COMPANY RESEARCH AND ANALYSIS REPORT

Qol Holdings Co., Ltd.

3034

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FISCO Ltd. Analyst
Hiroyuki Asakawa

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Possible major turning point for the industry/Qol Holdings from the 2019 revised Pharmaceuticals and Medical Devices (PMD) Act, targeting medium- to long-term growth with the "one-on-one pharmacy" approach as an advantage

Qol Holdings Co., Ltd. (Qol) <3034> is a major dispensing pharmacy chain positioned at No.2 in dispensing pharmacy store quantity and No.3 in sales (using data from listed companies). Qol's strategy in Pharmacy Business adopts a two-pronged approach of "one-on-one pharmacies" and "new-format pharmacies" developed through alliances with companies from other industries. In the fields other than pharmacy business, the Company advanced into pharmaceuticals manufacturing and sales business in 2019 in addition to BPO business.

1. Healthy growth in two businesses drove higher sales and operating income in FY3/20 1H

The Company reported higher sales and profits in FY3/20 1H at ¥81,249mn in net sales (up 17.7% YoY) and ¥3,432mn in operating income (up 11.8%). Pharmacy Business benefitted from steady gains in the number of prescriptions and average price and upbeat expansion of store volume thanks to a major M&A deal. BPO Business supported by continuation of the MR outsourcing trend, all-time high CMR volume, and a steep YoY rise in the number of dispatched pharmacists in placements and dispatching services business. These trends fueled healthy 1H results that enabled upward revisions versus period-start guidance.

2. Medium- to long-term growth strategy unchanged, community medical cooperation pharmacy format in the revised PMD Act offers a good fit with the "one-on-one pharmacy" approach

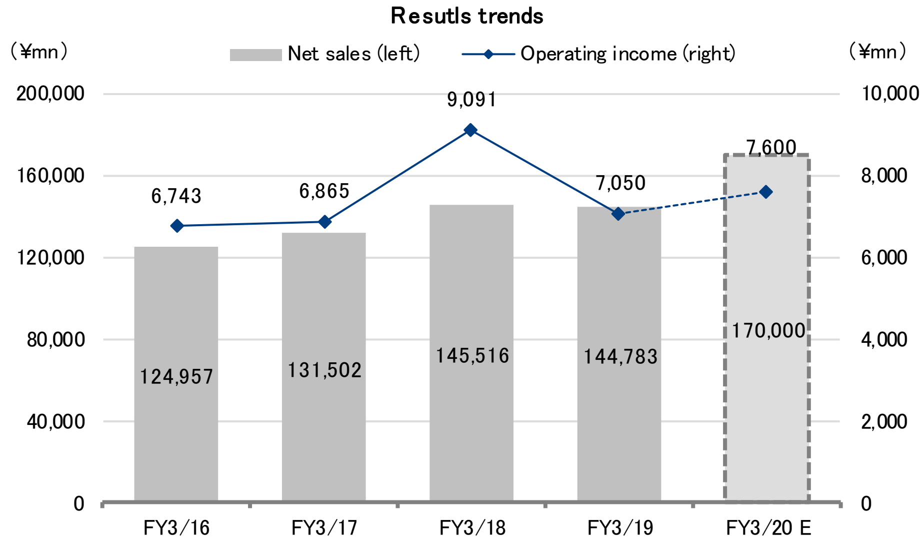
The Company has retained its existing medium- to long-term growth strategy without revisions. In Pharmacy Business, it is pursuing a two-pronged strategy of scale expansion with strategic store openings and value creation at existing locations. Revisions of the Pharmaceuticals and Medical Devices (PMD) Act in 2019 that separate pharmacies into two certified pharmacy formats and non-certified pharmacies might force changes in the Company's growth strategy and trigger significant acceleration of industry reorganization. While the Company promotes store rollout based on a one-on-one pharmacy concept as the core business model for dispensing pharmacies, these pharmacies fit well with the community medical cooperation pharmacy format (type of certified pharmacy), and we think this provides an advantage. In BPO Business, increase in CMR dispatching demand is structural and the Company aims to build operations that reliably obtain this demand and achieve sustainable growth over the longer term. The Company took its first step in pharmaceutical manufacturing business with the acquisition of Fujinaga Pharm Co., Ltd. in August 2019. We are waiting for additional measures toward realization of medium-term goals.

3. No major surprises likely in FY3/20 results, focus on progress in system responses

The Company raised FY3/20 guidance with new targets of ¥170,000mn in net sales (up 17.4% YoY) and ¥7,600mn in operating income (up 7.8%). We expect the business environment in 2H to remain almost the same as in 1H and continuation of healthy expansion. Nevertheless, we are cautious about anticipating further upward revision of results along the lines of FY3/18 because of tough content in revised dispensing fees from April 2018 and difficult hurdles to restoring dispensing technical fees. We intend to focus on initiatives to deal with changes in the business environment in light of the 2019 revised PMD Act in 2H due to the prospect of continued stable results conditions without surprises.

Key Points

- Aims for net sales of ¥300bn and operating income of ¥25.0bn over the medium term with three main businesses including pharmaceuticals manufacturing and sales business
- Intends to proactively acquire certification as community medical coordination pharmacies that have a high affinity for one-on-one pharmacies
- Initiated the pharmaceuticals manufacturing and sales business while the 2nd and the 3rd measures are awaited to achieve goals of medium- to long-term growth strategy



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

Company profile

Established in 1992. Under a holding company structure, the Company is currently developing two businesses, Pharmacy Business and BPO Business, and advancing into pharmaceuticals manufacturing and sales business as a new business

1. History

Chairman Masaru Nakamura founded Qol Co., Ltd. in 1992. Qol Co., Ltd. steadily expanded its dispensing pharmacy network after opening the first location in Nihombashi Kabutocho in 1993. In addition to opening its own stories, the Company has been expanding its dispensing pharmacy network through aggressive M&A and it also moved into related and peripheral areas, including SMO (site management organization) business with the founding of PhaseOn Co., Ltd. in 2003, as well as worker placements and dispatching services business in 2008.

Subsequently, the Company arranged its businesses into two business segments, Pharmacy Business and BPO Business, and thereby aimed to improve management efficiency and expand its business. Moreover, the Company transitioned to a purely holding company structure on October 1, 2018. Following this, the Company changed its corporate name to Qol Holdings Co., Ltd., and it is leading the Group as a whole toward enhancing corporate governance and achieving the medium- to long-term growth strategy.

The Company announced entry into pharmaceutical manufacturing and sales business as a new business and its current business consists of existing Pharmacy Business and BPO Business.

The two business segments are the responsibilities of the respective core business companies. Alongside the transition to a holding company structure, Qol Co., Ltd., was newly established and it inherited Pharmacy Business from the Company. Qol manages over 800 dispensing pharmacies, together with a dispensing pharmacies subsidiary acquired in the past through an M&A (a subsidiary of a subsidiary from the perspective of the Company). Also, APO PLUS STATION Co., Ltd., which is responsible for BPO Business, is the same as before the transition to the holding company structure.

Business segment income composition in FY3/19 was Pharmacy Business at 92% and BPO Business at 8% in net sales and 82% and 18% respectively in operating income.

The Company acquired Fujinaga Pharm as a subsidiary in August 2019 for the pharmaceutical manufacturing and sales business and effectively started this business in FY3/20 2H. In this segment, the corporate entity might expand further through acquisitions and other measures (details will be described later).

Pursuing a two-pronged approach of “one-on-one pharmacies” and “new-format pharmacies” (through alliances with companies from other industries)

2. Pharmacy Business

(1) Business scale and positioning in the industry

The specific content of Pharmacy Business segment is operation of dispensing pharmacies and shop sales in hospitals. Looking at FY3/20 1H results, dispensing pharmacies were at 781 stores out of 802 total stores (about 97%) in end-1H store volume, and prescription net sales (dispensing net sales) provided ¥69,588mn of ¥75,660mn in segment net sales (about 92%).

The Company is ranked second in store volume and third in sales in Japan’s dispensing pharmacy industry. The Company operates 802 dispensing pharmacies (781 in total including 21 shops) at the end of FY3/20 2Q, putting it second after listed pharmacy chain AIN HOLDINGS <9627>. In sales, it ranks third in the industry among listed companies after AIN HOLDINGS and NIHON CHOUZAI <3341>. NIHON CHOUZAI CO., LTD. beats the Company in sales as its sales per pharmacy are higher than the industry average, whereas the Company’s sales per pharmacy are about the industry average. The gap in their sales per pharmacy originates from their different pharmacy strategies.

(2) Pharmacy development strategy

A feature of the Company's business strategy in Pharmacy Business is that it conducts it through two formats that are largely different in type. The first type is the "one-on-one pharmacies", and the second type is "new-format pharmacies" through business alliances with different industries such as the group companies of major convenience store operator Lawson, Inc. <2651>, the West Japan Railway Company (JR-West) <9021> Group, and others.

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

In its one-on-one pharmacies, the Company is aiming to utilize cooperation with medical institutions to realize efficient and low-cost operations, and to invest the results of this into improving services for patients. More specifically, it is aiming to open these pharmacies by adjusting physical designs and functions in accordance with factors such as the departments of target medical institutions (mainly self-run clinics and smaller hospitals) and local characteristics. The funds for this are generated from the pharmacies' low-cost structures, including more efficient drug inventories, which is one of the benefits of one-on-one management. Based on the concept of one-on-one pharmacies, the Company positions its opening of pharmacies that have high-use value for patients and that are therefore selected by patients as the core of its pharmacy strategy. In addition, the concept of one-on-one pharmacies, which essentially entails cooperation with medical institutions, can be said to be in line with the Japanese Government's Vision of Pharmacies for Patients, which is also an important point for the growth strategy.

The catalyst for Qol's pursuit of new-format pharmacies through alliances with companies from other industries, which is also another type of industry, was a reform in the Revised Pharmaceuticals Affair Law from June 2009 that lets convenience stores, drugstores, supermarkets, and other industry stores sell OTC drugs as registered businesses. Qol responded to subsequent efforts by companies from other industries to start dispensing pharmacy businesses by arranging business alliances with the two above-mentioned companies. It also entered into business alliances with BIC CAMERA INC. <3048> and others.

Qol views stores opened through the alliances as a "new format" because its target customer is different from that of "one-on-one pharmacies" as described previously. "One-on-one pharmacies" have somewhat restricted customer scope that enables Qol to improve efficiencies in drug inventory management. New-format pharmacies, meanwhile, target unspecified large number of customers in locations with heavy people flow, so-called foot-traffic type pharmacies. While these sites require larger inventory investments and other outlays than the "one-on-one pharmacies," they are likely to attract more customers (and thus receive more prescriptions). We think Qol views "one-on-one pharmacies" as its core model and aims to accelerate growth with the new format.

Overall image of the pharmacy strategy

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

Source: Prepared by FISCO from Company materials and interviews

Developing four businesses in BPO Business, including the core CSO business that dispatch CMRs, and CRO business

3. BPO Business

BPO stands for Business Process Outsourcing (continuous outsourcing of some business processes to external specialist companies). BPO Business segment basically handles business consignments from other companies. Its four main areas are CSO business, placements and dispatching services business, CRO business, and publishing related business.

(1) CSO business

CSO stands for Contract Sales Organization, and its specific business content is dispatching medical representatives (MR). APO PLUS STATION runs this business and hires MRs and dispatches them to pharmaceutical companies that have contracts.

Pharmaceutical companies traditionally hired MRs as full-time employees, and MRs conducted sales activities to doctors and medical entities for drugs manufactured and sold by the subject companies. However, a major industry trend is outsourcing MR tasks with the aim of lowering fixed costs and using external MRs on a contract basis to the extent necessary at the required time (such as new drug releases). These MRs are known as CMRs (contract MRs) to differentiate from full-time employee MRs at pharmaceutical companies. APO PLUS STAION MRs come under this category.

The CSO business has an overwhelmingly large weight and is positioned as the core business. It seems that the combined net sales of the CSO business and placements and dispatching services business, which as described below is mainly for medical personnel, provide around 90% of net sales in BPO Business segment. Therefore, when looking at BPO Business, it can be said that the important points to look at are the CSO industry's business environment and the labor demand-and-supply trends for medical personnel.

(2) Placements and dispatching services business

Placements and dispatching services business, as the name indicates, handles placement and dispatching of medical professionals. While the Company mainly dispatches pharmacists to pursue synergies with Pharmacy Business, its core business, it stands out by dispatching nurses and public health nurses, registered salespeople, registered dieticians, and other medical personnel as well. Another characteristic is that it does not dispatch doctors.

As for pharmacists who constitute the core of this business, we estimate that the Company ranks in the industry's top ten in dispatching them. We think high name recognition as the operator of a domestic leading dispensing pharmacy chain contributes to this business.

The Company's dispatching services business continue to grow rapidly amid constant shortages of manpower in the medical industry, and along with CRO business, placements and dispatching services business is positioned for further growth in BPO Business. The focus is placement and dispatching of pharmacists. We think the 2019 revised PMD Act is likely to affect the approach to dispensing pharmacies and pharmacists and intend to closely monitor how it impacts placements and dispatching services business and how the Company responds to changes and whether it is capable of leveraging them as income opportunities and thereby sustaining strong growth.

(3) CRO business

CRO is an abbreviation of Contract Research Organization. The CRO business provides total solutions from testing and clinical research plans to publications in ethical drug, OTC drug, food, and healthcare fields. The most typical format is total support for some clinical tests based on a consignment from pharmaceutical companies.

(4) Publishing related business

The publishing related business is conducted by the subsidiary, Medical Qol Co., Ltd. It mainly involves the outsourced production of drug sales promotion materials, pamphlets used by medical personnel and patients, books, magazines, and other materials. The Group possesses extensive knowledge in this field and distribution channels both with medical institutions and patients through Pharmacy Business and the CSO and CRO businesses, and this business leverages these resources. In recent years, in line with the trend of digitization, it has established an in-house studio for customers and is also developing a support business for customers' Web delivery.

Business trends

Healthy growth in Pharmacy Business and BPO Business, beat period-start targets

1. Overview of FY3/20 1H results

The Company reported FY3/20 1H results with higher sales and profits at ¥81,249mn in net sales (up 17.7% YoY), ¥3,432mn in operating income (up 11.8%), ¥3,616mn in ordinary income (up 14.0%), and ¥1,830mn in profit attributable to owners of parent (down 7.3%). Decline in profit attributable to owners of parent mainly occurred on backlash from booking ¥366mn in gain on sale of investment securities as extraordinary profit in the previous fiscal year.

Overview of FY3/20 1H results

(¥mn)

	FY3/19			FY3/20					
	1H Results	2H Results	Full year Results	1H Initial forecasts	1H Results	YoY	vs. forecast	Progress rate	Full year Initial forecasts
Net sales	69,025	75,758	144,783	72,100	81,249	17.7%	12.7%	50.8%	160,000
Gross profit	8,238	9,625	17,863	-	10,128	22.9%	-	-	-
SG&A expenses	5,169	5,643	10,812	-	6,695	29.5%	-	-	-
Operating income	3,069	3,981	7,050	3,200	3,432	11.8%	7.3%	45.8%	7,500
Operating margin	4.4%	5.3%	4.9%	4.4%	4.2%	-	-	-	4.7%
Ordinary income	3,171	4,037	7,208	3,200	3,616	14.0%	13.0%	48.2%	7,500
Profit attributable to owners of parent	1,975	1,933	3,908	1,700	1,830	-7.3%	7.6%	45.8%	4,000

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

The business environment at the start of FY3/20 was relatively calm because FY3/20 is a skip year for dispensing fee revisions that occur every two years. While the Company began with a cautious outlook, it announced upward revisions of 1H and full-year targets on October 21, 2019 in light of healthy progress in Pharmacy Business and BPO Business, as explained below. The 1H results were on track with updated guidance.

* The government revises dispensing fees and drug prices every two years as a principle. Since previous revisions took place in April 2018, the period from April 2019 through March 2020 is a skip year. Yet it is not a skip year in strict terms because of drug price revisions in October 2019 accompanying the consumption tax hike.

Net sales climbed sharply with a 17.7% (¥12,223mn) YoY increase on steady gains in the number of prescriptions and the prescription unit price, as expected, in Pharmacy Business (as explained below). The Company also lifted sales by acquiring two groups with 38 stores through M&A in 1H. BPO Business posted higher sales and profits too on upbeat growth in the core CSO business (CMR dispatching business).

Operating income rose 11.8% YoY (¥363mn). Growth seems relatively low compared to the gain in net sales, but mainly due to one-time costs that boosted SG&A expenses. Gross margin improved 0.6pts to 12.5% in 1H, versus 11.9% in the previous year, and gross profit increased by ¥1,890mn (22.9%). However, SG&A expenses expanded by ¥1,526mn (29.5%) because of system maintenance costs and M&A-related costs. Operating income hence only improved by ¥363mn and operating margin slipped 0.2ppt to 4.2% (vs. 4.4% a year earlier).

Non-operating income was stronger than in the previous year due to booking ¥139mn in insurance surrender profit and other items. Ordinary income hence increased 14.0% YoY (¥455mn), a larger gain in operating income.

Breakdown by business segments

(¥mn)

		FY3/19			FY3/20			FY3/20		
		1H	2H	Full year	1H	YoY	Change	Full year (Initial forecasts)	YoY growth rate	Change
Net sales	Pharmacy Business	63,751	70,397	134,148	75,660	18.7%	11,909	149,600	11.5%	15,452
	BPO Business	5,526	5,818	11,344	6,123	10.8%	597	12,500	10.2%	1,156
	Prior to adjustment	69,278	76,214	145,492	81,783	18.1%	12,505	162,100	11.4%	16,608
	Adjusted value	-252	-457	-709	-534	-	-282	-2,100	196.2%	-1,391
	Net sales total	69,025	75,758	144,783	81,249	17.7%	12,224	160,000	10.5%	15,217
Operating income	Pharmacy Business	2,850	3,499	6,349	3,309	16.1%	459	7,100	11.8%	751
	BPO Business	657	709	1,366	727	10.6%	70	1,650	20.8%	284
	Prior to adjustment	3,507	4,208	7,715	4,036	15.1%	529	8,750	13.4%	1,035
	Adjusted value	-438	-226	-664	-604	-	-166	-1,250	88.3%	-586
	Operating income total	3,069	3,981	7,050	3,432	11.8%	363	7,500	6.4%	450
Operating margin	Pharmacy Business	4.5%	5.0%	4.7%	4.4%	-	-	4.7%	-	-
	BPO Business	11.9%	12.2%	12.0%	11.9%	-	-	13.2%	-	-
	Company total	4.4%	5.3%	4.9%	4.2%	-	-	4.9%	-	-

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

The Company acquired Fujinaga Pharm in August 2019 as a wholly owned subsidiary related to pharmaceutical manufacturing and sales business that it is pursuing as a third major business area. This addition did not affect sales and profit in 1H due to only consolidating the balance sheet. We describe Fujinaga Pharm and pharmaceutical manufacturing and sales business in the section on the medium- to long-term growth strategy and its progress.

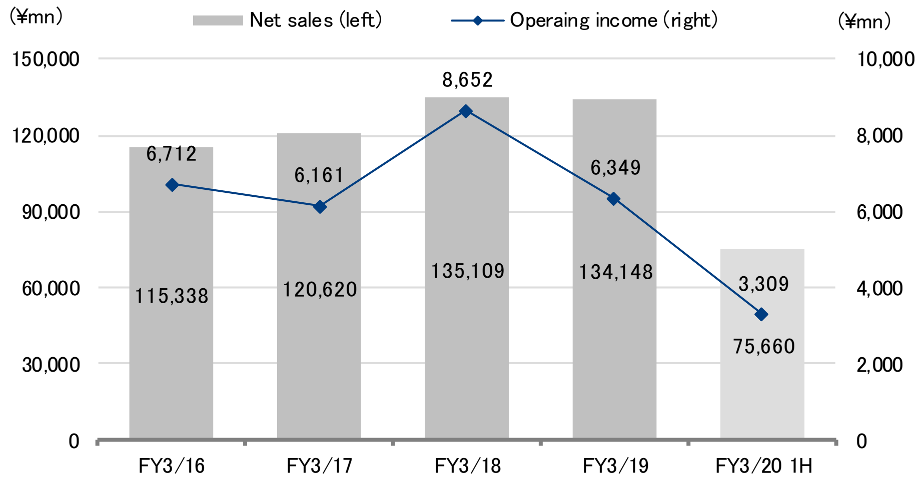
Steady increases in the number of prescriptions and the prescription unit price at existing pharmacies
Acquired attractive businesses with large effects in scale and regional deployment through M&A

2. Trends in Pharmacy Business

In Pharmacy Business in 1H, sales and profits increased, with net sales of ¥75,660mn (up 18.7% YoY) and operating income of ¥3,309mn (up 16.1%). Operating margin slightly decreased from 4.5% a year ago to 4.4%.

The Company switched to a holding company structure in October 2018 and changed business management fee allocation policy within the group. By adjusting the fee based on the same standard as the previous fiscal year puts 1H operating income at ¥3,813mn (up 33.8% YoY) and operating margin at 5.0%. Profitability has improved favorably on a real basis.

Results trends in Pharmacy Business segment



Source: Prepared by FISCO from the Company's financial results and FY3/20 1H results report

(1) Status of prescription net sales

Pharmacy Business net sales consist of both dispensing pharmacy and shop sales. While dispensing net sales technically reflect sales from prescriptions (below, referred to as prescription net sales for simplicity) and product sales, we think they are roughly equal to prescription net sales. In 1H, prescription net sales improved 19.9% (¥11,539mn) to ¥69,588mn (vs. ¥58,049mn in the previous year).

In the breakdown by opening period and operating format, the Company splits self-launched stores into existing pharmacies and newly opened pharmacies. Net sales made solid gain of 7.4% YoY in 1H for existing pharmacies, the more important category. Newly opened pharmacies made extremely high growth due to contribution of stores opened in the previous year from the beginning of this fiscal year and stores opened in 1H. In stores acquired through M&A and other deals, sales improved 25.8% (¥9,951mn) in 1H (though this is somewhat confusing because existing and new pharmacies are covered together).

Details of prescription net sales by the pharmacy opening period and format

(¥mn)

	FY3/19 1H			FY3/20 1H		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	19,102	-294	-1.5%	20,511	1,409	7.4%
Newly opened pharmacies	368	-357	-49.3%	546	178	48.3%
M&A, etc.	38,578	-1,889	-4.7%	48,529	9,951	25.8%
All stores	58,049	-2,541	-4.2%	69,588	11,539	19.9%

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

Dispensing net sales are the product of multiplying the number of prescriptions and the prescription unit price. In 1H, the number of prescriptions rose 13.4% YoY to 7,351,000 and the prescription unit price climbed 5.7% to ¥9,466. These are both healthy advances. We will examine look at these values in detail because they are affected by other factors such as the opening period, M&A, and others.

The number of prescriptions increased 13.4% on a total basis, but only 4.7% at existing pharmacies, which we think it is close to the actual situation. The growth rate is similar to the previous year's result and appears to have been on track with the period-start plan. Existing pharmacies include one-on-one pharmacies and new-format pharmacies and both showed stable growth.

Details of the number of prescriptions by the pharmacy opening period and format

(thousands)

	FY3/19 1H			FY3/20 1H		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	1,928	88	4.8%	2,019	91	4.7%
Newly opened pharmacies	43	-45	-50.9%	63	20	46.8%
M&A, etc.	4,509	45	1.0%	5,267	758	16.8%
Total	6,481	88	1.4%	7,351	869	13.4%

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

While the prescription unit price improved 5.7% YoY on a total basis, it only rose 2.5% for existing pharmacies which is close to the actual situation. Although the value itself seems low at first glance, it exceeded the Company's view.

Change in the prescription unit price largely stems from three factors. One is drug prices. This fundamentally refers to the downward trend due to drug price revisions. Another is the drug sales breakdown. A typical example is impact from change in prescription volume for high-priced drugs. The third is the dispensing technical fee. Dispensing fee revisions often lower fees, but it is possible to subsequently restore and raise fees through measures aimed at acquiring various point additions.

The Company expected a tough result in product mix in the period-start plan due to factoring in decline in high-priced drug prescriptions that raised the average price substantially in past years, but prescriptions did not actually drop as much as anticipated and emergence of new high-priced drugs supported the prescription unit price. Furthermore, in dispensing technical fees, the Company's efforts to acquire additional points, such as raising the volume percentage of generic drugs, paid off. These factors kept the average prescription prices at the above-mentioned level.

Details of the prescription unit price by the pharmacy opening period and format

(¥)

	FY3/19 1H			FY3/20 1H		
	Results	Change	Growth rate	Results	Change	Growth rate
Existing pharmacies	9,907	-634	-6.0%	10,157	250	2.5%
Newly opened pharmacies	8,463	270	3.3%	8,548	85	1.0%
M&A, etc.	8,555	-510	-5.6%	9,213	658	7.7%
Total	8,957	-521	-5.5%	9,466	510	5.7%

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

(2) Status of opening and closing of pharmacies and M&A

The Company had a net increase of 36 stores in FY3/20 1H with 46 new stores and 10 closures (including two new openings and two closures for shops). Breakdown of the 44 newly opened dispensing pharmacies was six self-launched sites and 38 acquired sites through M&A.

In store types, four of the six self-launched sites were typical (one-on-one) Qol pharmacies and two sites were new-format pharmacies in collaboration with West Japan Railway Group (acquired stores through M&A are placed under one-on-one pharmacies as a general rule).

Status of changes in pharmacies in FY3/20 1H

		End of FY3/19	Opened		Closed	End of FY3/20 1H
QOL pharmacies		698	Self-launched	4	7	733
			M&A, etc.	38		
New-format	Lawson	35		0	0	35
	Bic Camera	5		0	0	5
	JR-West	7		2	1	8
Shops		21		2	2	21
Total		766		46	10	802

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

The Company acquired two groups in 1H through M&A. Both groups have healthy businesses and retain customers with deep-rooted local strategies. Sales scale per store is relatively large. From perspective of region, the acquisitions of store networks in areas where its presence is relatively weak helped build a complementary relationship in light of the Company's heavy exposure to the Kanto area.

Natural Life Group, which the Company acquired as a subsidiary in April, operates a total of 28 stores with 19 sites in Ishikawa Prefecture and 9 sites in Saga Prefecture. Business is upbeat, and this group has potential to continue expansion of the store network even after joining the Company's group. The Hokuriku area, in particular, provides room for growth because of the low percentage of separation of medical and dispensing practices. As evidence of Natural Life's local presence and penetration rate, two of its stores successfully obtained Community-support-system Premium in the absence of basic dispensing fee 1. While dispensing companies have been trying to acquire this certification, the addition sets very difficult criteria and remains highly unusual nationwide. We think this is a good way of understanding the sales stance and store development approach of Natural Life.

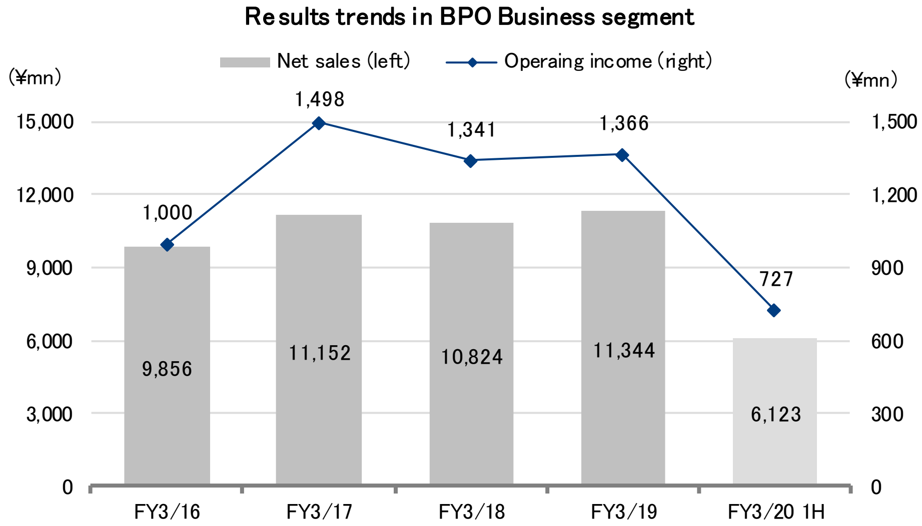
SERA MEDIC, which the Company acquired as a subsidiary in August, operates 10 stores mainly in eastern Osaka (one of the stores is located in Nara Prefecture). While the Company has focused on bolstering its store network in the Kinki region as one of the three major metropolitan areas along with Kanto and Chubu, it did not have much coverage in eastern Osaka previously. The acquisition of 10 stores hence has considerable significance.

Reached an all-time high in the number of CMRs in core CSO business and posted higher segment sales and profits

3. Trends in BPO Business

BPO Business in 1H reported higher sales and profits with ¥6,123mn in net sales (up 10.8% YoY) and ¥727mn in operating income (up 10.6%). On the other hand, operating margin was 11.9%, the same as a year ago.

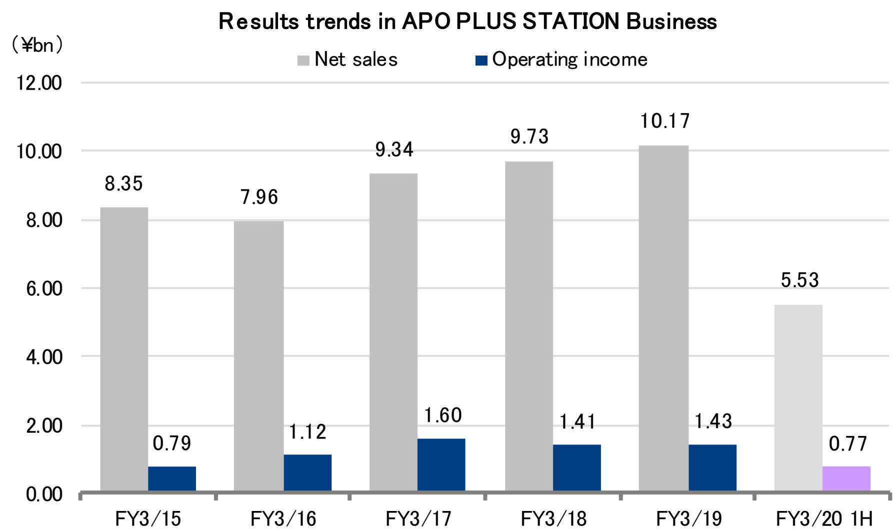
After adjusting for change in the business management fee allocation policy, operating income rose 18.6% YoY to ¥779mn, and operating margin improved to 12.7%.



Source: Prepared by FISCO from the Company's financial results and FY3/20 1H results report

APO PLUS STAION, the core entity in BPO Business, booked higher sales and profits YoY in 1H at ¥5.53bn in net sales and ¥770mn in operating income. In APO PLUS STAION's main business is CSO business, which dispatches CMRs, the number of CMRs increased to an all-time high of 570 CMRs in 1H. Key drivers of dispatching volume growth are the transitioning MRs from full-time employees to CMRs as a major trend among pharmaceutical companies and favorable assessment of specialty MRs (MR with a specialized field), a strategy promoted by the Company.

Placements and dispatching services business for medical personnel performed well too, particularly in placement and dispatching of pharmacists, occupational health nurses, and registered salespeople that are the Company's strengths. The Company is also focusing on recruitment measures, and this led to increase in dispatched staff entry volume and thus the number of dispatched people.



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

Medium- to long-term growth strategy and progress

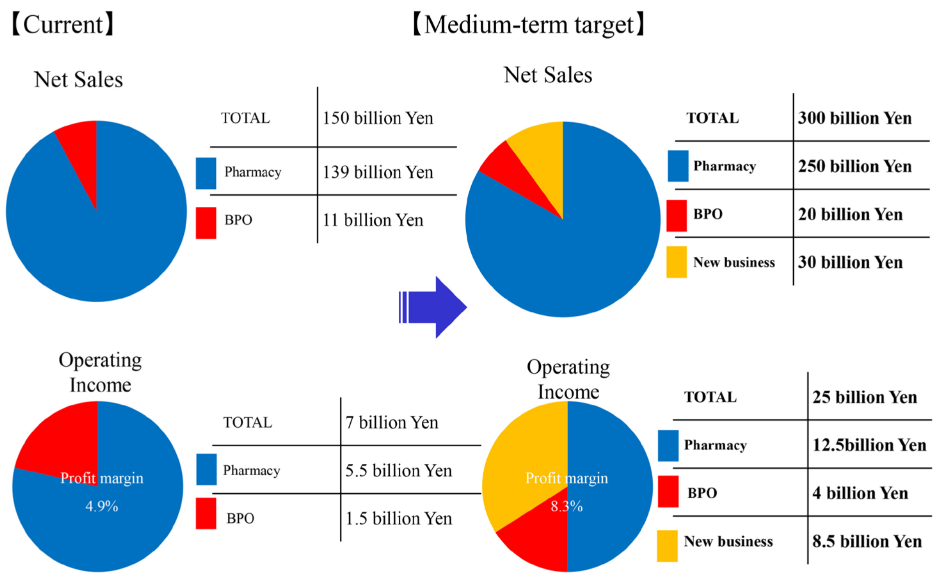
Fundamental growth strategy unchanged, targeting medium-term goals of ¥300bn in net sales and ¥25bn in operating income from the three businesses, including pharmaceutical manufacturing and sales business

1. Overview of the medium-term growth strategy

The Company's medium-term targets and growth strategy have always been consistent and therefore no changes have been made so far.

The Company is targeting ¥300bn in net sales and ¥25bn in operating income as medium-term numerical goals. Management indicated for some time its intension to establish business portfolio with three business segments – existing Pharmacy Business and BPO Business and new business. At the timing of our previous report (dated June 25, 2019), the Company disclosed pharmaceutical manufacturing and sales business is the new business. In August 2019, during 1H, it acquired Fujinaga Pharm as a subsidiary, making the first step for pharmaceutical manufacturing and sales business.

Medium-term targets and ideal business portfolio



Source: The Company's results briefing materials

In Pharmacy Business, the Company retained its two-pronged policy of (1) business scale expansion driven by strategic openings and (2) value creation at existing pharmacies. However, it might be necessary to revise the business plan (even though there would be no drastic change) due to recent business environment changes.

BPO Business, meanwhile, has much higher operating margin than Pharmacy Business. The Company aims to sustain high profitability while strategically pursuing expansion and growth of APO PLUS STAION business, which is the core business segment. Business conditions have been receiving a tailwind, particularly by the switch at pharmaceutical companies from full-time employee MRs to CMRs, and we expect this trend to continue over the medium term. The Company obviously needs to effectively leverage this trend, and we hope to see an accelerated growth pace through proactive measures that lead the trend by utilizing strengths as a top firm in the industry.

The Company's first step of acquiring Fujinaga Pharm as a subsidiary was a major advancement in the pharmaceutical manufacturing and sales business, a new business. However, this is not nearly enough to realize the medium-term goals of ¥30bn in net sales and ¥8.5bn in operating income. The Company needs to develop Fujinaga Pharm as a model case and establish a unique business model promptly with speed and scale and take measures to make further expansion of its business including M&A initiatives.

We will explain growth strategies of each business segments and progress.

Possibility of a major turning point with the 2019 revised PMD Act, pursue to receive certification of the "community medical cooperation pharmacy" that fits with the "one-on-one pharmacy" approach

2. Pharmacy Business growth strategy and progress

In the dispensing pharmacy business, the revision of PMD Act is currently underway headway and has the potential to influence growth strategies and competitive advantages of industry companies. We think the revisions have enough impact to be said as "PMD Act revisions in 2019 was the trigger of restructuring of the industry" in the future." We would like to confirm key points and impact of growth strategy and competitive advantages of the Company in below.

(1) Points of revised Pharmaceuticals and Medical Devices Act

The PMD Act revision proposal called for changes to pharmacist and pharmacy formats by clearly stating the aim of "enabling patients to confidently use drugs in the local area familiar to them," as the preliminary. Despite progress in separation of medical and dispensing practices (the prescription receipt ratio exceeded 70% in FY3/19 at 74.0%), it is understood that separation of medical and dispensing practices is not sufficiently addressing patient needs and anticipated effects and benefits of separation have not been realized.

Specific revisions in the law related to pharmacies and pharmacists are mainly – (1) introducing "community medical cooperation pharmacy" and "specialty medical entity collaborative pharmacy" formats as pharmacies with defined functions, (2) codifying a legal obligation for pharmacists to continuously confirm the state of drug usage and provide drug usage guidance, (3) introducing drug usage guidance over video conference and other means, and (4) establishing legal compliance rules for pharmacies. While all of these measures are important, rollout of two pharmacy formats with defined functions is particularly notable and has major implications for dispensing pharmacy business operators.

The Ministry of Health, Labor and Welfare (MHLW) formulated and disclosed a "Pharmacy vision for patients" in 2015 that referred to the "primary-care pharmacist and pharmacy" and "advanced pharmaceutical management function" as specific formats of functionality needed from pharmacies. The revised PMD Act realized the system. While official adoption of the two formats could be seen as just implementing an existing policy direction, we think it is likely to affect dispensing pharmacy business operators.

The first concern is that stratification (or disparity) might occur between pharmacies certified as one of the two formats (referred to as "certified pharmacies" below for convenience) and non-certified pharmacies (we expect the vast majority of pharmacies to be non-certified initially) and this might lead to large discrepancies in customer draw and sales. Since the purpose of introducing the two types is "enabling patients to select the pharmacy that suits their needs," the government might even conduct promotional activities on certified pharmacy characteristics and functions. If these activities reinforced preference for certified pharmacies among patients, significant disparity might appear depending on whether a pharmacy is certified or not. A typical case might be weeding out of hospital-adjacent pharmacies based on whether they are certified or not.

The second concern is the possibility of tougher hurdles for pharmacies to acquire certification than expected. The revised law stipulates definition of certification standards by an MHLW ordinance (prefecture governors grant actual certification in accordance with the standards). While details are still unclear, health support pharmacy and primary-care pharmacy formats presented in the "Pharmacy vision for patients" are likely to remain. If this is how it proceeds, it would be necessary to clarify the relationship with newly introduced certified pharmacies and differences in roles, advantages, and other aspects. If it appears as strict criteria, the burden for dispensing pharmacy businesses may increase and become obstacle to increase the number of certified pharmacies. As example, during discussion of revision of the law that "we may need to prevent a pharmacist to certify to have advanced pharmaceutical management function who has no work experience in hospital and no experience of serious side-effect conditions." This debate clearly suggests that pharmacists working at a certified pharmacy might need to have considerable experience, skill, and qualification.

There are other items to become hurdles in implementation of the revised law. Meanwhile, revisions might have a positive impact since introduction of drug usage guidance by video conference and other measures might create opportunities for income and improve business efficiency.

An important point from an investor perspective in light of latest revisions to the PMD Act is which type of pharmacy is likely to weaken first among the various types (such as major chain, smaller corporate, or self-managed, large or small physical size, hospital-adjacent pharmacies or those located to address a wider area, and dispensing pharmacy or drugstore). We previously expected declines to begin with self-run stores that have weaker resources. Looking at the MHLW's policy guidance in revisions to dispensing fees and results, we have changed our view that self-run pharmacies are not so weak in terms of survival.

In latest revisions to the PMD Act, we anticipate increase in the cost burden on individual stores to accommodate changes. While self-run pharmacies have a choice to abandon such efforts from the beginning, major chains and other companies at a certain size or more may need to make extra effort to meet the criteria (and become certified pharmacies) because of their "brand name." We think this could result in significant business risk. It resembles the current situation in the convenience store industry that is facing a major turning point. Operators that are not sufficiently differentiated in store development concept or from other companies could encounter challenges in trying to deal with changes in the system and environment, and might deplete their resources and be forced out of the market.

(2) The Company Group's response to revised Pharmaceuticals and Medical Devices Act

The Company (also other companies) has not announced its detailed policy and direct measures to respond to the revised PMD Act (introduction of certified pharmacies) due to the absence of an MLHW ordinance of the certification standards. However, the authority has already outlined the overall direction in the "Pharmacy vision for patients," and we expect store and organizational development in line with the vision to contribute to the Company's response to the revised PMD Act. The Company is moving in this direction.

A major point in formulation of detailed actions and measures is to decide one out of two certified pharmacy types as the main format. We believe the Company has a clear stance in this respect and is likely to seek "community medical cooperation pharmacy" certification. This view primarily takes into account strong affinity between the Company's "one-on-one pharmacy" concept and the "community medical cooperation pharmacy" format.

As explained in the company overview section, the one-on-one pharmacy approach relies on close collaboration between medical entities issuing prescriptions and Qol Pharmacy. While this is similar to hospital-adjacent pharmacies in terms of the one-on-one relationship with a medical entity, hospital-adjacent pharmacies typically cover a certain "hospital" versus one-on-one pharmacies that handle a certain clinic. While size (the number of prescriptions) is an obvious difference, the customer segment is an even large discrepancy. Patients from a variety of areas (or broader areas) come to hospitals. Clinics, however, have a narrower on potential patients than hospitals such as nearby residences and workplaces. This aspect naturally promotes closer collaboration among the medical entity issuing the prescription, the patient, and the Company (pharmacy). We think the Company's fundamental stance toward the revised PMD Act is utilizing this point as strength to obtain certification as a community medical cooperation pharmacy and thereby survive.

The Company has been actively promoting health support pharmacies highlighted in the "Pharmacy vision for patients" based on the same concept. Health support pharmacies possess core primary-care pharmacist and pharmacy functionality as well as capabilities to actively assist health retention and enhancement by local residents. Pharmacies with these features can promote themselves as a "health support pharmacy" after submitting a notification. The Company completed notifications for over 100 health support pharmacies as of end-November 2019, which is 12–13% of its total store volume. It plans to add even more by the end of FY3/20.

The Company's focus on health support pharmacies is aligned with its strategy of emphasis on acquiring "community medical cooperation pharmacy" certification in the certified pharmacy system. At FISCO, we think this is a rational policy. We also think the value of health support pharmacies will increase from a system standpoint too because the government is not satisfied with the low adoption ratio, in contrast to robust expectations for health support pharmacies. In addition, the health support pharmacy framework is likely to continue alongside of the certified pharmacy system. If it remains in place, the authority might utilize notification as a health support pharmacy as one of the criteria for a community medical cooperation pharmacy as a way of lifting the health support pharmacy adoption ratio. In this scenario, we expect the Company's measures to reinforce health support pharmacies to genuinely become a major source of differentiation and securing advantages.

Going further, pharmacist and pharmacy format revision is also important as a focal point of the revised PMD Act. While the changes established two types of certified pharmacies, we think the government's main aim is to expand local collaborative pharmacies. Specialty medical entity collaborative pharmacy might mainly target university hospitals and this could naturally limit the number of pharmacies in this category. In market potential, meanwhile, local collaborative pharmacies might be much larger. This supports a view that the Company holds an advantageous position since it already implements measures aimed at this segment.

(3) Approach and progress on "Expanding scale through strategic pharmacy openings"

Since we have explained store development, which could be called the core of the Company's growth strategy, in detail in our previous report (issued on June 25, 2019), so we will note its key essence in below.

On store volume, the Company asserts that volume pursuit is not a goal. This does not mean halting additions to store volume, but instead that the Company intends to put top priority on efficiency and correspondence of strategy toward profit growth in expansion of the store network. Increase in store volume hence comes as a result. Establishment of a store presence in all prefectures is not a part of the Company's aims at all.

We think M&A activity, which is another key theme in the Company's approach to expansion of the store network, is proceeding smoothly. "Smooth" refers to steady acquisition of high-quality operators in target areas as subsidiaries in accordance with its store development strategy, rather than a massive deal that attracts attention or implementation of many deals at a rapid pace. "High-quality," meanwhile, refers to the size in store volume of the acquired business. It also means that the acquired entities still have a capability and sales foundation to open new stores within existing framework.

As explained above, the Company acquired Natural Life Group and SERA MEDIC as subsidiaries in 1H of FY3/20. Despite fierce competition in both cases, the Company succeeded to obtain a favorable response from executives of acquired entities to from management of the Company which emphasize collaboration with medical entities which prescribe prescriptions (the Company's one-on-one pharmacy strategy). Since this quality is not something that can be easily copied or overturned, we believe the Company has high possibility to continue to succeed in M&A competition.

The Company also continues to make smooth progress in expansion of new format pharmacies through collaboration with firms from other industries as another characteristic (besides the one-on-one pharmacy format). It opened the JR Kyoto and JR Kishibe stores in FY3/20 1H and launched a store at Nagatsuta Station as its first collaborative store with Tokyu <9005> on November 1, 2019 (2H).

The number of prescriptions at stores located inside and under trains stations have been steadily rising in recent years (mainly in response to growing awareness of their presence). The Company intends to continue focusing on development of new format stores in light of these results.

(4) Approach and Progress on "Creating value at existing pharmacies"

Regarding this point, there is considerable overlap with what was explained under the response to the revised PMD Act. Direction of store development is the main purpose of this theme. We think the Company has solidified a direction of putting its utmost effort into certification of local collaborative pharmacies under the revised PMD Act and is strengthening its activities with primary-care pharmacists and pharmacies and health support pharmacies as the "base."

Furthermore, the Company is investing to improve efficiency and automate drug handling tasks in response to current demand for pharmacists to shift from drug preparation and other drug handling tasks to provision of detailed drug usage guidance to patients and other human interaction tasks.

Outlook for continued healthy growth in CMR dispatching due to increase in outsourcing needs throughout the industry
Focus on impact from the revised PMD Act and responses for placements and dispatching services business

3. BPO Business growth strategy and progress

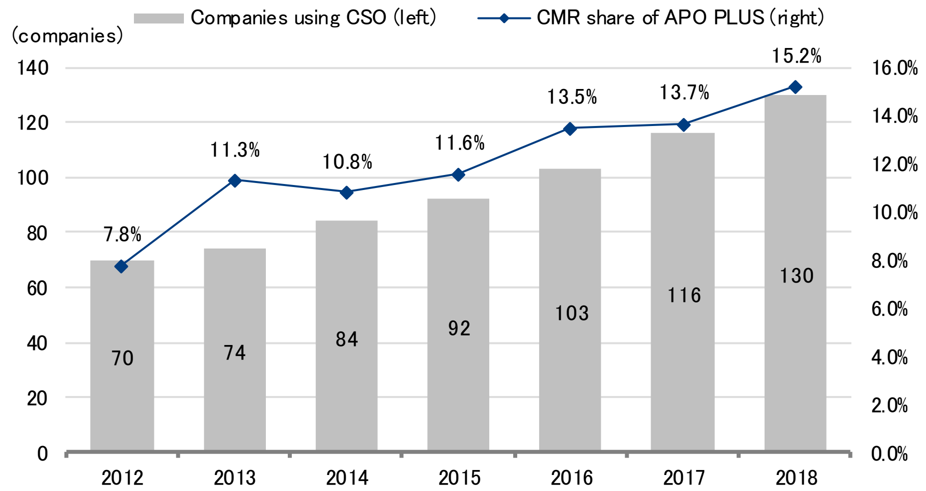
BPO Business is mainly the businesses of the two subsidiaries, APO PLUS STATION and Medical Qol. As stated in the Company Profile section, the core company, APO PLUS STATION, conducts three businesses, the CSO business, the placements and dispatching services business, and the CRO business, while Medical Qol conducts the publishing-related business. So, this business can be divided into four sub-segments. BPO Business growth strategy mainly focuses on the CSO business and the placements and dispatching services business for medical personnel.

(1) CSO business progress

As stated in the Company Profile section, the CSO business entails dispatching CMR to pharmaceutical manufacturers. The pharmaceutical industry is in the process of reducing the number of full-time MR and outsourcing their work to external companies. This is the basis for the growth scenario of CMR businesses for the Company.

The number of MRs in the pharmaceutical industry peaked at 65,752 people in 2013, and declining since 2014. In this situation, the Company is implementing a strategy to realize profit growth through utilizing the number of companies with transactions with (pharmaceutical) companies, for which it ranks top in the industry, by increasing its CMR share (the percentage of the number of the Company's CMR to the total number of CMR). The Company is to achieve a share of 20% in FY3/22. The target is calculated based on the Company to establish resources of 900 to 1,000 CMRs which is 20% of total of CMRs at that time, assumed as 4,500 to 5,000 in total. In FY3/19, the Company had 530 CMRs and its share was 15.2%.

Trends in the number of companies utilizing CSO and the CMR share of APO PLUS STATION



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

As mentioned in the section on results trends, the Company's CMR volume reached an all-time high of 570 people in FY3/20 1H. While this is on an extension of the MR outsourcing trend continues for years, we think growing demand for specialty CMRs offers a tailwind for the Company.

Pharmaceutical companies are accelerating selection and concentration of business (field) and requirement for more detail explanation for products is increasing at sales activities than ever. As explained above, demand for CMRs with strong expertise is rapidly growing while pharmaceutical companies reduce full-time MR employees MRs and switching to CMRs.

However, few organizations have capabilities to train CMRs in specialty areas. A group company APO PLUS STAION conducts this type of training for specialty fields in its skill development section and provides trained personnel to the market. At FISCO, we expect growing demand for specialties to serve as a major tailwind for the Company as it pursues a 20% share in the CMR market.

(2) Progress of the placements and dispatching business for medical personnel

The Company's placements and dispatching services business targets medical practitioners. Its feature is setting target of wide range of occupations. In in terms of the earnings structure, it seems that about two thirds of total sales are from pharmacists, and the remainder is divided approximately into two, from nurses and registered sales staff. In addition to these three occupations, it also provides placements and dispatching services for other occupations, including midwives, public health nurses, registered dietitians, and medical clerical staff.

For the mainstay placements and dispatching services for pharmacists, the Company ranks second for scale among companies conducting a dispensing pharmacies business, (first is Pharma Staff, part of the NIHON CHOUZAI Group), and it would seem to be among the top ten of companies conducting a pharmacist placements and dispatching services business.

The number of dispatched pharmacists increased by 55% YoY base in 1H and this gain fueled higher sales and profits in the placements and dispatching services business. We think upbeat entry volume played a major role in increasing the number of dispatched pharmacists. While pharmacist dispatching demand was already strong, we believe the Company had substantial opportunity losses due to fail to meet the needs. In 1H, entry volume climbed by focusing on recruitment measures which led to rise in the number of dispatched people.

We strongly expect continued growth in demand for pharmacist placements and dispatching services business, though business content might change with a shift from dispatching to placements. Dispensing pharmacies are moving toward segmentation into certified pharmacies and non-certified pharmacies. Certified pharmacies might face qualification criteria for their pharmacists, and it is possible depending on the content of stipulations that the category might seek reinforcement of full-time employee pharmacists. There is a possibility that the qualification requirement of the pharmacist may be added as a requirement of the certified pharmacy. There may be a case where it is necessary to strengthen a full-time pharmacist based on the contents of the regulations. In such a case, the Company's placements and dispatching services business might shift from dispatching to placements. While this is still a theoretical case, we think it is important for the Company to steadily enhance human resource recruitment capabilities to respond flexibly to changes.

The Company is also striving to enhance arrangement of nurses, public health nurses, registered salespeople, and other medical professionals other than pharmacists. While many other companies in the same industry focus on placements business for doctors with expensive annual salaries that support strong profitability, the Company does not intend to enter this area because of strong existing companies and concerns about tough competition due to increase in market entrants. At FISCO, we think this choice is very rational and reasonable.

Acquired Fujinaga Pharm as the first step in pharmaceutical manufacturing, expecting additional initiatives aimed at realizing medium-term goals

4. Approach and progress on the pharmaceuticals manufacturing and sales business

At its FY3/19 financial results briefing, the Company announced its plan to enter into the pharmaceuticals manufacturing field as a new business that the Company has been examining. Subsequently, the Company acquired Fujinaga Pharm in August 2019 as the first step to advance into the pharmaceuticals manufacturing and sales business.

Fujinaga Pharm is a pharmaceutical manufacturer established in 1941 (founded in February 1924) that mainly covers psychiatry and dermatology fields. It manufactures brand-name drugs Phenobal and Hydantol, generic-drug Fujinaga lithium carbonate, and other products and booked ¥1,761mn in net sales in FY9/18.

The Company decided to enter pharmaceutical manufacturing and sales business with the aim of becoming a comprehensive healthcare company. Besides being a top-class dispensing pharmacy chain in Japan, it dispatches CMRs for pharmaceutical sales, as a CSO business and supports drug R&D activities as a CRO business. By entering pharmaceutical manufacturing and sales business, the Company is able to provide integrated services related to drugs that extend from R&D through manufacturing, sales, and dispensing to patients.

Aiming to be a comprehensive healthcare company

Source: The Company's results briefing materials

As explained earlier, the Company targets ¥300bn in net sales and ¥25bn in operating income as medium-term goals and hopes to generate ¥30bn in net sales and ¥8.5bn in operating income from new business. We think the new business portion corresponds to the anticipated scale of its pharmaceutical manufacturing and sales business.

Since it is obviously not possible to reach this goal just through organic growth by Fujinaga Pharm, we expect the Company to make additional initiatives. At FISCO, we think this might involve a second M&A deal, acquisition or construction of production sites, reinforcement of consignment manufacturing, or other actions and are waiting to see what happens next.

Outlook

Anticipating steady momentum also in 2H, though recommend a cautious stance toward expectations of further upward revisions in light of previous harsh revisions of dispensing fees

● FY3/20 outlook

In light of the steady progress up to 1H, the Company upwardly revised FY3/20 forecast to ¥170,000mn in net sales (up 17.4% YoY), ¥7,600mn in operating income (up 7.8%), ¥7,600mn in ordinary income (up 5.4%), and ¥4,050mn in profit attributable to owners of parent (up 3.6%).

Overview of FY3/20 outlook

(¥mn)

	FY3/19			FY3/20				
	1H Results	2H Results	Full year Results	1H Results	2H Forecasts	YoY	Full year Revised forecasts	YoY
Net sales	69,025	75,758	144,783	81,249	88,751	17.2%	170,000	17.4%
Operating income	3,069	3,981	7,050	3,432	4,168	4.7%	7,600	7.8%
Operating margin	4.4%	5.3%	4.9%	4.2%	-	-	4.5%	-
Ordinary income	3,171	4,037	7,208	3,616	3,984	-1.3%	7,600	5.4%
Profit attributable to owners of parent	1,975	1,933	3,908	1,830	2,220	14.8%	4,050	3.6%

Note: 2H outlook values are amounts obtained by deducting 1H results from updated FY3/20 guidance (more precisely, 2H values needed to attain FY3/20 guidance).
Source: Prepared by FISCO from the Company's financial results

We think the Company has a sufficient possibility to achieve attaining guidance in FY3/20 results, but we recommend a cautious stance regarding whether the expected revisions are sufficiently upward to be subject to timely disclosure.

Pharmacy Business only reached low single-digit operating margin in FY3/17 due to the impact of revisions to dispensing fees and drug prices in April 2016. During this period, however, the Company steadily restored dispensing fees that had declined (particularly the calculated portion of basic dispensing fees) and substantially exceeded the period-start operating income target (¥7,500mn) in FY3/18, the second year after revisions, at ¥9,091mn.

Despite having this track record, we do not expect a reoccurrence of the FY3/18 outcome in FY3/20, mainly because dispensing fee reductions in April 2018 revisions (especially stricter calculation standards for basic dispensing fee 1) blocked restoration actions along the lines seen in April 2016 revisions. The government also eliminated the standard dispensing incentive that had previously existed and established the local assistance addition as a replacement. The basic dispensing fee 1 is an effective requirement to obtain this addition. Pharmacies must fulfill eight items in order to receive the local assistance addition in the absence of basic dispensing fee 1, setting very difficult hurdles. We think it would be a risk to expect the upside from the previous survey without understanding these points.

Meanwhile, the Company has been preparing for the revised PMD Act and start of the certified pharmacy program and aims to obtain certification under the community medical cooperation pharmacy format. Even though the government has not clarified specific certification requirements yet, the Company has been focusing on accelerating measures for expanding health support pharmacy as a key initiative.

The Company also focuses on M&A. As mentioned above, the company's stance on companies acquired through M&A has become more acceptable to the management to be acquired, which has been leading successful acquisitions. Based on this understating, we think that there is a sufficient possibility that M&A will result in higher earnings. However, it will be a high risk to add profit contribution of M&A into forecasts.

In BPO business, core CSO business is expected to continue healthy expansion in 2H. While the outsourcing of MRs at pharmaceutical companies is unlikely to be reversed, the Company is focusing on developing specialized MRs to accelerate this trend. We expect CMR demand to make stable growth. Under favorable situation of demand and needs, CMR demand is expected to continue steadily increase. Its placements and dispatching services business for medical-related personnel to make stable growth.

The Company intends to consolidate Fujinaga Pharm's income statement in the pharmaceutical manufacturing and sales business from 2H. However, the Company is yet to decide how to incorporate it in the business-segment structure. While the simplest approach is considered of pharmaceutical manufacturing and sales business as an independent segment, the Company might put it under another segment initially due to the small size. In this case, we anticipate the business to be put it under "BPO and Other Business" segment. As income contributions, we estimate just under ¥1bn in net sales and a few ten million yen in operating income.

Income statement and main indicators

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20	
					1H	Full year (E)
Net sales	124,957	131,502	145,516	144,783	81,249	170,000
YoY growth rate	9.3%	5.2%	10.7%	-0.5%	17.7%	17.4%
Gross profit	15,793	16,876	19,648	17,863	10,128	-
Gross margin	12.6%	12.8%	13.5%	12.3%	22.9%	-
SG&A expenses	9,050	10,010	10,557	10,812	6,695	-
SG&A expense ratio	7.2%	7.6%	7.3%	7.5%	29.5%	-
Operating income	6,743	6,865	9,091	7,050	3,432	7,600
YoY growth rate	-	1.8%	32.4%	-22.4%	11.8%	7.8%
Operating margin	5.4%	5.2%	6.2%	4.9%	4.2%	4.5%
Ordinary income	6,688	7,065	9,333	7,208	3,616	7,600
YoY growth rate	-	5.6%	32.1%	-22.8%	14.0%	5.4%
Profit attributable to owners of parent	3,709	4,353	4,986	3,908	1,830	4,050
YoY growth rate	-	17.4%	14.5%	-21.6%	-7.3%	3.6%
Split-adjusted EPS	107.78	128.35	141.19	101.73	47.90	105.98
Split-adjusted dividend	24.00	24.00	28.00	28.00	14.00	28.00
Split-adjusted BPS	602.36	652.42	936.74	1,006.55	-	-

Note: YoY not presented for profit items in FY3/16 because of changes in accounting policy
Source: Prepared by FISCO from the Company's financial results

Balance sheet

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20 1H
Current assets	37,824	36,578	42,288	46,127	47,533
Cash and deposits	16,523	14,174	19,820	20,220	18,287
Notes and accounts receivable-trade	15,242	15,785	16,640	17,330	21,902
Inventory assets	4,254	4,660	4,719	5,157	5,808
Noncurrent assets	31,996	44,668	44,952	48,087	58,485
Property, plant and equipment	8,969	10,373	10,544	11,079	13,177
Intangible assets	18,474	29,483	27,938	30,075	38,216
Investments and other assets	4,551	4,812	6,469	6,933	7,090
Deferred assets	27	43	29	21	17
Total assets	69,847	81,290	87,270	94,236	106,036
Current liabilities	29,344	31,183	33,991	34,424	39,485
Notes payable and accounts payable-trade	18,096	17,626	18,265	17,741	21,520
Short-term loans payable, etc.	4,696	6,373	7,629	9,430	10,552
Noncurrent liabilities	19,481	28,473	17,343	20,795	27,499
Long-term loans payable, etc.	18,498	27,234	16,361	19,443	25,288
Shareholders' equity	20,394	21,149	35,694	38,734	38,665
Capital stock	2,828	2,828	5,786	5,786	5,786
Capital surplus	9,354	9,366	13,489	13,489	13,490
Retained earnings	9,680	13,137	17,245	20,064	21,350
Treasury stock	-1,469	-4,182	-827	-607	-1,962
Total accumulated other comprehensive income	368	167	241	24	14
Non-controlling interests	259	315	-	259	371
Total net assets	21,022	21,632	35,935	39,017	39,051
Total liabilities and net assets	69,847	81,290	87,270	94,236	106,036

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

Cash flow statement

(¥mn)

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20 1H
Cash flow from operating activities	7,539	5,813	11,116	5,773	2,430
Cash flow from investing activities	-3,348	-15,392	-3,775	-8,287	-7,719
Cash flow from financing activities	4,085	7,435	-1,685	2,906	3,346
Net increase (decrease) in cash and cash equivalents	8,276	-2,143	5,656	392	-1,942
Cash and cash equivalents at the beginning of the period	8,011	16,287	14,144	19,800	20,193
Cash and cash equivalents at the end of the period	16,287	14,144	19,800	20,193	18,251

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

Shareholder return

Announced its dividend forecast of ¥28 for FY3/20 unchanged from the previous year and bought back its own shares

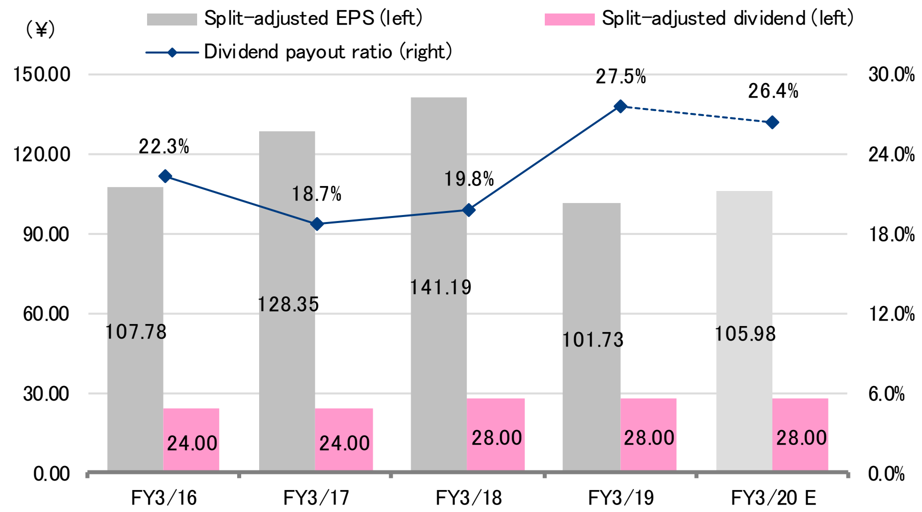
Qol primarily relies on dividends as shareholder compensation. Its basic policy is to make stable return of profits to shareholders while also retaining profits in order to pursue future business initiatives and reinforce corporate operations. It does not set an official payout ratio or other standards on dividend.

For FY3/20, the Company announced a dividend forecast of ¥28 (an interim dividend of ¥14 and a year-end dividend of ¥14), which is the same as in the previous fiscal year. While the Company upwardly revised its FY3/20 forecast, it has kept the dividend forecast as initially anticipated. Consequently, based on the revised forecast earnings per share (EPS), the dividend payout ratio will be 26.4%.

Meanwhile, the Company conducted share buybacks as part of shareholder return. It decided at the Board of Directors meeting on June 18, 2019 to acquire shares with upper limits of 1.2mn shares (3.08% of outstanding share volume (excluding treasury shares)) or ¥1.5bn during a period of June 19 to August 23, 2019 and purchased 1,000,500 shares for ¥1,499mn.

At FISCO, we expect the Company to continue to seek various types of shareholder returns, such as share buybacks, based on stock dividends depending on the situation. While the Company has not clearly committed to a gross payout ratio, we think it intends to continuously seek reinforcement of shareholder return with a similar concept.

Dividend per share and dividend payout ratio



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

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■ For inquiry, please contact: ■
FISCO Ltd.
5-11-9 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (Financial information Dept.)
Email: support@fisco.co.jp