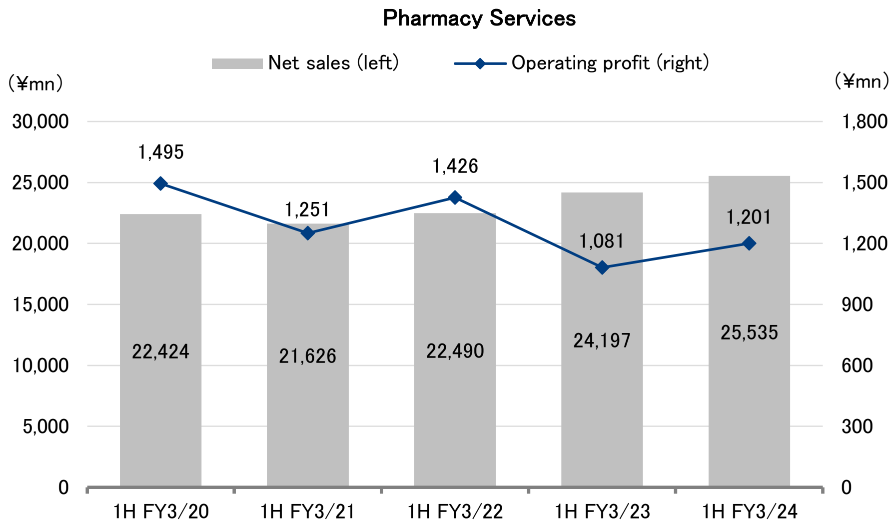
The Elderly Care Equipment Business posted a YoY net sales increase of ¥515mn and operating profit decline of ¥141mn. The sales growth rate slowed after the classification change of COVID-19 to a class 5 disease, because some users who had been receiving in-home services moved to hospitals and nursing care facilities. However, direct rental sales increased a solid 5.5% as a result of steady growth of new contracts. Negative factors for profit were increases in materials costs and personnel expenses and a one-off charge of ¥93mn associated with the startup of the maintenance center. 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 5 business sites in Mie Prefecture versus TOKAI's one. The acquisition will enable TOKAI to increase its market share in Mie Prefecture.

c) Food Supply and Other Business

In Food Supply Services, net sales increased by ¥100mn YoY, but operating profit fell by ¥18mn. Net sales increased for the first time in two fiscal years as a result of winning new consignment contracts, but profit fell due to increases in food prices and personnel expenses. In Other Services (mainly cleaning equipment manufacturing), net sales were up by ¥142mn and operating profit rose by ¥7mn. Cleaning equipment orders recovered at consolidated subsidiary Purex Co., Ltd. amid a rebound in linen supply demand, resulting in a 22.0% net sales increase in Other Services. Group sales (equipment for the Saitama Plant) accounted for a large share of Purex's sales in 1H, but external sales will be the mainstay from 2H onward. With the order backlog at a high level, we expect Purex to make a larger contribution going forward.

(2) Pharmacy Services

Pharmacy Services posted a 5.5% YoY increase in net sales to ¥25,535mn and 11.1% rise in operating profit to ¥1,201mn. 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 sales growth absorbing the cost of opening stores. The Company opened 3 stores to bring the total at end-1H FY3/24 to 152, up by 5 from a year earlier.



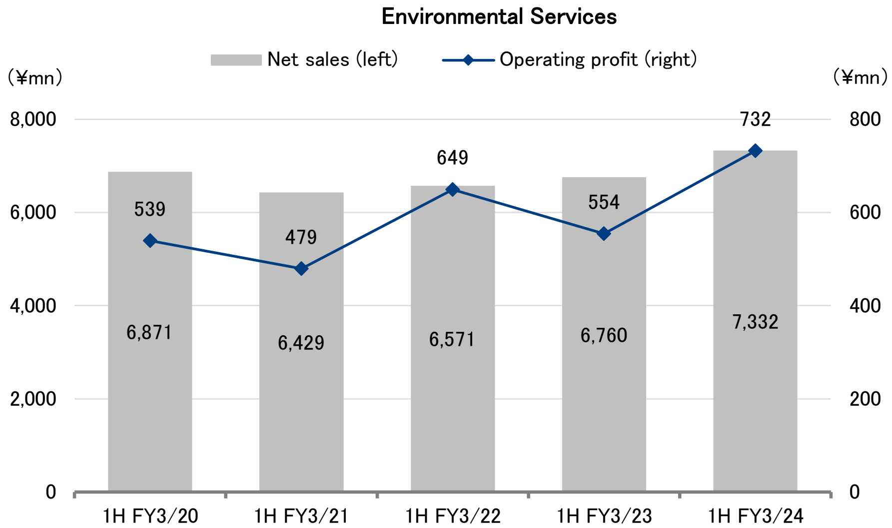
Source: Prepared by FISCO from the Company's financial results

Breaking down factors contributing to net sales growth, sales from drug fees increased by ¥1,124mn and sales from technical fees went up by ¥227mn. The number of prescriptions rose 3.8% YoY and the prescription unit price increased 1.7%. 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 and strengthening family pharmacy functions through collaboration with medical institutions and nursing care/welfare facilities made a positive contribution to the technical fee.

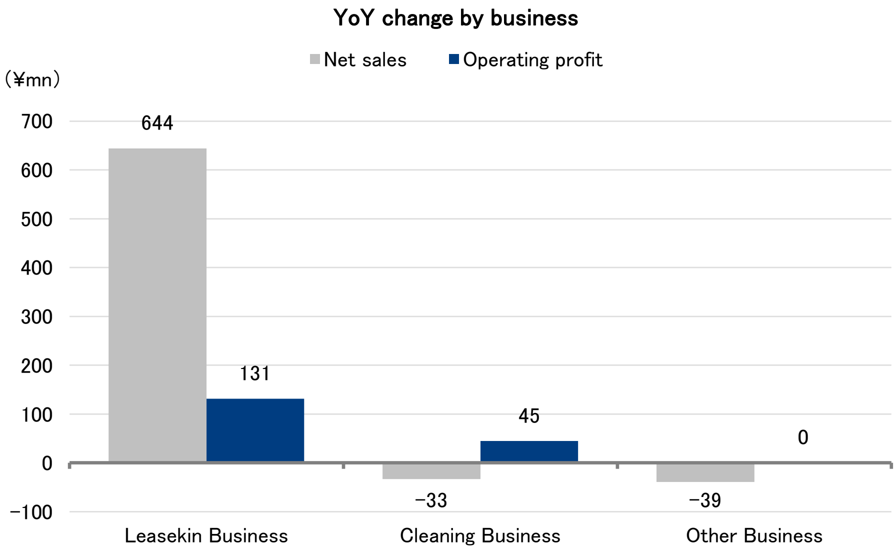
Factors affecting operating profit were as follows. Positive effects were increased sales from technical fees (¥227mn) and from drug fees (¥84mn), which absorbed the ¥192mn rise in store expenses. Increased sales from drug fees made a limited contribution to profit growth due in part to higher drug purchase costs associated with the supply shortage of generic drugs.

(3) Environmental Services

In Environmental Services, net sales increased 8.5% YoY to ¥7,332mn and operating profit increased 32.0% YoY to ¥732mn. These were record 1H highs, for the first time in five years for net sales and two years for operating profit.



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



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

In the Leasekin Business, net sales were up by ¥664mn YoY and operating profit rose ¥131mn. 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 11.6% 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 ¥33mn decline in net sales YoY, but a ¥45mn increase in operating profit. Net sales were hurt by a drop in contracted work for COVID-19 wards. Profit increased due to startup expenses for new business sites (booked as a one-off expense a year ago) being reduced almost to zero and higher productivity as a result of improving production processes.

Cash on hand is plentiful and the financial condition is good

3. Financial condition and management indicators

The Company's financial condition as of the end of 1H FY3/24 was as follows. Total assets increased ¥4,916mn from the end of the previous fiscal year to ¥115,701mn. The main reasons for the changes were a decrease in current assets due to a decrease in cash and deposits of ¥3,045mn against respective increases of ¥1,294mn in notes and accounts receivable - trade and ¥1,068mn in inventories. In non-current assets, there were increases of ¥3,394mn in construction in progress related to the Saitama Plant and ¥1,496mn in investment securities.

Total liabilities increased by ¥3,163mn to ¥31,725mn compared to the end of FY3/23. There were decreases in interest-bearing debt of ¥288mn and income taxes payable of ¥265mn and respective increases of ¥1,738mn in trade accounts payable - other and ¥1,379mn in notes and accounts payable - trade. Total net assets increased ¥1,753mn to ¥83,976mn. The reason for the increases was recording ¥2,626mn in profit attributable to owners of parent and ¥518mn in valuation difference on available-for-sale securities despite ¥1,373mn in expenses for payment of dividends.

Turning to management indicators, the equity ratio remains at a high level of 72.1%, and the interest-bearing debt ratio is also stable at a low level of 3.1%, which indicates 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)

	FY3/21	FY3/22	FY3/23	2Q FY3/24	Change
Current assets	58,769	59,748	62,628	62,218	-410
(Cash and deposits)	35,148	35,794	36,070	33,024	-3,045
(Inventories)	5,646	4,635	5,424	6,492	1,068
Non-current assets	43,411	46,151	48,157	53,483	5,326
Total assets	102,180	105,900	110,785	115,701	4,916
Total liabilities	28,302	28,381	28,562	31,725	3,163
(Interest-bearing debt)	3,876	3,398	2,876	2,588	-288
Total net assets	73,878	77,519	82,223	83,976	1,753
(Stability)					
Equity ratio	71.8%	72.7%	73.7%	72.1%	-1.6pt
Interest-bearing debt ratio	5.3%	4.4%	3.5%	3.1%	-0.4pt
Net cash	31,365	32,757	34,121	31,355	-2,766

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

Business Outlook

Forecasts lower profit on higher net sales in FY3/24, but rate of profit decline may contract due to steady progress in 1H

1. Outlook for FY3/24

For the FY3/24 consolidated results outlook, the initial outlook remains unchanged as the Company forecasts an increase in net sales by 4.2% YoY to ¥135,609mn, a decrease in operating profit by 5.3% to ¥7,437mn, a decrease in ordinary profit by 3.4% to ¥7,804mn, and a decrease in profit attributable to owners of parent by 16.1% to ¥5,121mn. The rate of progress on these forecasts as of the end of 1H was 50.0% for net sales and 49.5% for operating profit, with each making steady progress. We at FISCO view the Company's forecast as achievable.

Consolidated outlook for FY3/24

(¥mn)

	FY3/23		FY3/24			1H progress rate
	Results	Vs. sales	Forecasts	Vs. sales	YoY	
Net sales	130,184	-	135,609	-	4.2%	50.0%
Operating profit	7,855	6.0%	7,437	5.5%	-5.3%	49.5%
Ordinary profit	8,080	6.2%	7,804	5.8%	-3.4%	49.6%
Profit attributable to owners of parent	6,106	4.7%	5,121	3.8%	-16.1%	51.3%
EBITDA*	12,144	9.3%	12,478	9.2%	2.8%	
Earnings per share (¥)	173.39		145.47			

* 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 Saitama Plant, which began operation in October 2023, has hospital linen laundry facility 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 is equipped with automated conveyers 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 Company is currently shifting work from the old plant to the Saitama Plant in stages, with the shift scheduled for completion by the end of FY3/24. The old plant will continue 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.

The FY3/24 capital investment plan (including investment in the new plant) totals ¥9,580mn, up by ¥3,106mn YoY. The main negative factor for profit is the increase in depreciation (up by ¥740mn to ¥4,929mn). However, we at FISCO think that the rate of increase in depreciation might be smaller than expected, because the Company is now likely to open 6 dispensing pharmacies instead of the 11 initially planned, and the core system upgrade is falling behind schedule. The Company has made good progress overall with revisions to prices for providing services to cope with rising energy and other costs, which started in FY3/23, but it has been cautious about price revisions for linen supply services for hospitals and nursing care facilities amid customers' severe operating conditions. We are therefore keeping a close eye on changes to medical and nursing care fees in the spring 2024 NHI fee revisions.

Breakdown of capital investment and depreciation

(¥mn)

	FY3/21	FY3/22	FY3/23	FY3/24 forecast	YoY difference
Rental materials	1,082	1,285	1,396	1,979	583
Plant and other facilities	410	599	465	778	313
New pharmacy opening costs, etc.	395	1,262	186	693	507
System-related	609	693	499	1,001	502
Plant construction costs	-	211	2,784	3,833	1,049
Other	916	670	1,142	1,294	152
Total capital investment	3,414	4,722	6,474	9,580	3,106
Depreciation	3,553	3,863	4,189	4,929	740

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

Net sales increase in all 3 segments and operating profit growth in Pharmacy Services and Environmental Services forecast in FY3/24

2. Outlook by business segment

Results outlook by business segment

(¥mn)

Net sales by business	FY3/21	FY3/22	FY3/23	FY3/24 E	YoY	1H progress rate
Healthcare Services	60,631	63,517	67,088	69,607	3.8%	50.2%
Pharmacy Services	44,098	46,561	49,334	50,880	3.1%	50.2%
Environmental Services	13,072	13,194	13,559	14,939	10.2%	49.1%
Other Services	206	211	202	181	-10.3%	47.5%
Total	118,009	123,484	130,184	135,609	4.2%	50.0%

Operating profit by business	FY3/21	FY3/22	FY3/23	FY3/24 E	YoY	1H progress rate
Healthcare Services	5,403	6,312	6,663	6,241	-6.3%	48.2%
Pharmacy Services	3,006	3,097	2,680	2,765	3.1%	43.4%
Environmental Services	944	1,101	1,032	1,147	11.1%	63.8%
Other Services	31	34	16	-18	-	-
Elimination of internal transactions	-2,091	-2,294	-2,538	-2,696	-	-
Total	7,294	8,252	7,855	7,437	-5.3%	49.5%

Operating profit margin by business	FY3/21	FY3/22	FY3/23	FY3/24 E	YoY
Healthcare Services	8.9%	9.9%	9.9%	9.0%	-0.9pt
Pharmacy Services	6.8%	6.7%	5.4%	5.4%	0.0pt
Environmental Services	7.2%	8.3%	7.6%	7.7%	0.1pt
Other Services	15.0%	16.1%	7.9%	-9.9%	-17.8pt
Total	6.2%	6.7%	6.0%	5.5%	-0.5pt

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 3.8% YoY in net sales to ¥69,607mn and a decrease of 6.3% in operating profit to ¥6,241mn. The progress rate as of 1H was 50.2% for net sales and 48.2% for operating profit, so both are making steady advances. Depreciation will be recorded for the Saitama Plant from 2H onward, but we think steady net sales will offset the impact of other cost increases.

The Company forecasts a ¥1,293mn increase in net sales of Hospital Business and Bedding and Linen Supply Business in FY3/24. This forecast is likely to be exceeded, because net sales of the segment increased by ¥1,117mn in 1H due to factors such as a sharp recovery in hotel linen supply. In Hospital Business, the Company expects linen supply for hospitals and nursing care facilities to remain brisk, as well as continued growth of strategic product hospitalization/residency set and NEXSURG. The Company looks for a ¥432mn operating profit decline, but the rate of decline may be smaller if net sales overshoot its forecast.

The Company forecasts increases of ¥1,004mn in net sales and ¥80mn in operating profit in the Elderly Care Equipment Business. The segment's net sales increased by ¥515mn in 1H, more or less on track. Operating profit was down by ¥141mn in 1H, but profit growth over the full year is possible considering the booking of a one-off expense and aggressive input of materials associated with the Saitama maintenance center. Two new sales sites were initially planned in FY3/24, but this has been postponed to FY3/25. The Company also postponed the opening of a maintenance center in Kyushu to 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 ¥286mn in net sales and ¥54mn in operating profit. Net sales were up by ¥100mn and operating profit fell ¥18mn in 1H, slightly below target. The Company aims to reach its target by revising transaction prices and improving productivity.

The Company forecasts declines of ¥64mn in net sales and ¥124mn in operating profit in the Other Business, but recorded increases of ¥142mn in net sales and ¥7mn in operating profit in 1H. To reiterate, demand for cleaning equipment remains brisk and external sales are forecast to grow in 2H. We therefore expect full-year net sales and operating profit to further exceed the Company's forecast.

(2) Pharmacy Services

In Pharmacy Services, the Company forecasts increases of 3.1% YoY in net sales to ¥50,880mn and 3.1% in operating profit to ¥2,765mn. The progress rate as of 1H was 50.2% for net sales and 43.4% for operating profit, giving the impression that it is a little sluggish when viewed on a profit basis. The Company initially had plans to open 11 pharmacies (including those acquired by M&A), but appears to be settling on 6.

By composition of net sales, the Company's sales forecast assumes a 3.0% YoY increase in the number of prescriptions and 0.2% prescription unit price rise, which appear to be achievable targets. As noted above, with regard to the prescription unit price, the Company had assumed a small decrease in the drug fee unit price, but this has been trending slightly higher, which is a positive factor. That being said, price talks with drug wholesalers are becoming even tougher as the shortage of pharmaceuticals continues to impact the industry. This means that drugstores cannot be optimistic about securing a profit from drug fees. The Company will therefore focus on strengthening its at-home dispensing services and family pharmacy functions as ways to raise the technical fee unit price.

The Company uses as indicators of strengthened family pharmacy functions the number of specialist pharmacists*1 trained (58 at end-September 2023, targeting 120 at end-March 2024; same dates apply below) and increase in the number of stores with pharmacy certification (stores with community cooperating pharmacy certification to increase from 48 to 74 and stores with health support pharmacy certification to increase from 11 to 14). It aims to raise the technical fee unit price through these initiatives. A major concern is that the Company is likely to be significantly impacted*2 by the tightening of the basic dispensing fee calculation requirements expected in the spring 2024 NHI price revisions. Accordingly, it is important to strengthen initiatives for increasing community support system incentives and premium for generic drug dispensing system.

*1 Pharmacists with specialist qualifications to provide community guidance to recuperating diabetics and kidney disease patients, and those accredited to provide guidance to dementia patients and their families

*2 The prescription concentration rate for specific medical institutions (one of the requirements for calculating the basic dispensing fee) has been trending down. Some stores that have been awarded Basic Dispensing Fee 1 (42 points) may only be awarded Basic Dispensing Fee 2 (26 points) after the revision.

As part of the government-led medical DX initiative, the Company has made all of its stores capable of handling electronic prescriptions (national average is approximately 14%), promoted the use of My Number Insurance Cards, and is actively working on smooth links with online medical care and medical guidance. It is also focused on the utilization and spread of its LINE Mini App to retain users through improved patient convenience. The number of registered patients has increased steadily since the Mini App was launched in August 2022, exceeding 80,000 as of December 2023. The Company targets 100,000 registered users for now.

(3) Environmental Services

In Environmental Services, the forecasts are for double-digit increases in sales and profit, with net sales to increase 10.2% YoY to ¥14,939mn and operating profit to increase 11.1% to ¥1,147mn. The progress rate as of 1H was 49.1% for net sales and 63.8% for operating profit, so both are steadily progressing.

In the Leasekin Business, the Company forecasts increases of ¥1,242mn in net sales and ¥40mn in operating profit. Net sales increased by ¥644mn and operating profit went up by ¥131mn in 1H, surpassing the full-year target on a profit basis. The Company expects the subsidiary integration effect and growth of toilet-related products to continue through 2H.

Full-year forecasts for the Cleaning Business are increases of ¥127mn in net sales and ¥22mn in operating profit. Net sales were down by ¥33mn, while operating profit increased by ¥45mn in 1H. Net sales are weaker than expected, but profit is ahead of target. The Company is focusing on initiatives to expand earnings such as establishing a structure to provide high added value operating room preparation operations (operating room cleaning and assistance)* services under contract and train personnel. Demand for efficient cleaning and disinfection know-how between surgeries is high especially at advanced acute care hospitals, which perform many procedures. The Company sees the business as a growth opportunity.

* 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.

Medium-term management plan

Steady progress with growth strategies in each segment and heightened growth potential after new Saitama Plant begins operation

1. Overview of the medium-term management plan

The Company formulated "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. The basic policies, progress status and numerical management targets are as follows.

(1) Basic policies

a) "Continue" to meet the needs of society and of customers

- Rental business model that contributes to a recycling-based society
- Stably provide services that support the societal infrastructure of medical care and nursing care (Hospital Business, Food Supply Business, Elderly Care Equipment Business, Pharmacy Business, and Cleaning Business)
- Strengthen the existing core businesses and improve share in regions (Hospital Business, Elderly Care Equipment Business, Pharmacy Business, and Leasekin Business)
- Provide services from the customers' perspective and pursue even higher levels of specialism
- Strengthen "human capital" that is essential for differentiation

b) "Change" to respond to changes in the business environment and that will lead to further growth

- Establish new workstyles for individuals and organizations in the new normal era
- Promote DX to improve work efficiency and productivity
- Establish and maintain corporate governance suitable for the Prime Market
- Train management-level human resources and proactively promote the young generation
- Conduct management that prioritizes diversity

c) "Create" to generate new value that will lead to next-generation businesses

- Develop new businesses and services in the healthcare business (including for the at-home services market for which demand is expected to grow)
- Promote DX to create a new business model (including creating services based on the data accumulated in the Elderly Care Equipment Business and Pharmacy Business)
- Create new business value by organically combining the Group's management resources (implement coordination between businesses that leads to sales increases)
- Discover investment fields that will contribute to growth and flexibly conduct investment
- Foster a corporate culture in which employees can continue to work with motivation and pride

(2) Business strategies

Based on the basic polices, the Company is aiming to realize sustainable growth in each business segment by progressing the following business strategies.

a) Healthcare Services

In Healthcare Services, in order to further deepen relations of trust with medical institutions and nursing care facilities, which are the foundation of this business. For Hospital Business, the Company will strengthen the structure that can provide existing services stably and at high levels of quality, centered on linen supply. At the same time, it will aim to differentiate from the products of competitors with strategic products, hospitalization sets and NEXSURG, including by creating high added value and adding new items. With the Saitama Plant in operation, the Company expects to further strengthen its production capacity and sales capabilities in the Kanto area, where market expansion is anticipated, from FY3/25 onward. In addition, it is working on measures including creating new core items for medical institutions and improving work efficiency through digitalization.

In Elderly Care Equipment Business, with the goal of further solidifying its place as Japan's No. 1 provider of elderly care equipment rentals, the Company will proactively invest management resources. Along with the Saitama Maintenance Center (operational from October 2023) and the Kyushu Maintenance Center (operational from summer 2024) lifting its sales growth potential, the Company will strive to differentiate itself from competitors by improving service provision and speed and offering highly convenient services through logistics reforms and promoting DX, and training skilled, highly specialized personnel. In addition, the Company intends to enhance business sites and work to achieve the No. 1 share of local markets while actively promoting M&A, primarily in urban areas where the elderly population is expected to increase going forward.

In addition to the above, in the healthcare business, the Company continues to focus on developing and commercializing new medical care services that will help to solve societal problems. Specific examples include two clinical studies with a view to commercialization of iAide2, a wristband type wearable device. The Company aims to complete in FY3/24 a clinical study*2 to detect asymptomatic atrial fibrillation*1 in collaboration with Tokyo Medical and Dental University Hospital, which started in January 2022. This clinical study had by the end of March 2023 confirmed some positive results by detecting asymptomatic atrial fibrillation in nine out of 417 participants examined.

*1 Asymptomatic atrial fibrillation has no subjective symptoms and is said to increase the risk of developing cardiogenic cerebral infarction if left untreated. Around one million people in Japan are estimated to have this condition. The early detection of asymptomatic atrial fibrillation through using iAide2 to collect pulse-wave data and a program that utilizes AI is expected to lead to the prevention of cerebral infarctions.

*2 A joint project with Tokyo Medical and Dental University Hospital, Shizuoka City, the Shizuoka City Shimizu Medical Association and TDK Corporation <6762>.

In October 2022, the Company and Gifu University Hospital began a joint clinical study with chronic heart disease patients who require cardiac rehabilitation. The research, which is aimed at patients with chronic heart conditions who require cardiac rehabilitation, will verify that providing appropriate exercise management by visualizing the status of their in-home activities through vital data (such as pulse rate, steps and volume of activity) collected using iAide2, which a doctor or physical therapist will use as a base, contributes to improving the exercise tolerance of test subjects. The current reality is that although there are medical staff who provide guidance for appropriate rehabilitation during hospital stays, doctors and physical therapists are unable to determine whether or not patients are doing the same type of rehabilitation at home unless stated by the patients themselves, and symptoms worsen for many after they leave hospital. If iAide2 can be used to continue appropriate rehabilitation while examining the patient's at-home status as data, this will ultimately prevent the symptoms of heart conditions from worsening and help to extend healthy life expectancies. The research team plans to publish their findings at an academic conference after acquiring data for around 100 patients. The Company intends to use the evidence obtained through the clinical research to work toward practical implementation after two to three years.

The Company is also aggressively implementing initiatives to pioneer overseas markets. It established a company for linens, medical equipment and materials leasing in South India in October 2022 in a joint venture with Toyota Tsusho Corporation <8015>, with a 45% stake. The joint venture began a hospital linen supply service in India in collaboration with a local hospital cleaning company and laundry company in which the Company has a stake. It attaches radio frequency identification (RFID) to linen products for IC tag management at time of shipments and within the factory. The RFID system began operation in May 2023 at a Japanese-style general hospital run by Secom Medical System Co., Ltd. (a group company of Secom Co., Ltd. <9735>) and Toyota Tsusho and the company is now marketing it to hospitals in earnest. Using hospital linen supply services as a starting point, the company intends to work on obtaining business opportunities for medical peripheral services in the Indian market, where high-level growth will continue.

b) Pharmacy Services

In Pharmacy Services, the Company's vision is to become the No. 1 family pharmacy for local communities. To this end, it is improving customer convenience with work reforms through DX and expanding services that utilize LINE. Its store opening strategy is to open a diverse range of stores from pharmacies in and near hospitals, those near clinics and in medical malls, and those specializing in at-home dispensing services to build a well-rounded management structure. The Company also plans to develop a new "life solution pharmacy" format rooted in local communities. The first life solution pharmacy is scheduled to open in April 2024 as a tenant in iiNE! TOWN Mizuho, a mixed-use community that brings multiple generations together under development in Nagoya.

Another new initiative is the health café, which opened in Nagoya next to one of its stores in January 2024. It provides a health-oriented menu developed in collaboration with hospitals, universities, and technical colleges, contributing toward solving a social issue of extending healthy lifespans with a new business format. Also, the Company plans to begin selling Tanpopo Pharmacy's original DHA Chocolate, which contains DHA and was co-developed with a food manufacturer, at all Tanpopo Pharmacy stores in February 2024.

c) Environmental Services

In Environmental Services, the Company will further bolster its strength of being a "sanitation management professional" and work on changing to a business structure that can sustain growth. In the Leasekin Business, it will focus on increasing sales of and developing products that meet sanitation management needs, centered on toilet-peripheral products, and increase the percentage of sales provided by these products. Meanwhile, in the cleaning business, the Company is aiming to differentiate itself from other companies by developing proprietary services that can meet the needs of medical institutions, including operating room preparation operations* to enhance hospital cleaning. It intends to improve profitability by increasing the ratio of sales for hospitals to total sales (the current ratio is about 70% to 80%). In Environmental Services, we at FISCO see substantial growth potential for both the Leasekin and cleaning businesses, because demand will expand in a labor shortage situation.

(3) DX Initiatives

As one strategy for future growth, the Company has begun to build a company-wide DX platform. In order to achieve Business Value Transformation (use of DX to improve process efficiency and raise productivity) and Customer Value Transformation (use of DX to create new businesses and services), the Company is planning aggressive DX investment during the medium-term management plan period.

For concrete initiatives, after holding an e-learning lecture for all employees starting in June 2022, it ran a course to develop DX promoters beginning in July of the same year. The Company plans to train 180 DX promoters by FY3/25, and has trained 90, half of them (including 21 who are scheduled to complete the program in February 2024). Those who complete the program will promote DX initiatives in their own departments. Moreover, to share knowledge Companywide, an internal portal site for DX-related information was launched in July 2023.

In terms of progress with DX initiatives in its business, the Company introduced an e-signature system for electronic contracts in the Elderly Care Equipment Business (ratio of electronic contract use is approximately 87%) and has been transitioning to online invoice processing in the Leasekin Business since 2023 (ratio of online invoice processing use is approximately 70%*), in addition to use of the LINE Mini App at Tanpopo Pharmacy. These initiatives not only reduce work time by automating clerical work, but also cuts costs by going paperless.

* Percentage of corporate customers who use online invoice processing

(4) Numerical management targets and progress

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 numerical targets are basically to be achieved through organic growth and do not incorporate the effects of M&A. Among CAGR for net sales by segment, the rate is the highest in Pharmacy Services at 5.2%, factoring in the effect of opening large pharmacies, followed by 4.0% in Healthcare Services, and 3.2% in Environmental Services.

The Company projects the operating profit margin to increase from 6.2% in FY3/21 to 6.8% in FY3/25. Among these, in Pharmacy Services, it is difficult to foresee the impact of dispensing fee revisions, so the assumption is that the profit margin will decline compared to FY3/21. On the other hand, in Healthcare Services and Environmental Services, profit margins are expected to rise on growth in products and services with high added value.

Numerical management targets

(¥mn)

	FY3/21	FY3/22	FY3/23	FY3/24 E	FY3/25 targets	CAGR*
Net sales	118,009	123,484	130,184	135,609	140,000	4.4%
Healthcare Services	60,631	63,517	67,088	69,607	71,000	4.0%
Pharmacy Services	44,098	46,561	49,334	50,880	54,000	5.2%
Environmental Services	13,072	13,194	13,559	14,939	14,800	3.2%
Other Services	206	211	202	181	200	-0.7%
Operating profit	7,294	8,252	7,855	7,437	9,500	6.8%
Operating profit margin	6.2%	6.7%	6.0%	5.5%	6.8%	

* Four-year CAGR with FY3/21 as the first years
Source: Prepared by FISCO from the Company's results briefing materials and medium-term management plan

Progress through 1H FY3/24 is as follows. Net sales are on track, with the FY3/25 target within range. However, the hurdle to achieving the operating profit target is somewhat higher than when the plan was formulated due to increased cost factors such as higher energy prices, tight supply of pharmaceuticals, and higher personnel expenses amid the ongoing labor shortage. It is unclear whether the Company can achieve its initial target for FY3/25, because it could be negatively impacted by the NHI medical fee and nursing care fee revisions scheduled for spring 2024. That being said, the Company is continuing to make the necessary investment for sustained growth. We at FISCO think that the construction of its foundation for growth is progressing well.

(5) Growth investment plan

The Company was planning to make a total of ¥25.0bn in growth investments during the period of its medium-term management plan, but is likely to achieve ¥20.7bn in FY3/24, which is 80% of the target, so is ultimately projected to slightly exceed this total. Related costs not included in capital investment are investments in DX-related initiatives, M&A expenses, and new business-related investment. The Company intends to reinforce its foundation for future growth by maintaining and expanding its growth investment.

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

2. Initiatives to improve PBR

The Tokyo Stock Exchange has asked companies whose shares are trading at PBRs below 1.0 to take action to improve their performance. 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.

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 explore 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.

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 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. It also plans to publish its first integrated report around February 2024. TOKAI intends to strengthen its IR initiatives further 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.

Direction of initiatives for improving PBR

	Initiatives to Improve P/B	Policy Going Forward	Disclosure timing
1	Successfully complete the current medium-term plan (ending in FY3/25)	● Continue measures for "Continuing," "Changing," and "Creating" ● Promote steps to raise profitability	—
2	Capital efficiency-conscious management	● Set ROE targets ● Present view on growth investments and returns	May 2024
3	Medium- to long-term growth strategy	● Establish a medium- to long-term vision for the TOKAI Group focused on "cleaning and health" ● Clarify new growth strategies in each business ● Create new businesses that help improve profitability ● Clarify financial strategy and cash allocation ● Present basic view on the business portfolio	Reflect in the next medium-term plan
4	Improve P/E via constructive dialogue	● Engage in dialogue and communication to rectify information gaps ● Strengthen IR activities ● Issue integrated report (scheduled for around February 2024)	—
5	Promote non-financial measures to generate added value	● Disclose and actively engage in ESG initiatives ● Expand investment in human capital ● Promote DX initiatives to raise added value, improve operational efficiency, etc.	—

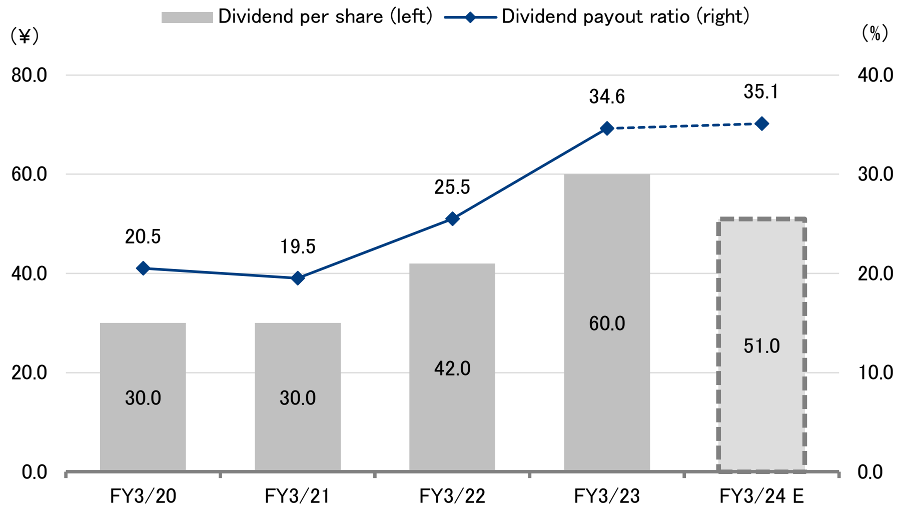
Source: The Company's results briefing materials

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. As a result, dividend per share in FY3/24 is expected to fall due to a decrease in profit attributable to owners of parent due to having recorded extraordinary income in the previous fiscal year. The dividend is planned to decrease ¥9.0 per share from the previous fiscal year be ¥51.0 per share (dividend payout ratio of 35.1%). If profit growth continues going forward and the dividend payout ratio falls below 35%, dividend increases can be expected. The Company will also flexibly and appropriately consider share buybacks depending on the level of its stock price. In any case, the Company is expected to continue to be proactive in returning profits to shareholders, given that improving PBR is one of its management issues.

Dividend per share and dividend payout ratio



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

Disclaimer

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