

Medical System Network Co., Ltd.

4350

Tokyo Stock Exchange First Section

15-Dec.-2017

FISCO Ltd. Analyst

Yuzuru Sato



FISCO Ltd.

<http://www.fisco.co.jp>

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Index

Summary	01
1. The FY3/18 1H results exceeded the initial forecasts for higher profits	01
2. The outlook for FY3/18 is for the two mainstay businesses to grow for a double-digit increase in profits...	01
3. The outlook is for the improvements in the stability of earnings and in growth to continue from the expansion of the pharmaceutical network business	02
Business overview	03
1. Pharmaceutical network business	03
2. Dispensing pharmacy business	05
3. Rental & medical facilities-related business	05
4. Catering business	06
5. Other businesses	06
Results trends	07
1. Summary of the FY3/18 1H results	07
2. Earnings by business segment	08
3. Financial position and management indicators	13
Business outlook	14
1. Forecast for FY3/18	14
2. Outlook by segment	15
Group reorganization and home medical service initiatives	18
1. Group reorganization	18
2. Initiatives in the home medical service	19
Shareholder return policy	20
Information security measures	21

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Summary

The disadvantageous market environment is advantageous for the Company and is accelerating the pace of increase in pharmaceutical network member numbers

Medical System Network Co., Ltd. <4350> (hereafter, also “the Company”) operates two main businesses: a pharmaceutical network business that caters to small and mid-sized pharmacies and a dispensing pharmacy business. The increase pace in pharmaceutical network members has been accelerating with a tailwind from changes in the environment facing dispensing pharmacy and brings within sight the Company’s goal of 5,000 members, which amounts to a market share of about 10%. In dispensing pharmacy business, the Company aims to reach ¥300bn in consolidated sales in 10 years from now through a strategy of expanding the number of stores utilizing M&A.

1. The FY3/18 1H results exceeded the initial forecasts for higher profits

In the FY3/18 1H consolidated results, net sales increased 7.3% year-on-year (YoY) to ¥46,552mn and operating profit rose 131.5% to ¥1,271mn, both exceeding the initial Company forecasts (net sales of ¥45,500mn and operating profit of ¥1,100mn). Within the increasingly severe management environment in the dispensing pharmacy industry, the number of members of the network service, which contributes to keeping down pharmaceutical purchase prices and reducing the pharmaceutical disposal loss, increased above the forecast, up 242 on the end of the previous fiscal year to 2,012 members. In addition, in the dispensing pharmacy business, the Company is progressing its responses to the revisions to the medical treatment fees, and the main factors behind the higher sales and profits were the YoY increases in the prescription unit price and the number of prescriptions.

2. The outlook for FY3/18 is for the two mainstay businesses to grow for a double-digit increase in profits

For the FY3/18 consolidated results, the initial forecasts have been left unchanged, of net sales to increase 6.9% YoY to ¥95,000mn and operating profit to rise 46.7% to ¥3,100mn. In the dispensing pharmacy business, although the pace of the increase in pharmacy numbers is slightly behind schedule, in the pharmaceutical network business, member numbers are accelerating at a pace above the forecast (up 430 on the end of the previous fiscal year to 2,200 members). So at FISCO, we think it is highly likely that the Company will achieve its forecasts for its full fiscal year results.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

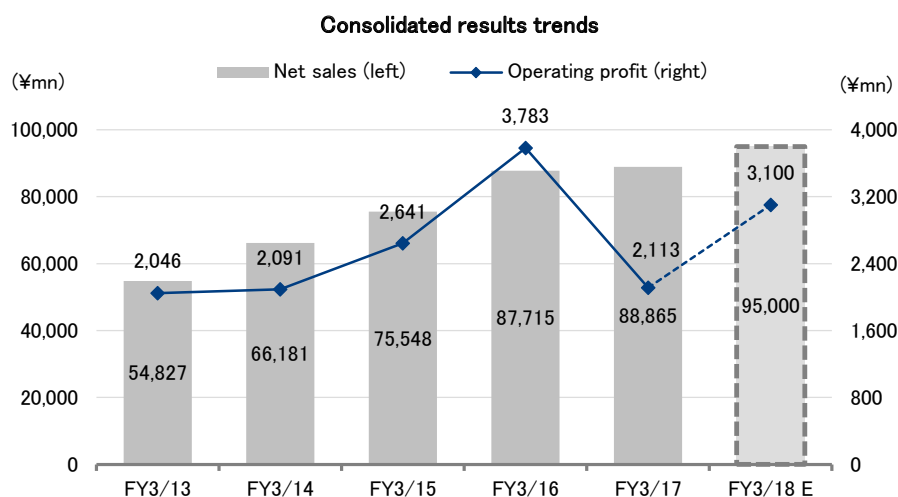
Summary

3. The outlook is for the improvements in the stability of earnings and in growth to continue from the expansion of the pharmaceutical network business

The management environment in the dispensing pharmacy industry is expected to become even more severe due to the revisions to the medical treatment fees in April 2018, but this will actually be advantageous for the pharmaceutical network business. This is because currently, there are around 58,000 pharmacies in Japan, the majority of which are the Company's target customers of small-to- medium sized pharmacies or those managed by individuals, and the severe management environment they are facing is expected to accelerate the increase in member numbers. This business is a stock-type business that is highly profitable and stable. It provides slightly more than 40% of total consolidated operating profit, but sooner or later it is expected to provide more than 50% from the increase in member numbers. The expansion of the pharmaceutical network business will lead not only to medium-to-long term earnings growth, it will also improve the stability of earnings. The Company implemented a restructuring and integration of its subsidiaries in October 2017 in order to construct an optimal Group organizational structure for future growth. Specifically, it conducted an absorption merger of three subsidiaries, including PHARMAHOLDINGS Co., LTD., which supervised the dispensing pharmacy business, and it changed the Group organizational structure from the previous three-level structure to a two-level structure. The aims of this reorganization are to reduce costs by eliminating the duplication of functions between organizations, to strengthen Group governance, and to speed-up decision making, and its effects are expected to appear from FY3/19 onwards.

Key Points

- Operating profit is rapidly recovering from the increase in pharmaceutical network member numbers and the recovery of earnings in the dispensing pharmacy business
- In the pharmaceutical network business, the pace of the increase in member numbers is accelerating, rising by 500 members a year
- Expecting boosts to profitability and growth potential from reorganization and steadily promoting home medical services



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

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

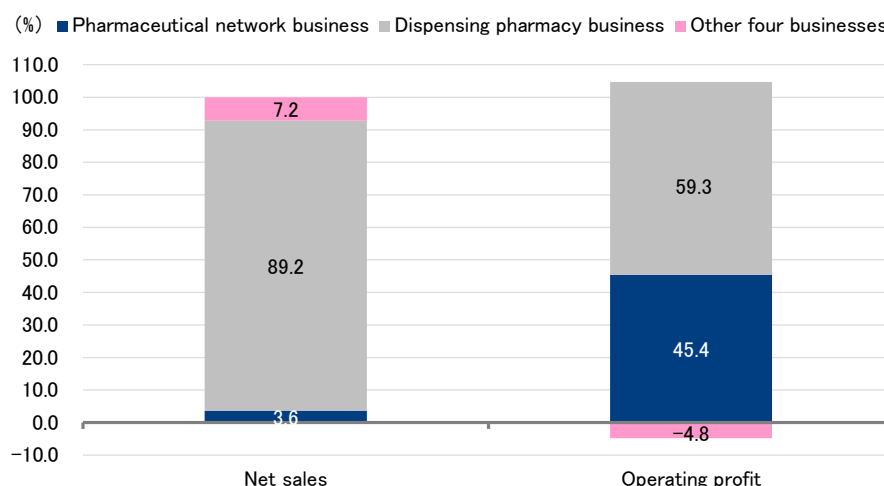
Business overview

The pharmaceutical network business and the dispensing pharmacy business are the two main businesses

The Company has two main businesses; the pharmaceutical network business and the dispensing pharmacy business. It also undertakes peripheral businesses through the Group companies, including a rental & medical facilities-related business, a catering business, and a home visit nursing business.

Looking at the breakdown by business segment, we see that in FY3/18 1H, the dispensing pharmacy business provided 89.2% of total net sales, while for operating profit, the dispensing pharmacy business provided 59.3%, and pharmaceutical network business 45.4%, making them the Company's two main businesses. An overview of each segment is as described below.

Contribution by business segment (FY3/18 1H)



Note: Before the offsetting of internal transactions. The other four businesses are the rental & medical facilities-related business, the catering business, the clinical trial facilities support business and the home visit nursing business.
Source: Prepared by FISCO from the Company's results briefing materials

1. Pharmaceutical network business

The business model for the pharmaceutical network business is that it supports the improvement of pharmaceutical distribution efficiency by acting as an intermediary in pharmaceutical sales between dispensing pharmacies, medical facilities and pharmaceutical wholesalers. Customers are mainly small, medium-sized or self-run dispensing pharmacies.

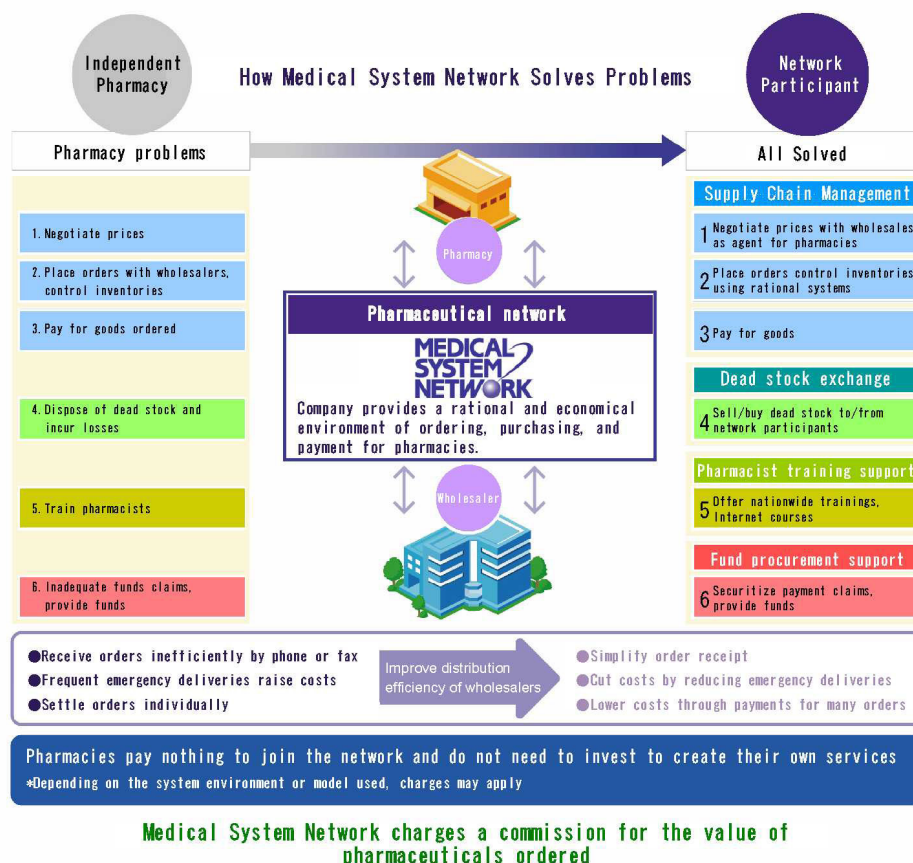
The services the Company provides in the pharmaceutical network business are a supply chain management service, in which it negotiates prices with wholesalers as an agent, orders as an agent, and acts as an agent for account functions, and furthermore it provides a dead stock exchange service (immobile stock liquidation), which allows member pharmacies to exchange dead stock at each of their pharmacies. The Company also provides support for pharmacist training and for fund raising.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Business overview

Outline of pharmaceutical supply (network) business



Source: Company materials

By becoming a member of the network, dispensing pharmacies are able to conduct price negotiations with pharmaceutical wholesalers on more favorable terms than if they did so alone. In addition, they can enjoy a number of other operational benefits, such as reducing pharmaceutical disposal losses and simplifying ordering-related work. The benefits of becoming a network member are particularly large for small- to medium-sized dispensing pharmacies.

Also, in its other businesses, the Company conducts development, sales and maintenance operations for the receipt computer systems, O/E systems (pharmaceutical ordering system) and peripheral equipment that it installs in dispensing pharmacies, as well as sales of prescription dispensing equipment, fixtures and fitting.

As of the end of September 2017, the total number of member pharmacies in the network, including those in the Group and external members, was 2,012 (including 38 hospitals and clinics) and the number is continuing to increase. The only three prefectures in which the Company does not have a presence are Tottori, Tokushima, and Kochi (in Tokushima one pharmacy became a member in November 2017), and it is aiming to have a presence in them and reach 5,000 members as soon as possible. Ordering fees, which arise corresponding to the order volumes, and system sales represent the majority of the sales of this segment, and revenue from ordering fees has become a major source of earnings. Therefore, it can be described as a stock business model in which sales rise stably in line with the increase in the number of member pharmacies.

Medical System Network Co., Ltd. | 15-Dec.-2017
4350 Tokyo Stock Exchange First Section | <http://www.msnw.co.jp/ir/>

Business overview

Breakdown of member stores in the pharmaceutical network business

						(pharmacies)
By member type	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18 2Q	Change from FY3/17
General member	842	855	1,047	1,393	1,628	235
MSN Group	321	345	353	377	384	7
Total	1,163	1,200	1,400	1,770	2,012	242

By area	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18 2Q	Change from FY3/17
Hokkaido	216	207	221	228	237	9
Tohoku	91	93	99	112	142	30
Kanto/Koshinetsu	298	362	425	535	580	45
Tokai/Hokuriku	160	182	227	348	408	60
Kinki	187	131	147	201	242	41
Chugoku/Shikoku	87	84	86	75	94	19
Kyushu/Okinawa	124	141	195	271	309	38
Total	1,163	1,200	1,400	1,770	2,012	242

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

2. Dispensing pharmacy business

This business develops dispensing pharmacies in each area mainly under the Nanohana Pharmacy brand, and it is expanding its number of pharmacies while actively utilizing M&As. As of the end of September 2017, the Company had 384 dispensing pharmacies, making it one of the market leaders. By area, it has the most pharmacies in Hokkaido at 120, making it the industry leader for the most pharmacies in the area, followed by Kanto/Koshinetsu at 85, Kinki at 59 and Tokai/Hokuriku each at 53. In addition to pharmacies, the Company operates eight drugstores and one healthcare center.

Further, its subsidiary, Hokkaido Institute for Pharmacy Benefit Co., Ltd., provides training services to pharmacists and operational staff at both Group and non-Group dispensing pharmacies.

3. Rental & medical facilities-related business

This business mainly develops sites for building pharmacies, as well as renting buildings and providing other leasing and insurance services. Further, at the same time as offering consulting services for medical practices, it also provides consulting for medical malls that gather multiple medical disciplines on the same floor, and for medical buildings that gather various medical clinics in the same building, and also management of housing for the elderly with support services.

As serviced senior living facilities, the Company operates Wisteria Kiyota and Wisteria N17 in Sapporo (Hokkaido), Wisteria Otaru Inaho in Otaru (Hokkaido), and Wisteria Senri Chuo in Toyonaka (Osaka). It also plans to open Wisteria Minami Ichijo (provisional name) in Sapporo in November 2018. These facilities are generally profitable at an occupancy rate of 90% or more and reach 90% in about three years.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Business overview

Rental & medical facilities-related business – Building areas with integrated medical and care services

■ Development style combining serviced senior living facilities with dispensing pharmacies, hospitals, care business, and day-care sites

 **Wisteria Minami Ichijo** (provisional name)

Building "comprehensive support capabilities" for local residents from all generations, including medical entities and day-care sites, in areas central to Hokkaido's medical coverage with excellent transportation access

[Address] 14-291-81, others, Minami Ichijo Nishi, Chuo-ku, Sapporo, Hokkaido
[Land area] About 3,100m²
[Property outline] 106 units
In a building with 12 above-ground floors and one basement floor, serviced senior housing on floors 5-11
Single-room to 2LDK units that range from 21.24 to 60.39m²
[Rent] Undecided



 **Wisteria Senri Chuo**

Emergency hospital and integrated facilities that creates a multi-functional safety net in areas with urban convenience and a living environment with lush nature

30 units occupied as of November 2, 2017

[Address] 1-1-7-3 Shin-Senri Nishimachi, Toyonaka, Osaka Prefecture
[Land area] About 5,950m²
[Property outline] 82 units
14 floors above ground and one floor underground, serviced senior residences on floors 10-14
Single-room to 1LDK (19.02-51.17m²)
[Rent] Starting at ¥137,000 (management, living services and food fees not included)



 **Wisteria Otaru Inaho**

[Address] 1-4-2 Inaho, Otaru, Hokkaido
[Land area] About 1,870m²
[Property outline] 81 units, 10 floors above ground

93 % occupancy rate as of September 30, 2017



 **Wisteria Kiyota**

[Address] 1-1-15 Shinei Ichijo, Kiyota-ku, Sapporo, Hokkaido
[Land area] About 3,000m²
[Property outline] 75 units, 7 floors above ground, one floor underground

91 % occupancy rate as of September 30, 2017



 **Wisteria N17**

[Address] 3-2-1 Kita 17-jo Nishi, Kita-ku, Sapporo, Hokkaido
[Land area] About 1,750m²
[Property outline] 64 units, 10 floors above ground, one floor underground

94 % occupancy rate as of September 30, 2017



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

4. Catering business

Total Medical Service, which was made into a subsidiary in November 2013, its subsidiary Sakura Foods, and Kyushu Iryo Shoku, which was made into a subsidiary in October 2015, carry out catering outsourcing operations within hospitals and welfare facilities.

5. Other businesses

Other businesses include home visit nursing business operated by Home-Visit Nursing Care Station Himawari Co., Ltd., which was made into a subsidiary in May 2016. Home visit nursing is a service in which home visit nursing stations dispatch nurses and other staff to the living environments of recuperating patients for provision of nursing care, assistance in achieving independence, and support in recuperative living. For the community-based integrated care system advocated by the national government, nursing stations occupy a central role in provision of high-quality medical and care services by collaborating with pharmacists, nutritionists, doctors, care managers, and other professionals. The Company added home visit nursing business to its group as a way of bolstering home medical services in the dispensing pharmacy business. The service is currently available in parts of Tokyo (Nerima Ward, Nishi-Tokyo City) and Saitama (Wako, and Niiza cities), and it aims to expand this business nationwide by working with group pharmacies.

SMO-MDS Co., Ltd., which was a subsidiary that was previously included in other businesses and that provided clinical trial facilities support, was sold by the Company in June 2017 through a transfer of all shares to EP-SOGO Co., Ltd., which is a major company in the same industry. Therefore, it has been removed from the scope of consolidation. In the last few years, this subsidiary continued to record a loss in a range of ¥100mn to ¥150mn a year, and the Company decided to sell this business based on its policy of concentrating its management resources into its core businesses. The effects on the consolidated results of this sale of shares will be negligible, but it will improve the profitability of the other businesses segment.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends

Operating profit is rapidly recovering from the increase in pharmaceutical network member numbers and the recovery of earnings in the dispensing pharmacy business

1. Summary of the FY3/18 1H results

In FY3/18 1H consolidated results, the Company reported higher earnings on increased sales for the first time in two years with ¥46,552mn in net sales (+7.3%), ¥1,271mn in operating profit (+131.5%), ¥1,272mn in recurring profit (+134.6%), and ¥363mn in net profit attributable to owners of parent (+447.2%).

The pharmaceutical network business is steadily expanding from the increase in member numbers. In the dispensing pharmacy business also, the progress being made in responding to the revisions to medical treatment fees at the existing pharmacies is a factor behind the higher sales and profits. In addition, profitability is improving in the rental & medical facilities-related business, the catering business, and the other businesses, which is contributing to the higher profits. Compared to the initial Company forecasts, net sales and operating profit exceeded their forecasts by 2.3% and 15.6%, respectively. The main factors behind this were that in the pharmaceutical network business, member numbers are increasing at a pace above forecast, while in the dispensing pharmacy business, the prescription unit price was higher than expected.

FY3/18 1H consolidated results

	FY3/17 1H		Company forecast	FY3/18 1H			
	Results	% of net sales		Results	% of net sales	YoY	Vs. forecast
Net sales	43,401	-	45,500	46,552	-	7.3%	2.3%
Cost of sales	26,943	62.1%	-	28,443	61.1%	5.6%	-
SG&A expenses	15,908	36.7%	-	16,837	36.2%	5.8%	-
Operating profit	549	1.3%	1,100	1,271	2.7%	131.5%	15.6%
Recurring profit	542	1.2%	1,050	1,272	2.7%	134.6%	21.2%
Net profit attributable to owners of parent	66	0.2%	-	363	0.8%	447.2%	-

*In the initial forecasts, net profit was not determined.

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

Factors behind the changes to operating profit (FY3/18 1H, YoY)

Category	Change	Category	Change
Dispensing pharmacy business	513	Pharmaceutical network business	95
(breakdown of change in operating profit)		Rental & medical facilities-related business	12
Existing pharmacies	635	Catering business	137
Pharmacies opened FY3/17-18	- 39	Other businesses	27
M&A FY3/17-18	92	Group expenses (adjustments)	- 64
Pharmacies closed, etc.	- 47		
Headquarters' expenses	- 127	Total	722

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

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends

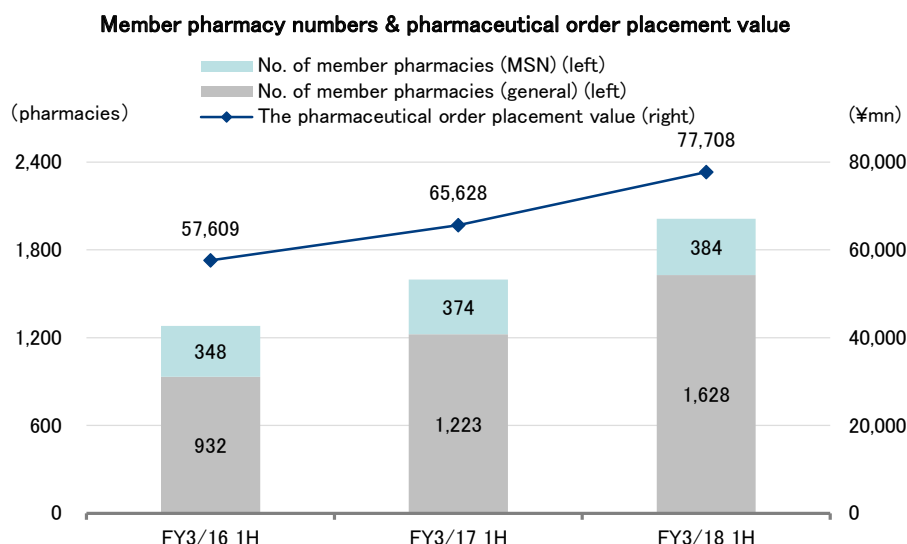
Profits increased or the loss decreased YoY in all business segments

2. Earnings by business segment

(1) Pharmaceutical network business

In the pharmaceutical network business, net sales increased 6.9% YoY to ¥1,728mn and operating profit rose 11.4% to ¥934mn. At the end of September 2017, network member numbers had grown by 415 on the end of the previous fiscal year to 2,012 members, while ordering fee income rose by double digits, up 11.6% to ¥1,072mn, which were the main reasons for the higher sales and profits.

The pharmaceutical order placement value increased 18.4% YoY to ¥77,708mn, while the average fee rate (ordering fee income ÷ the pharmaceutical order placement value) fell by 0.08 of a percentage point, from 1.46% to 1.38%. The fee rate varies by customer size, and it seems that the increase in recent years of the number of comparatively large-sized customers that manage 10 to 20 pharmacies is a factor causing the fee rate to decline. In the future also, it is forecast that this moderate downward trend in the fee rate will continue alongside the rise in the number of this type of customer.

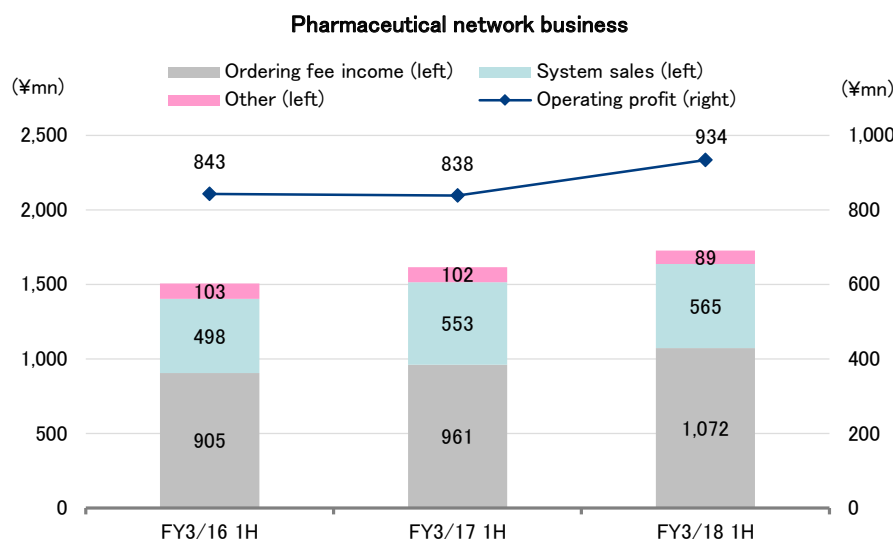


Source: Prepared by FISCO from the Company's Data Book and results briefing materials

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends



Source: Prepared by FISCO from the Data Book

The point to focus on in the current 1H is the acceleration in the pace of the increase in new member numbers. Looking at the change in numbers on a biannual basis, it is considered that in the background to the first time that the increase reached over 200 pharmacies was the worsening of the management environment for dispensing pharmacies due to the revisions to medical treatment fees in April 2016. In the 2016 revisions to medical treatment fees, pharmacies were positioned as one of the functions of the community-based integrated care system, and they were required to strengthen their functions as family pharmacies. Therefore, the management environment became more severe for medium-, small-, and micro-sized pharmacies, so the number of such businesses that joined the Company's network, from which they could expect to realize cost reductions, started to increase.

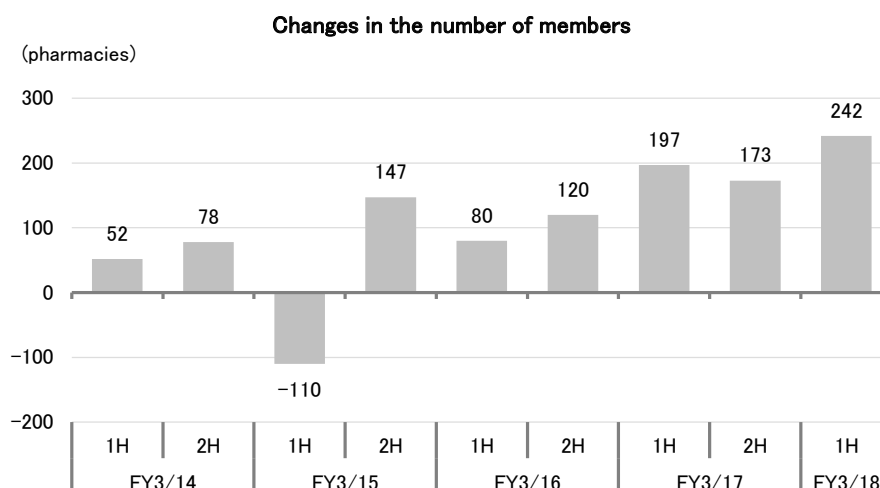
Of course, the effects are also appearing of the measures the Company has been implementing to acquire new customers. Specifically, these include strengthening collaborations with external partner companies and working to improve the name recognition of its services. Within these measures, it received a great response for the seminars it held for the first time for dispensing pharmacies (in Tokyo and Osaka), and it has decided to hold them regularly in the future. The contents of the seminars include on improving the efficiency of pharmacy management and measures to respond to the revisions to medical treatment fees, and the level of interest in topics such as on the direction being taken by the government for its medical administration and management expertise is extremely high among medium- and small-size businesses. It is also clear that their need of wanting to participate in the seminars to share information with others is strong. Therefore, the Company will hold the seminars regularly in the future and it is considered that they will play a hook role for the acquisition of new customers.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends

The effects are also starting to appear from other measures, such as strengthening collaborations with pharmaceutical wholesale companies and pharmacist associations. At first glance, there appears to be a conflict of interests between the Company and pharmaceutical wholesale companies. But in the last few years, wholesale companies have also decided that it is more efficient to consolidate sales negotiations in order to reduce logistics costs, so they are collaborating with the Company, depending on the region. During the current 1H, there was an increase in introductions from these pharmaceutical wholesalers and from pharmacist associations. Another feature is that introductions from existing member pharmacies have also started to increase. This can be said to be evidence of the high level of satisfaction in the Company's service, and in the current 1H, approximately 30% of new members were from introductions by existing member pharmacies. If these word-of-mouth introductions spread, it will reduce the costs to acquire new customers and accelerate the speed that the usage of the service expands. So this business, in which the high level of growth is continuing, can be said to have entered a stage of a virtuous circle.

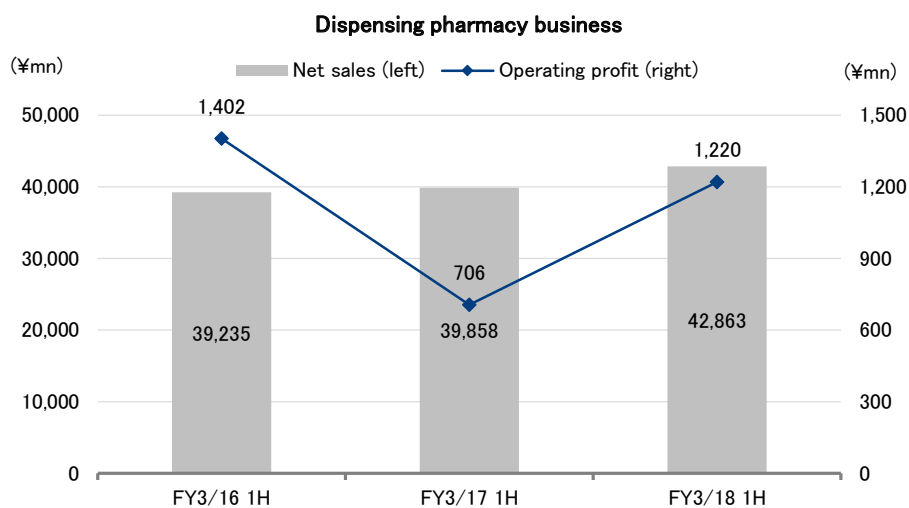


Source: Prepared by FISCO from the Company's results briefing materials

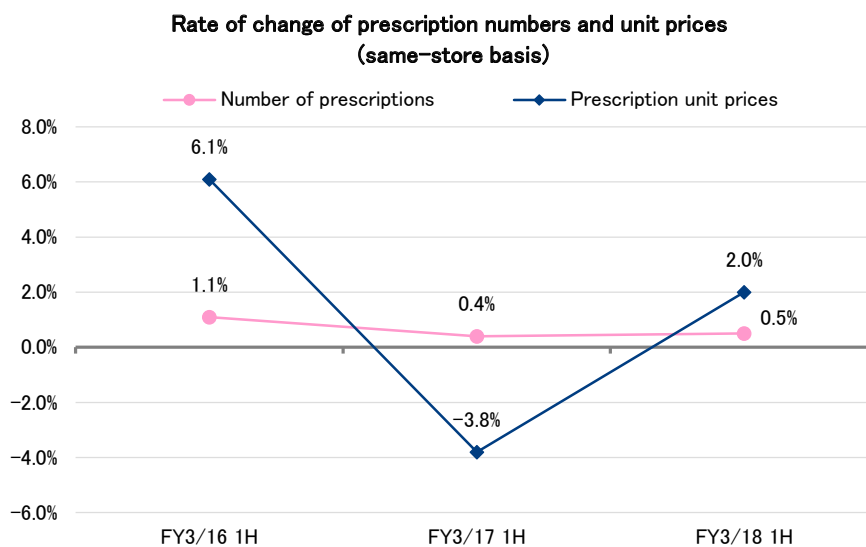
(2) Dispensing pharmacy business

In the dispensing pharmacy business, net sales increased 7.5% YoY to ¥42,863mn and operating profit rose 72.7% to ¥1,220mn. The number of pharmacies increased by 7 on the end of the previous fiscal year to 384 pharmacies. This increase was the total of the 6 newly opened pharmacies and the 5 pharmacies acquired through M&A and business transfers, minus the 4 pharmacies that were closed or were lost due to business transfers. The acquisition prices for M&A remain high and progress has been slow, but despite this, sales and profits still increased due to the measures to respond to the revisions to medical treatment fees and the improvement in earnings at existing pharmacies.

Results trends



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

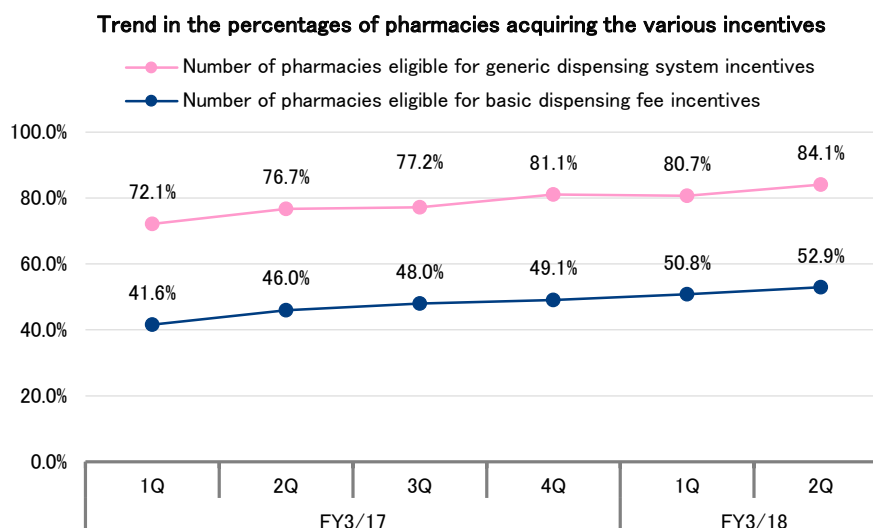


Source: Prepared by FISCO from the Company's results briefing materials

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends



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

Looking at the breakdown in net sales, drug fees increased 5.1% YoY to ¥30,271mn, technical fees rose 8.4% to ¥9,454mn, and sales of over-the counter (OTC) drugs and other items climbed 33.7% to ¥3,137mn. Sales of OTC drugs and other items grew greatly, but this was due to the growth in inbound demand and online sales, and their impact on profits is small.

Looking at the breakdown of existing pharmacies' dispensing fees, the number of prescriptions increased 0.5% YoY and the prescription unit price rose 2.0% (of which, drug fees were up 1.6% and technical fees were up 3.2%), for a total increase in sales of 2.6%. The prescription unit price greatly declined in the previous fiscal year, by 3.8%, due to the effects of the revisions to the medical treatment fees, and this was a factor behind the lower earnings. But subsequently, earnings grew as the Company worked to increase the number of pharmacies that receive the generic pharmaceutical dispensing system incentives and the basic dispensing fee incentives. A round of sales of the hepatitis C drug, which was released in the fall of 2015, came to an end, and this caused a decline in sales of approximately ¥800mn in the current 1H.

(3) Rental & medical facilities-related business

In the rental & medical facilities-related business, net sales increased 9.8% YoY to ¥1,086mn and the operating loss was ¥73mn (compared to a loss of ¥85mn in the same period in the previous fiscal year). Sales grew as real estate rental income trended steadily. In profits also, even though personnel costs rose to strengthen the personnel structure, the loss was reduced from the effects of the higher sales.

In housing for the elderly with support services, within the current four properties, Wisteria N17 and Wisteria Kiyota are already profitable. Also, the occupancy rate at Wisteria Otaru Inaho is 93%, which means that it has already cleared the profit-loss break-even point, but it recorded a loss for the period due to heavy depreciation costs. However, it is expected to become profitable from FY3/19. Also, the number of occupants in Wisteria Senri Chuo, which was opened in May 2016, increased by 7 on the end of the previous fiscal year to 27. But as before, the occupancy rate remains low at 33%, and the rate of progress toward achieving the target of 50 occupants by the end of March 2018 is somewhat behind schedule. The Company's policy is to increase the occupancy rate in accordance with demand, including by renovating two units into one unit. As of November 2, 2017, 30 units had contracted occupants.

We encourage readers to review our complete legal statement on "Disclaimer" page.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends

(4) Catering business

In the catering business, net sales decreased 0.7% YoY to ¥2,298mn and operating profit was ¥34mn (compared to a loss of ¥102mn in the same period in the previous fiscal year). Although sales declined slightly due to the reviews of unprofitable deals, the business still became profitable due to the reviews of the contract unit prices and the progress made in optimizing the costs of ingredients.

(5) Other businesses

In other businesses, net sales declined 31.5% YoY to ¥53mn and the operating loss was ¥58mn (compared to a loss of ¥86mn in the same period in the previous fiscal year). Sales fell following the sale of the clinical trial facilities support business, but in profits, the amount of the loss was reduced. In Home-Visit Nursing Care Station Himawari, although results in existing stations improved up to the profit-loss break-even line, it recorded a loss from the costs of launching new stations. In home visit nursing services, collaborations with the Company Group's dispensing pharmacies have begun. Demand is robust but it is proving difficult to recruit nurses, which will be a management issue in the future.

The strategy is to prepare to invest from having an abundance of cash on hand in a situation of ultra-low interest rates.

3. Financial position and management indicators

Looking at the financial position at the end of FY3/18 1H, total assets were up ¥6,670mn on the end of the previous fiscal year to ¥57,408mn. Breaking down the main factors, in current assets, cash and deposits increased ¥5,303mn, while in fixed assets, tangible fixed assets rose ¥1,404mn, mainly from construction and related costs for Wisteria Minami Ichijo (provisional name. Scheduled to open in November 2018, total investment cost of approximately ¥5.5bn), which is a new property in housing for the elderly with support services.

Total liabilities were up ¥7,553mn on the end of the previous fiscal year to ¥47,646mn. This was mainly due to increases in interest-bearing debt of ¥6,560mn and accrued income taxes of ¥320mn. Net assets were down ¥883mn on the end of the previous fiscal year to ¥9,761mn, because while net profit attributable to owners of parent of ¥363mn was recorded, there were expenditures of ¥149mn for the payment of dividends and of ¥1,201mn to acquire additional shares of PHARMAHOLDINGS.

Looking at the management indicators, due to the increase in interest-bearing debt, the equity ratio fell from 20.1% at the end of the previous fiscal year to 17.0%, while the interest-bearing debt ratio rose from 212.5% to 289.2%. The current accumulation of interest-bearing debt is to supplement the construction costs of Wisteria Minami Ichijo, and also, in the context of the continuing ultra-low interest rates, because the Company has decided it is preferable to have an abundance of cash on hand in order to be able to respond to sudden investment opportunities. Interest payments are at the level of slightly more than ¥200mn a year, which is not judged to be a problem when considering its current level of operating profit.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Results trends

Consolidated balance sheet

	FY3/15	FY3/16	FY3/17	FY3/18 1H	Change
(¥mn)					
Current assets	11,023	10,783	11,098	16,153	5,055
(Cash & deposits)	2,499	2,081	2,252	7,556	5,303
Fixed assets	34,564	38,063	39,639	41,254	1,615
(Goodwill)	13,214	12,916	13,184	13,367	183
Total assets	45,587	48,847	50,737	57,408	6,670
Total liabilities	39,451	38,581	40,092	47,646	7,553
(Interest-bearing debt)	22,743	19,562	21,725	28,285	6,560
Net assets	6,135	10,265	10,644	9,761	-883
Key management indicators					
(Stability)					
Equity ratio	12.7%	20.3%	20.1%	17.0%	
Interest-bearing debt ratio	391.3%	197.3%	212.5%	289.2%	
(Profitability)					
ROA (return on assets)	5.7%	8.2%	4.2%		
ROE (return on equity)	16.2%	21.9%	5.7%		
Operating profit margin	3.5%	4.3%	2.4%		

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

Business outlook

Expects a rebound to double-digit profit growth in FY3/18 led by the two main businesses

1. Forecast for FY3/18

The forecasts for the FY3/18 consolidated results are for net sales to increase 6.9% YoY to ¥95,000mn, operating profit to rise 46.7% to ¥3,100mn, recurring profit to increase 42.2% to ¥3,000mn, and net profit attributable to owners of parent to increase 74.9% to ¥1,000mn, for the first increase in profits in two fiscal years. The 1H results were slightly above the forecasts, but the Company has left the initial full fiscal year forecasts unchanged. This is because the results forecasts are weighted more to the 2H. Looking by business segment, apart from the rental & medical facilities-related business that was below forecast, each segment is basically trending steadily in line with or above the forecasts. In particular, member numbers in the pharmaceutical network are increasing at a pace above the forecast, and at FISCO, we think that, depending on conditions in the near future, we can expect the results to exceed the forecasts.

FY3/18 consolidated earnings forecast

	FY3/17	FY3/18			
	Full-year results	1H results	YoY	Full-year forecast	YoY
(¥mn)					
Net sales	88,865	46,552	7.3%	95,000	6.9%
Operating profit	2,113	1,271	131.5%	3,100	46.7%
(Operating profit margin)	2.4%	2.7%	-	3.3%	-
Recurring profit	2,109	1,272	134.6%	3,000	42.2%
Net profit attributable to owners of parent	571	363	447.2%	1,000	74.9%
Net income per share (¥)	19.31	12.28	-	33.77	-

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

We encourage readers to review our complete legal statement on "Disclaimer" page.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Business outlook

Outlook by segment

	FY3/17		FY3/18		(¥mn)
	Full-year results	1H results	Full-year forecast	YoY	
Net sales					
Pharmaceutical network business	3,237	1,728	3,397	5.0%	
Dispensing pharmacy business	81,650	42,863	87,539	7.2%	
Other four businesses	6,878	3,437	6,923	0.7%	
Adjustments	-2,900	-1,478	-2,860	-	
Total	88,865	46,552	95,000	6.9%	
Operating profit					
Pharmaceutical network business	1,718	934	1,839	7.0%	
Dispensing pharmacy business	2,314	1,220	2,943	27.2%	
Other four businesses	-436	-97	-254	-	
Adjustments	-1,482	-785	-1,428	-	
Total	2,113	1,271	3,100	46.7%	
The number of member pharmacies in the pharmaceutical network business	1,770	2,012	2,200	24.3%	
The number of pharmacies	377	384	407	8.0%	

Note: The other four businesses are the rental & medical facilities-related business, the catering business, the clinical trial facilities support business and the home visit nursing business.

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

Accelerating increase pace in member stores to 500/year for the pharmaceutical network business

2. Outlook by segment

(1) Pharmaceutical network business

In the pharmaceutical network business, the initial forecasts are for net sales to increase 5.0% YoY to ¥3,397mn and operating profit to rise 7.0% to ¥1,839mn. But the rate of progress up to 2Q was above the forecasts, so it is highly possible that the full fiscal year results will exceed their respective forecasts. A precondition for the forecasts was that the number of network members would increase by 430 on the end of the previous fiscal year to 2,200 members. But member numbers had already reached 2,139 by November 6, 2017, so it looks like it will achieve this precondition of 2,200 members within 2017, and an increase of more than 500 members for the fiscal year is in sight.

The Company is implementing a review of its sales structure (constructing a team structure by area) in order to increase member numbers in 2H also. Its policy is to steadily increase introductions from existing member pharmacies. In terms of its target at the present time, it would seem to be aiming to reach 5,000 member pharmacies, which is about 10% of the approximately 58,000 pharmacies that there are currently in Japan. If the current pace of increase accelerates, it can achieve this in around 3 or 4 years' time. Also, if it can acquire shares of around 10% of the pharmacies within each area, to a certain extent it will acquire an influential voice when negotiating prices with pharmaceutical wholesalers, and as a result, the value of its network service will also rise. Looking by prefecture, it already has shares of more than 10% in Hokkaido, Fukui Prefecture, Mie Prefecture, and Kagoshima Prefecture. In particular, in Kagoshima Prefecture, where it does not have a single one of its own pharmacies, it has acquired a share of more than 14%. Word-of mouth introductions from local pharmacist associations and existing member pharmacies are spreading, which seems to be also expanding the usage of the service.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Business outlook

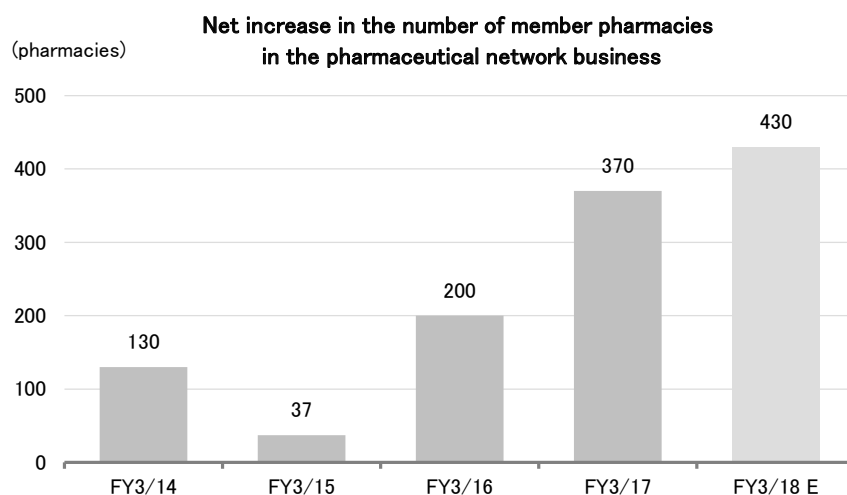
The relationships with pharmaceutical wholesale companies in each region are an important element, and in Kochi Prefecture and other regions in which it currently has no members, the situation is that it has been struggling to acquire members over many years. But as previously mentioned, due to the rise in logistics costs, it is a fact that the management environment has become more severe for wholesale companies also, and going forward, it is fully possible that the Company will expand its cooperative relationships with them in various regions. The management environment is forecast to become even more severe for dispensing pharmacies due to the revisions to medical treatment fees scheduled for April 2018. The three choices for a pharmacy's management to survive in the future are to join the group of a major company, to become a member of the Company's network service, or to go it alone. Whichever the case, as the number of potential customers is enormous for the Company, at FISCO we think that the pace of increase in member numbers may accelerate in the future.

Share of member numbers by prefecture

Hokkaido	10.1%	Saitama	4.3%	Gifu	1.5%	Tottori	-	Saga	4.1%
Aomori	5.4%	Chiba	3.3%	Shizuoka	8.8%	Shimane	1.2%	Nagasaki	2.6%
Iwate	1.7%	Tokyo	2.1%	Aichi	2.5%	Okayama	1.9%	Kumamoto	5.3%
Miyagi	3.0%	Kanagawa	4.1%	Mie	13.5%	Hiroshima	3.1%	Oita	0.2%
Akita	6.0%	Niigata	0.2%	Shiga	3.1%	Yamaguchi	1.1%	Miyazaki	3.0%
Yamagata	3.5%	Toyama	0.2%	Kyoto	2.1%	Tokushima	-	Kagoshima	14.3%
Fukushima	1.5%	Ishikawa	1.4%	Osaka	2.7%	Kagawa	1.5%	Okinawa	1.4%
Ibaraki	1.1%	Fukui	11.9%	Hyogo	2.8%	Ehime	1.2%		
Tochigi	2.3%	Yamanashi	0.9%	Nara	2.5%	Kochi	-		
Gunma	2.5%	Nagano	2.4%	Wakayama	1.6%	Fukuoka	2.4%		

Note: share is calculated as the number of members at the end of September 2017 ÷ the number of pharmacies in the relevant prefecture at the end of March 2017

Source: the total number of pharmacies is from the Report on Public Health Administration and Services by the Ministry of Health, Labour and Welfare



Note: Net increase is small in FY3/15 because of the exit of a large customer with 230 pharmacies.

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

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

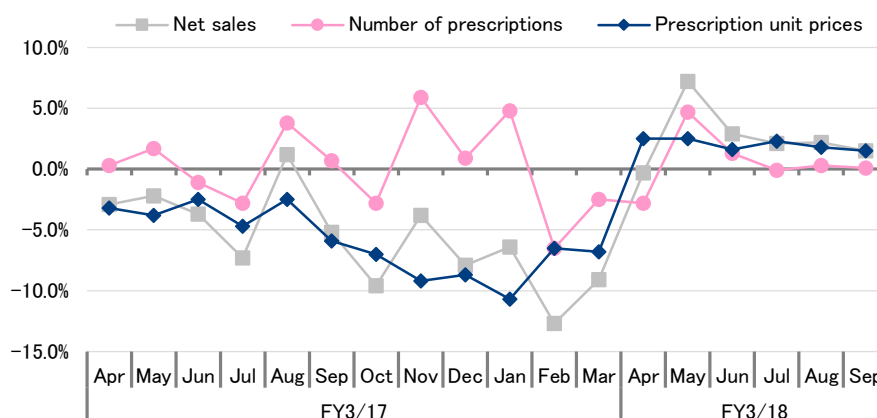
Business outlook

(2) Dispensing pharmacy business

In the dispensing pharmacy business, the initial forecasts are for net sales to increase 7.2% YoY to ¥87,539mn and operating profit to rise 27.2% to ¥2,943mn. As the precondition, the number of pharmacies is forecast to increase by 30 on the end of the previous fiscal year (10 newly opened pharmacies and 20 pharmacies acquired through M&A), for a total of 407 pharmacies. In terms of the progress made for this, it had 384 pharmacies at the end of September, which is a little behind schedule. The reason for this is that although there are M&A candidates, the acquisition prices are higher than the price the Company wants to pay in order to recoup its investment in a period of around 10 years. Therefore, it is possible that the number of pharmacies will be less than the forecast. But in 2H, it will continue to work to raise the prescription unit price and to increase the number of prescriptions by supplementing the pharmacies' functions as family pharmacies, so it is considered that it will still achieve the forecasts.

In terms of some specific examples of measures at family pharmacies, they include counseling on nutrition by nutritionists, expanding the lineup of products such as OTC drugs and health foods, and regularly holding yoga and other exercise programs. The number of customers and the number of prescriptions are increasing through these measures. It is also strengthening its measures for home medical services. Approximately 70% of pharmacists in the Company Group have experience of providing home medical services, which is the leading level within the industry, and moreover it is working to make this 100% in the future. The measures to strengthen home medical services will be a negative factor for earnings, as they lower the number of prescriptions received per pharmacist, but they can be seen as being able to cover for basic dispensing incentives and other incentives. Currently, within the conditions to acquire the basic dispensing incentives, a judgment standard is whether or not there is a track record of performing home deliveries on the unit of single pharmacies, and it is possible that this judgment will be made on the unit of single pharmacists in the future. This is because within the construction of the community-based integrated care system that is being advanced within the medical care administration, the importance of home healthcare is rising, and at the same time, the structure for the provision of home medical services by pharmacists must also be strengthened. The Company is responding to the changing market environment by going ahead of its industry peers and strengthening its home medical services. Also, the strengthening of these services will ultimately contribute to increases in the number of regular customers and the number of prescriptions.

Trends (YoY) in existing pharmacies' net sales, the number of prescriptions, and the unit price



Source: Prepared by FISCO from the Data Book

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Business outlook

(3) Other four businesses

For the other four businesses (rental & medical facilities-related, catering, clinical trial facilities support, and home visit nursing), the FY3/18 plan targets ¥6,923mn in net sales (+0.7% YoY) and a narrower ¥254mn operating loss (vs. a ¥436mn loss in FY3/17).

Within these businesses, in the rental & medical facilities-related business, the number of occupancy contracts for Wisteria Senri Chuo was below forecast, and the Company is considering renovating some of the units in 2H. So it is possible that the results will be slightly below the initial forecasts (net sales to increase 7.1% YoY to ¥2,191mn and an operating loss of ¥74mn (a loss of ¥143mn in the previous fiscal year)).

On the other hand, in the catering business, the outlook is that the results will exceed the initial forecasts (net sales to decrease 4.0% YoY to ¥4,479mn and an operating loss of ¥46mn (a loss of ¥129mn in the previous fiscal year)). This business was profitable up to 2Q, and if there are no factors causing profits to decrease in the near future, such as sudden rises in the prices of ingredients, it is expected to achieve operating profit for the full fiscal year. In the home visit nursing business also, it is forecast that while existing stations will be profitable for the full fiscal year, it will record a slight loss due to the costs of launching new stations.

Group reorganization and home medical service initiatives

Expecting boosts to profitability and growth potential from reorganization and steadily promoting home medical services

1. Group reorganization

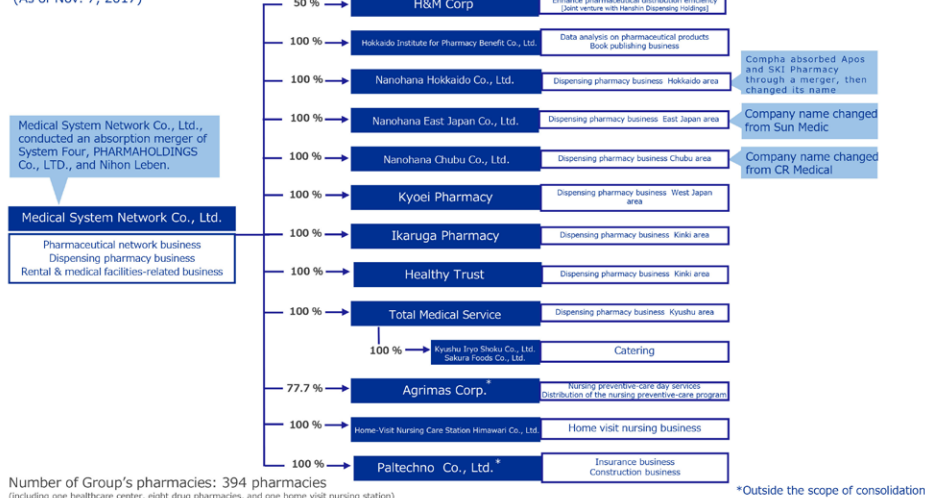
The Company implemented a review of the Group's organizational structure in October 2017, and it conducted an absorption merger of three subsidiaries, including PHARMAHOLDINGS Co., LTD., which supervised the dispensing pharmacy business, and also System Four and Nihon Leben. In the dispensing pharmacy business, this reorganization has created a two-level management structure, directly under which are placed the subsidiaries in each area. The aims of this reorganization are to improve the Group's profitability and growth potential by reducing costs through eliminating the duplication of functions between organizations, strengthening Group governance, and speeding-up decision making.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Group reorganization and home medical service initiatives

Organization chart
(As of Nov. 7, 2017)



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

In addition, in the dispensing pharmacy business, in Hokkaido three companies were merged into one to form Nanohana Hokkaido Co., Ltd. Company names were changed to Nanohana East Japan Co., Ltd., in the East Japan area, and Nanohana Chubu Co., Ltd., in the Chubu area. With regards to the Kyoei Pharmacy Co., Ltd., which has jurisdiction over the West Japan area, and Total Medical Service Co., Ltd., which has jurisdiction over the Kyushu area, the Company decided to keep the current company names for the time being, due to them having strong brands in their respective regions.

The effects on the results of the recent reorganization will be neutral for FY3/18. This is because the effects of the reduction of indirect business costs will be about the same as the expenses incurred to change the company names. In fact, in terms of earnings, its effects will be realized from FY3/19 onwards. Those personnel who have become surplus due to the integration of operations will be redeployed to other departments.

2. Initiatives in the home medical service

In terms of the measures for home medical services, the Company is providing in some regions the "prescription drugs home delivery service" and the "shopping support service" from its collaboration with JAPAN POST Co., Ltd. that it announced in May 2016.

Five Nanohana Pharmacy stores in Sapporo and Nagoya have been offering home delivery of transfusion packs and nutrients for home patients who received usage guidance in the prescription drugs home delivery service. The initial plan was to start a sequential, nationwide business deployment during FY17, but at the present time its policy is to deploy this business cautiously. That said, if the use of remote medical services spread as a result of the government's deregulation measures, pharmacists may be allowed to provide medication guidance remotely. If medication guidance can be provided remotely, demand for home delivery services may increase, and it can be said that the Company is currently at the stage of preparing a structure in advance of the launch of this market in the future.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Group reorganization and home medical service initiatives

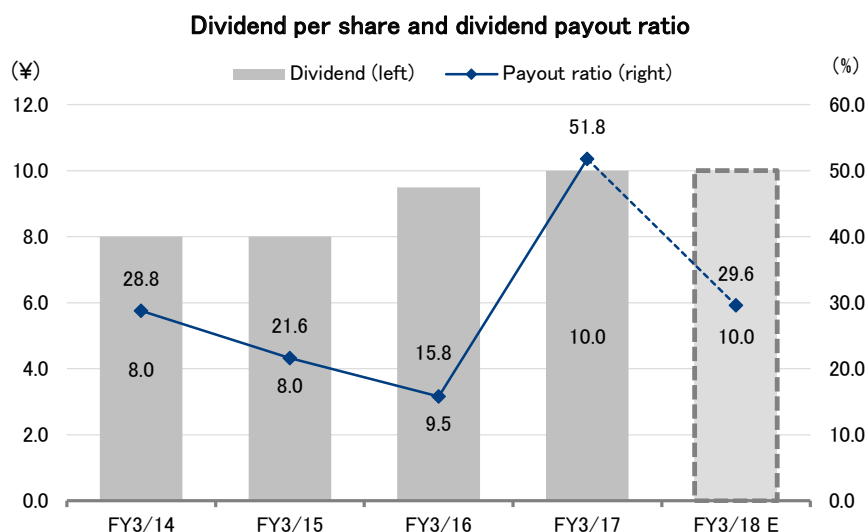
On the other hand, since October 2016, the Company has been providing the “shopping support service” in Otaru and Nagoya, with the product limited to adult diapers (this is a product jointly developed with JAPAN POST and whose manufacturing is outsourced to Nippon Paper Crecia Co., Ltd.). Customers are mainly nursing and hospital facilities where a certain volume of sales can be expected, and results are steadily expanding. Initially, the forecast for this service was that sales for facilities nationwide would be launched sequentially during FY17, but the Company has presently changed to a policy of deploying this business cautiously. It is considered that first it will establish an earnings model and then provide services nationwide. It seems that in the future, the Company would like to expand the products it provides, such as to daily necessities and health foods, but this will also depend on the intentions of JAPAN POST, its business partner.

Demand for home delivery service is likely to grow amid increases in patients living at home and people requiring care with the arrival of an ultra-aged society. In fact, the market for the home delivery of box lunches to the elderly and to carers is expanding. In the dispensing pharmacy industry, the Company is progressing measures for such home delivery services in advance of its industry peers, and if it can establish this business, it can be expected to improve its competitiveness and profitability in the dispensing pharmacy business in the medium-to-long term.

Shareholder return policy

Pays dividends with a dividend payout ratio goal of at least 20%

The Company’s policy is to return profits to shareholders by way of dividends. Its basic policy is to pay stable dividends that reflect results after securing sufficient internal reserves to strengthen its financial position and to expand operations, with the standard considered to be maintaining a dividend payout ratio of 20% or above. For FY3/18, the Company plans to leave the dividend unchanged at ¥10.00 (for a dividend payout ratio of 29.6%). Dividend growth can be expected in the future if profits increase and as a result, the dividend payout ratio falls below this 20% level.



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

We encourage readers to review our complete legal statement on “Disclaimer” page.

Medical System Network Co., Ltd.
4350 Tokyo Stock Exchange First Section

15-Dec.-2017
<http://www.msnw.co.jp/ir/>

Information security measures

In the Company, the Risk Management Office creates a list that describes the risks that the Company needs to respond to, and it constantly follows-up on the status of and the progress made in these responses. The specific measures to deal with the risk of cyber-attacks include installing anti-virus and anti-malware software, using a UTM (Unified Threat Management) service, and using a service to detect and delete malicious emails. It prevents intrusions by cyber-attacks through installing the software into each individual terminal and using a service that detects and prevents suspicious behaviors at the entrances and exits to the Internet and email.

Disclaimer

FISCO Ltd. (the terms “FISCO”, “we”, mean FISCO Ltd.) has legal agreements with the Tokyo Stock Exchange, the Osaka Exchange, and Nikkei Inc. as to the usage of stock price and index information. The trademark and value of the “JASDAQ INDEX” are the intellectual properties of the Tokyo Stock Exchange, and therefore all rights to them belong to the Tokyo Stock Exchange.

This report is based on information that we believe to be reliable, but we do not confirm or guarantee its accuracy, timeliness, or completeness, or the value of the securities issued by companies cited in this report. Regardless of purpose, investors should decide how to use this report and take full responsibility for such use. We shall not be liable for any result of its use. We provide this report solely for the purpose of information, not to induce investment or any other action.

This report was prepared at the request of its subject company using information provided by the company in interviews, but the entire content of the report, including suppositions and conclusions, is the result of our analysis. The content of this report is based on information that was current at the time the report was produced, but this information and the content of this report are subject to change without prior notice.

All intellectual property rights to this report, including copyrights to its text and data, are held exclusively by FISCO. Any alteration or processing of the report or duplications of the report, without the express written consent of FISCO, is strictly prohibited. Any transmission, reproduction, distribution or transfer of the report or its duplications is also strictly prohibited.

The final selection of investments and determination of appropriate prices for investment transactions are decisions for the recipients of this report.

FISCO Ltd.