

NIHON CHOUZAI Co., Ltd.

3341

Tokyo Stock Exchange First Section

27-Jul.-2020

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Summary

Forecast is for a decrease in profits, incorporating the impact of the spread of the novel coronavirus (COVID-19), but is still developing a growth strategy

NIHON CHOUZAI Co., Ltd. <3341> (hereinafter, also “the Company”) is a leading dispensing pharmacy company that ranks second in sales in the dispensing pharmacy industry. The Nihon Chouzai Group manufactures and sells generic pharmaceuticals, so one of its key characteristics is that it has a manufacturing function. It additionally has a staffing and placement business for medical professionals and it is aiming to increase earnings while growing these three main businesses in a well-balance manner.

1. Sales and profits increased in FY3/20, driven by the Dispensing Pharmacy business

Sales and profits increased in the FY3/20 results, with net sales rising 9.3% year-on-year (YoY) to ¥268,520mn and operating profit growing 12.8% to ¥7,593mn. Profits decreased in the Pharmaceutical Manufacturing and Sales business due to the impact of the revisions to drug prices, but they trended strongly in the Dispensing Pharmacy business and in the Medical Professional Staffing and Placement business. In the Dispensing Pharmacy business, net sales rose 10.7% YoY and operating profit grew 12.4% due to the increases in the number of pharmacies and the prescription unit price. The Company newly opened 65 pharmacies (of which 30 pharmacies from M&A), which was a new record high (number of pharmacies at end of period, 650 pharmacies), while existing pharmacies’ net sales also increased 7.7% due to the rise in the prescription unit price. In addition, in the Medical Professional Staffing and Placement business, although net sales declined 2.8% YoY, operating profit increased 25.2% because placement projects for pharmacists and doctors grew significantly

2. For FY3/21, is forecasting an increase in sales but a decrease in profits on considering the impact of the spread of the COVID-19

For the FY3/21 results, the Company is forecasting an increase in sales but a decrease in profits, with net sales to rise 8.7% YoY to ¥291,813mn and operating profit to fall 14.3% to ¥6,504mn. The spread of the COVID-19 is impacting the Dispensing Pharmacy business and the Medical Professional Staffing and Placement business, and the forecasts assume that the conditions in April will continue until June. In particular, within the recent situation in which people are refraining from visiting medical facilities, the Dispensing Pharmacy business is being affected by the double-digit decline in the number of prescriptions. The Company anticipates that this factor will have a negative effect in the 1Q of slightly less than ¥4bn on net sales and slightly more than ¥2bn on operating profit. In the Medical Professional Staffing and Placement business, demand has cooled-down in the short term, but it is expected to recover from the 2H onwards. Therefore, for these two businesses, the full fiscal year forecasts are for YoY decreases in profits of around 10%. Conversely, in the Pharmaceutical Manufacturing and Sales business, the outlook is for increases in sales and profits because the impact of the spread of the COVID-19 on this business is small, and also from the major effects on net sales of the launch of new products in June 2020.

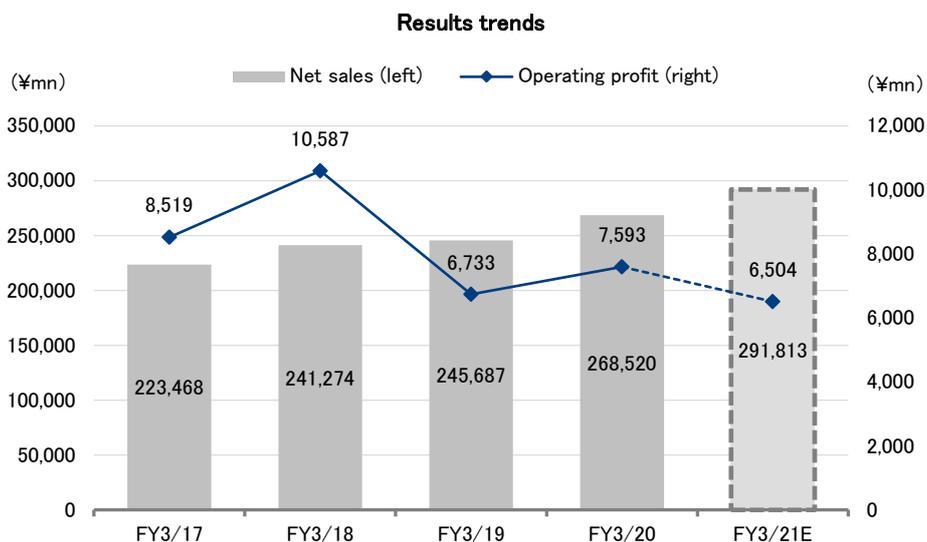
Summary

3. Is steadily developing a growth strategy to expand the 3 businesses with a good balance

In April 2018, the Company announced the Long-Term Vision for 2030, in which it sets the image of an earnings structure of net sales of ¥1tn in 2030 and in the breakdown of operating profit, of 50% from the Dispensing Pharmacy business and 50% from the remaining businesses. As its growth strategy for the dispensing pharmacy industry, its policy is to open pharmacies prioritizing a balance between “organic openings” and “M&A,” and between “hospital-adjacent pharmacies” and “hybrid-type pharmacies.” Also, it is thought that it is aiming for growth by strengthening efforts for one-to-one work through training human resources and by improving convenience for patients and work efficiency through utilizing ICT. Conversely, for the Pharmaceutical Manufacturing and Sales business, it is targeting increasing sales and improving earnings by strengthening in-house approved products and increasing production at the highly productive new plant. In the Medical Professional Staffing and Placement business, its policy is to aim for growth through actively developing the doctor placements business, in addition to the pharmacist business it is focusing on. Up to FY3/20, the Company had made steady progress for these growth strategies. The spread of the COVID-19 will have a negative impact on results in the short term, but on the other hand, it may increase opportunities for M&A in the Dispensing Pharmacy business, so we shall be paying attention to developments in the future.

Key Points

- Sales and profits increased by double digits in the Dispensing Pharmacy business from the record high number of new pharmacy openings, including from M&A, and also from the effects of the increase in the prescription unit price in existing pharmacies
- Is forecasting an increase in sales but a decrease in profits in FY3/21, assuming that the impact of the spread of the COVID-19 will continue until the 1Q
- In the Long-Term Vision for 2030, is aiming to dramatically expand the business scope through management prioritizing a good balance



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

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Results trends

In FY3/20, results were driven by the Dispensing Pharmacy business, and net sales continued to increase and operating profit rose for the first time in 2 fiscal periods

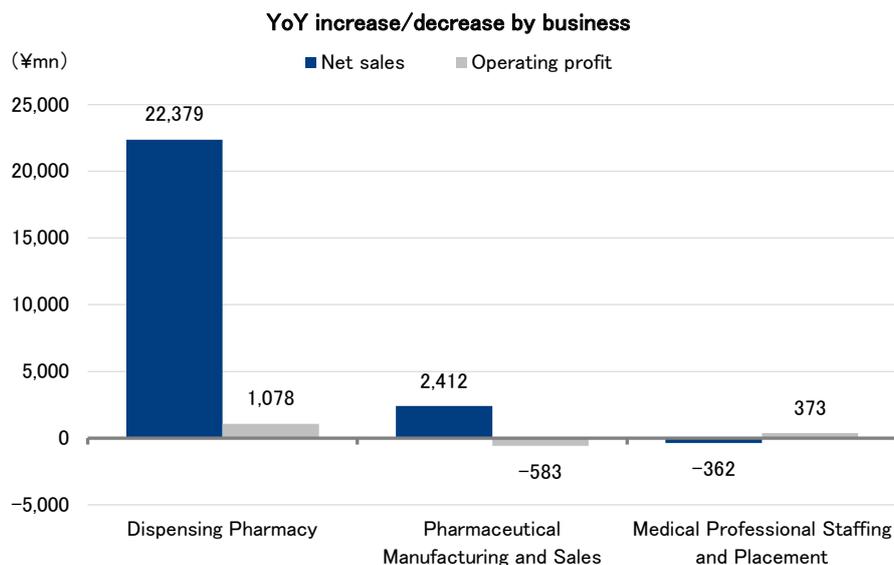
1. Overview of FY3/20 results

In the FY3/20 consolidated results, net sales increased 9.3% YoY to ¥268,520mn, operating profit rose 12.8% to ¥7,593mn, ordinary profit grew 21.8% to ¥7,405mn, and profit attributable to owners of parent increased 76.7% to ¥6,697mn. Net sales were once again a new record high, while each profit item increased for the first time in two fiscal periods. In addition, compared to the revised forecasts announced in December 2019, net sales were basically as forecast and each profit item was above forecast, despite the impact of the spread of the COVID-19 across the end of the period.

Overview of FY3/20 consolidated results

	FY3/19			FY3/20			
	Results	Vs. net sales	Company forecast*	Results	Vs. net sales	YoY	Vs. forecast
Net sales	245,687	-	268,599	268,520	-	9.3%	0.0%
Gross profit	41,975	17.1%	45,824	46,372	17.3%	10.5%	1.2%
SG&A expenses	35,242	14.3%	38,593	38,779	14.4%	10.0%	0.5%
(R&D expenses)	2,764	1.1%	3,308	2,991	1.1%	8.2%	-9.6%
Operating profit	6,733	2.7%	7,231	7,593	2.8%	12.8%	5.0%
Ordinary profit	6,077	2.5%	7,069	7,405	2.8%	21.8%	4.7%
Extraordinary income/losses	700	0.3%	-	4,480	1.7%	-	-
Profit attributable to owners of parent	3,790	1.5%	6,004	6,697	2.5%	76.7%	11.5%

*Company forecasts are the December 2019 revised values
 Source: Prepared by FISCO from the Company's financial results



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

Results trends

The main reason for the increase in net sales was that sales trended strongly in the Dispensing Pharmacy business, up 10.7% YoY, including due to the new pharmacy openings and the rise in the prescription unit price. In the Pharmaceutical Manufacturing and Sales business, sales increased 5.9% from the growth in the transaction amount for dispensing pharmacies in the Group. Sales decreased in the Medical Professional Staffing and Placement business, mainly due to the shift in demand from staffing projects to placements projects. Also, operating profit decreased in the Pharmaceutical Manufacturing and Sales business because of the impact of the revisions to drug prices implemented on conjunction with the consumption tax hike in October 2019. But this decrease was covered by the higher profits in the Dispensing Pharmacy business and the Medical Professional Staffing and Placement business.

Non-operating income/expenditure improved ¥468mn YoY, which was mainly because interest payments decreased ¥161mn following the reduction in interest-bearing debt and that ¥243mn was recorded as the total of compensation income, insurance claim income, and subsidy income. The Company also recorded a gain on sales of non-current assets of ¥6,662mn as extraordinary profit, while conversely, it recorded an impairment loss of ¥2,663mn (¥607mn in the previous period). It seems that this was due to the conservative review of the asset valuations of Group's pharmacies in the Dispensing Pharmacy business.

Sales and profits increased by double digits in the Dispensing Pharmacy business, as opened a record high number of new pharmacies, including through M&A, and also from the effects of the rise in the prescription unit price at existing pharmacies

2. Trends in the Dispensing Pharmacy business

In the Dispensing Pharmacy business, sales and profits increased by double digits, with net sales rising 10.7% YoY to ¥231,001mn, gross profit growing 15.2% to ¥34,898mn, and operating profit climbing 12.4% to ¥9,785mn. Compared to the forecasts also, net sales and all the profits items were higher than forecast.

Results in the Dispensing Pharmacy business

	FY3/18 Results	FY3/19 Results	FY3/20 Results			
			Company forecast	Results	YoY	Vs. plan
Net sales	205,192	208,622	226,908	231,001	10.7%	1.8%
Cost of sales	172,264	178,339	193,910	196,103	10.0%	1.1%
Gross profit	32,928	30,282	32,998	34,898	15.2%	5.8%
Gross profit margin	16.0%	14.5%	14.5%	15.1%	-	-
SG&A expenses	20,516	21,575	24,204	25,112	16.4%	3.8%
Ratio of SG&A expenses to net sales	10.0%	10.3%	10.7%	10.9%	-	-
Operating profit	12,411	8,707	8,794	9,785	12.4%	11.3%
Operating profit margin	6.0%	4.2%	3.9%	4.2%	-	-
Number of dispensing pharmacies at the end of the period	585	598	643	650	8.7%	1.1%
Net sales per dispensing pharmacy	359	352	365	370	5.0%	1.2%

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

Results trends

The Company opened a record high number of new pharmacies in FY3/20, of a total of 65 pharmacies, including 35 pharmacies through organic openings and 30 pharmacies from M&A. Conversely, it closed 13 pharmacies, so the number of pharmacies at the end of the period had steadily risen by 52 to 650 pharmacies. In particular, the management environment in the dispensing pharmacy industry continues to be severe due to the revisions to prescription dispensing fees and other revisions implemented in April 2018, so the trend for M&A deals for medium- and small-sized pharmacies is increasing. This is proving beneficial for the Company, which is implementing a strategy of expanding its pharmacy network.

The factors causing net sales to rise were the effects of the increase in sales from the pharmacies newly opened in the previous fiscal period and in FY3/20 (a factor increasing sales by a total of ¥9bn), and also as at existing pharmacies, sales increased 7.7% YoY or by approximately ¥13.4bn in monetary terms. At existing pharmacies, the number of prescriptions was basically unchanged YoY, as the number of people visiting hospitals declined over the end of the period due to the spread of the COVID-19, but sales still increased because the prescription unit price rose 7.7%. The main reason for the rise in the prescription unit price was the higher drug fees due to the effects of the increase in expensive drugs, such as anti-cancer drugs. Also, in response to the revisions to prescription dispensing fees in April 2018, the transaction volume of generic pharmaceuticals increased, while dispensing technical fees also rose as a result of measures to strengthen pharmacies functions as family pharmacies in communities. The government has set a target of a level of 80% for the transaction volume of generic pharmaceuticals, but the average in the Company's Group at the end of the period was already above this, at approximately 89%, and moreover, 89% of all its pharmacies were providing at-home medical care services (pharmacies providing at least 12 services a year).

Details of YoY changes to net sales, the number of prescriptions, and the prescription unit price

	FY3/20		
	Dispensing net sales	No. of prescriptions	Prescription unit price
Existing pharmacies	107.7%	100.0%	107.7%
Pharmacies opened in FY3/19	235.7%	224.3%	105.1%
All pharmacies	110.9%	103.6%	107.1%

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

For operating profit, SG&A expenses increased 16.4% YoY, including as personnel costs rose following the recruitment of around 400 new-graduate pharmacists, which was a record high number, and also from the higher costs burden from the tax increase following the consumption tax hike in October 2019, so the SG&A expenses ratio also rose, up 0.6 of a percentage point (pp). However, this was covered by the effects of the higher sales and the improved gross profit margin, so operating profit increased 12.4% YoY and the operating profit margin was maintained at 4.2%, the same as in the previous fiscal year.

Looking at the pharmacy-opening conditions in a little more detail by type, the Company opened 38 hospital adjacent-type pharmacies (including on-site pharmacies opened within hospital premises) and 27 hybrid-type* pharmacies. The hospital adjacent-type constitutes nearly 70% of the Company Group's pharmacies, but in the future, it is aiming to increase the percentage of the hybrid-type, which has family pharmacist and pharmacy functions for communities, to around 50% to realize a well-balanced pharmacy-opening structure (already 54% in the Tokyo metropolitan area). The pharmacy functions certification system will be newly introduced in August 2021, which will divide pharmacies according to their functions into regional-cooperation pharmacies and specialized medical facilities-cooperation pharmacies, and in the future, it seems that the division of dispensing pharmacies according to function will be progressed. It is considered that increasing the number of pharmacies while maintaining a good balance between both types will heighten business stability.

* Previously pharmacies were divided into the foot traffic-type and the medical mall-type, and hybrid is the name given to the type that integrates both these former types in order to target medical institutions more widely and to increase the number of pharmacy visitors.

Results trends

On looking at new pharmacy-opening conditions by region also, the Company opened 40 pharmacies in Kanto, which constituted 60% of the new pharmacy openings. At the end of the period, the percentage in Kanto was more than half, at approximately 51%. The Company's policy for pharmacy-opening regions is to open them in a well-balanced manner in the major cities, centered on Tokyo, Nagoya, and Osaka, and it has strengthened the pharmacies development department and is searching for candidate properties. For the hospital adjacent-type, the only opportunities for new openings is when, for example, a hospital relocates, so it is important to gather this sort of information. Looking at the current percentages of pharmacies compared to the population distribution ratio, it appears that the percentage is high in Kanto and low in the Kansai and Kyushu areas.

Pharmacy-opening conditions by type

	(No. of pharmacies)	
	FY3/19	FY3/20
No. of newly opened pharmacies	32	65
Hospital-adjacent type (on-site pharmacies)	16 (3)	38 (8)
Hybrid-type	16	27
No. of closed pharmacies	19	13
No. of pharmacies at the end of the period	598	650

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

Distribution of pharmacies by region

	FY3/20			Population-distribution ratio
	No. of pharmacies during the period	No. of pharmacies at the end of the period	Percentage of total at the end of the period	
Hokkaido	1	43	6.6%	4.2%
Tohoku	5	48	7.4%	7.0%
Kanto	40	329	50.6%	34.1%
Koshinetsu	1	24	3.7%	4.1%
Tokai	6	57	8.8%	11.8%
Kansai/Hokuriku	8	72	11.1%	18.6%
Chugoku/Shikoku	3	39	6.0%	8.8%
Kyushu/Okinawa	1	38	5.9%	11.4%
Total	65	650	100.0%	100.0%

Source: calculated from the population-distribution ratios in the Vital Statistics (2018) published by the Ministry of Health, Labour and Welfare

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

Net sales increased from the contribution of sales within the Group, but profits decreased due to the impact of the revisions to drug prices

3. Trends in the Pharmaceutical Manufacturing and Sales business

In the Pharmaceutical Manufacturing and Sales business, sales increased but profits decreased, with net sales rising 5.9% YoY to ¥43,072mn, gross profit falling 11.6% to ¥6,076mn, and operating profit decreasing 31.0% to ¥1,301mn. The results were below the Company forecasts, net sales by 5.3% and operating profit by 31.0%. Following the revisions to drug prices in October 2019, the sales prices of existing items declined more than expected, which was the main reason why profits decreased and were below the Company forecasts. SG&A expenses declined 4.3% YoY as the Company kept down R&D expenses and other expenses and also as it converted to a profit-oriented management strategy. But this was unable to completely absorb the deterioration of the gross profit margin due to the fall in sales prices.

Results trends

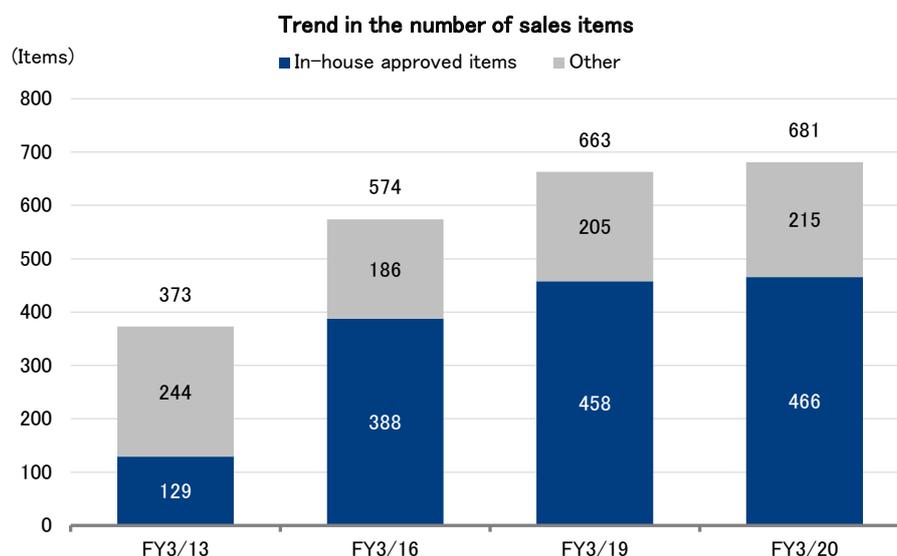
Results in the Pharmaceuticals Manufacturing and Sales business

	FY3/18 Results	FY3/19 Results	FY3/20 Results			
			Company forecast	Results	YoY	Vs. forecast
Net sales	38,066	40,659	45,493	43,072	5.9%	-5.3%
Cost of sales	31,746	33,782	38,188	36,995	9.5%	-3.1%
Gross profit	6,319	6,877	7,304	6,076	-11.6%	-16.8%
Gross profit margin	16.6%	16.9%	16.1%	14.1%	-	-
SG&A expenses	5,124	4,991	5,419	4,774	-4.3%	-11.9%
Ratio of SG&A expenses to net sales	13.5%	12.3%	11.9%	11.1%	-	-
Operating profit	1,194	1,885	1,884	1,301	-31.0%	-31.9%
Operating profit margin	3.1%	4.6%	4.1%	3.0%	-	-

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

The Company is utilizing its strength of having the leading domestic dispensing pharmacy chain within its Group to actively increase internal sales (sales to Group pharmacies), and alongside this, its strategy is also to aim to increase external sales, based on these internal sales. Looking at the breakdown of sales in FY3/20, internal sales increased 10.6% YoY to ¥18,172mn and external sales rose 2.8% to ¥24,899mn, so results were driven by the growth of internal sales.

The total number of sales items became 681 items (of which, 466 are in-house approved items) through sales of 22 newly listed items. For the 22 items it is newly selling, the Company has provisionally calculated sales of approximately ¥62bn for the estimated potential scale of switching to generics. As the forerunner drugs compete with the generics, it is not the case that it can capture all of this amount, but there has been no change to the situation in which we can expect sales to increase in the future.



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

Results trends

Is focusing on pharmacist placements business, while the doctor placements business is also growing, and although sales decreased, profits increased significantly

4. Trends in the Medical Professional Staffing and Placement business

In the Medical Professional Staffing and Placement business, although sales decreased, profits increased significantly, with net sales declining 2.8% YoY to ¥12,721mn, gross profit rising 9.2% to ¥5,404mn, and operating profit growing 25.2% to ¥1,851mn. Demand to employ medical professionals, mainly pharmacists, continues to trend at a high level, but sales decreased due to the demand for pharmacists shifting from staffing to placements. Conversely, the gross profit margin rose significantly, up from 37.8% in the previous fiscal period to 42.5%, because of the growth of both pharmacist and doctor placements in the placements business that has a high profit margin, and this was the main reason for the higher profits. Staffing demand declined more than expected, so compared to the Company forecasts, net sales were below forecast, but operating profit achieved its forecast.

Results in the Medical Professional Staffing and Placement business

	FY3/18 Results	FY3/19 Results	FY3/20 Results			
			Company forecast	Results	YoY	Vs. plan
Net sales	11,970	13,083	14,300	12,721	-2.8%	-11.0%
Cost of sales	7,366	8,133	8,730	7,316	-10.0%	-16.2%
Gross profit	4,604	4,950	5,570	5,404	9.2%	-3.0%
Gross profit margin	38.5%	37.8%	39.0%	42.5%	-	-
SG&A expenses	2,762	3,472	3,720	3,553	2.3%	-4.5%
Ratio of SG&A expenses to net sales	23.1%	26.5%	26.0%	27.9%	-	-
Operating profit	1,842	1,478	1,849	1,851	25.2%	0.1%
Operating profit margin	15.4%	11.3%	12.9%	14.6%	-	-

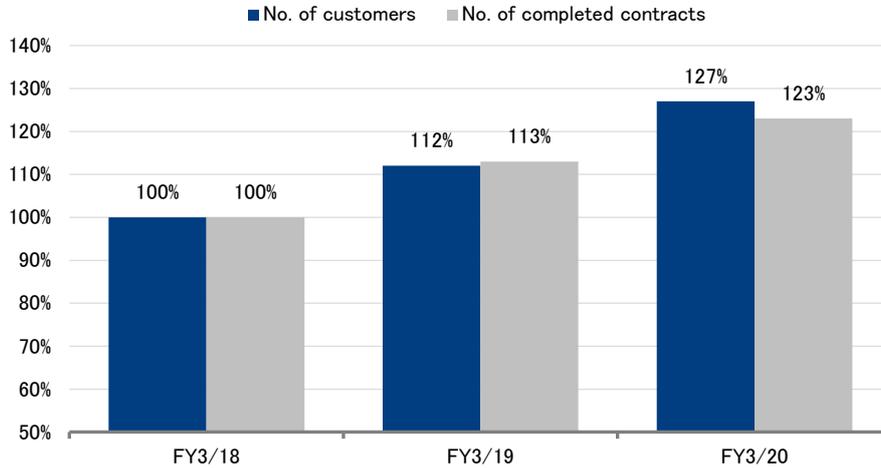
Source: Prepared by FISCO from the Company's results briefing materials

The factors in the background to the shift in demand for pharmacists from staffing to placements include the rise in the functions required of pharmacies and the need for the long-term development of human resources, and also that needs are rising for direct employment. Around 90% of net sales in this business are provided by the pharmacists staffing and placements business, while the staffing business constitutes slightly more than 80%, so this change in demand greatly affected sales. However, looking on a gross-profit basis, the staffing business constitutes around 60% of the total, so profits increased due to the effects of the higher sales of placement projects.

The Company has been strengthening its sales structure for business expansion since the previous fiscal period, and as a result, the number of completed contracts, which is a leading indicator for the number of customers and net sales, is steadily increasing. In the pharmacist placements business, compared to FY3/18 the number of customers increased 1.27 times and the number of completed contracts rose 1.23 times. Also, although its scale is still small, the doctor placements business is growing rapidly, with the number of customers increasing 3.21 times and the number of contracts rising 3.18 times.

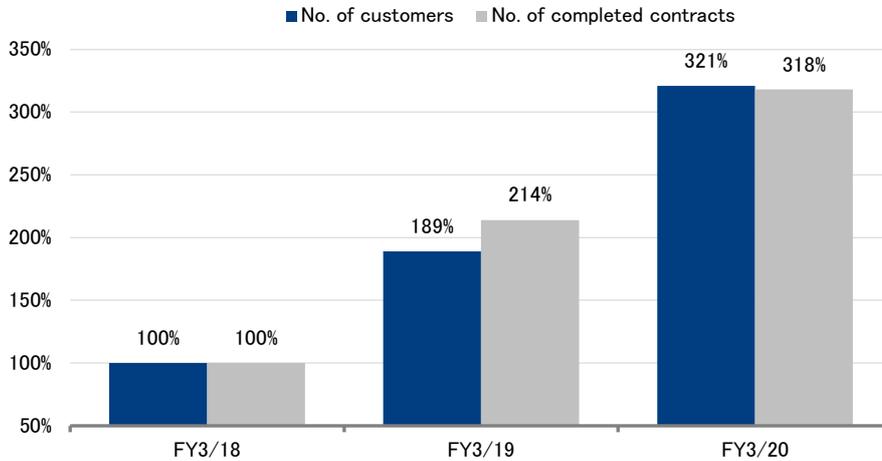
Results trends

**Number of customers and number of completed contracts
 in the pharmacist placements business
 (FY3/18=100%)**



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

**Number of customers and number of completed contracts
 in the doctor placements business
 (FY3/18=100%)**



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

FY3/21 results outlook

The outlook for FY3/21 is that sales will increase and profits will decrease, assuming that the impact of the spread of the COVID-19 will continue until the 1Q

1. FY3/21 results outlook

For the FY3/21 results, the Company is forecasting an increase in sales but a decrease in profits, with net sales to rise 8.7% YoY to ¥291,813mn, operating profit to decrease 14.3% to ¥6,504mn, ordinary profit to decline 15.4% to ¥6,266mn, and profit attributable to owners of parent to fall 53.4% to ¥3,122mn. In particular, on looking at the forecasts only for the 1H, the outlook is that operating profit will decline significantly, down 91.1% YoY. But this is because the forecast incorporates the assumption that the negative impact of the spread of the COVID-19 will continue until June. It seems that its negative impact will especially appear in the Dispensing Pharmacy business, of reducing net sales slightly less than ¥4bn and operating profit slightly more than ¥2bn.

Therefore, the full-fiscal year results may change, depending on the state of the spread of the COVID-19 in the future. Currently, the Japanese government has lifted the declaration of a state of emergency and economic activities are gradually returning to normal. But there is still the risk that should a second wave of the spread of the virus occur, it will have a further negative impact on results.

FY3/21 consolidated results outlook

	FY3/20		FY3/21			
	Full-year results	YoY	1H forecast	YoY	Full-year forecast	YoY
Net sales	268,520	9.3%	138,895	6.6%	291,813	8.7%
Gross profit	46,372	10.5%	-	-	48,806	5.2%
SG&A expenses	38,779	10.0%	-	-	42,302	9.1%
(R&D expenses)	2,991	8.2%	-	-	3,487	16.6%
Operating profit	7,593	12.8%	361	-91.1%	6,504	-14.3%
Ordinary profit	7,405	21.8%	249	-93.8%	6,266	-15.4%
Profit attributable to owners of parent	6,697	76.7%	-51	-	3,122	-53.4%
Earnings per share (¥)	223.33		-1.70		104.14	

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

In the mainstay Dispensing Pharmacy business, is forecasting that sales will rise from the increase in the number of pharmacies, but that profits will decrease by more than ¥2bn due to the impact of the spread of the COVID-19

2. Outlook by business segment

The outlook for FY3/21 by business segment is that sales will increase but profits will decrease in the Dispensing Pharmacy business, that both sales and profits will increase in the Pharmaceutical Manufacturing and Sales business, and that both sales and profits will decrease in the Medical Professional Staffing and Placement business.

FY3/21 results outlook

Outlook by business segment

		(¥mn)				
		FY3/18 Results	FY3/19 Results	FY3/20 Results	FY3/21	
					Company forecast	YoY
Net sales	Dispensing Pharmacy business	205,192	208,622	231,001	251,141	8.7%
	Pharmaceutical Manufacturing and Sales business	38,066	40,659	43,072	46,470	7.9%
	Medical Professional Staffing and Placement business	11,970	13,083	12,721	11,855	-6.8%
	Before adjustment	255,230	262,366	286,795	309,466	7.9%
	Adjustment	-13,955	-16,679	-18,275	-17,653	-
	Net sales total	241,274	245,687	268,520	291,813	8.7%
Operating profit	Dispensing Pharmacy business	12,411	8,707	9,785	8,606	-12.0%
	Pharmaceutical Manufacturing and Sales business	1,194	1,885	1,301	1,459	12.2%
	Medical Professional Staffing and Placement business	1,842	1,478	1,851	1,687	-8.8%
	Before adjustment	15,448	12,071	12,938	11,752	-9.2%
	Adjustment	-4,861	-5,337	-5,345	-5,248	-
	Operating profit total	10,587	6,733	7,593	6,504	-14.3%

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

(1) Dispensing Pharmacy business

In the Dispensing Pharmacy business, the forecasts are for net sales to increase 8.7% YoY to ¥251,141mn and for operating profit to decrease 12.0% to ¥8,606mn. Initially the forecasts were for higher sales and profits, but on observing the impact of the spread of the COVID-19 in March and April, the Company urgently revised the forecasts in the middle of April on the assumption that the April conditions would continue until June. Due to the spread of the COVID-19, the number of hospital outpatients decreased and also prescription periods have been lengthened, which led to a decline in the number of prescriptions.

In terms of the financial impact of the spread of the COVID-19, the Company has incorporated a negative impact of slightly less than ¥4bn on net sales and slightly more than ¥2bn on operating profit into its forecasts for 1Q. The extent of the decrease in profits seems large in comparison to the decrease in net sales, which is mainly due to the decline in the number of prescriptions. The reason for this is that the dispensing pharmacy sales framework is divided broadly into drug fees and technical fees, and while drug fees are on a yearly basis so are not easily affected by the lengthening of the prescription periods, technical fees are determined per single prescription, which means that when the number of prescriptions falls, this directly causes sales and profits to decrease.

The Company's result in FY3/20 for the number of prescriptions was approximately 14.7mn prescriptions, while its average unit price per prescription was ¥15,479. It does not disclose a breakdown of the prescription unit price, but within it, it is estimated that technical fees are in the ¥2,500 range. Their percentage of total sales is low, but on considering that purchasing costs are contained in the drug fees, technical fees have a significant effect on profits. As previously stated, technical fees are determined per pharmacy from the detailed evaluation standards and the number of points according to the revisions to prescription dispensing fees that are implemented once every two years, and the mechanism is that the total number of points is added to one prescription. In other words, it means that an increase or decrease in the number of prescriptions basically directly causes profits to increase or decrease.

Looking at the impact of the spread of the COVID-19, the number of prescriptions in March 2020 decreased by more than 5% compared to the Company forecast. In April, the Japanese government issued a declaration of a state of emergency and it seems that this caused a decrease of nearly 20% compared to the initial forecast. Assuming these April conditions will continue until June, the forecast is that the number of prescriptions will decline by more than 20% compared to the initial forecast

FY3/21 results outlook

On combining this with the technical fees (around ¥2,500), the result is that operating profit becomes a negative amount. Conditions basically did not change in May and April, but the declaration of a state of emergency was lifted in June, so the number of people visiting hospitals or other medical facilities may have recovered somewhat (= recovery in the number of prescriptions). But should there be a second wave for the spread of the infection from July onwards, the number of visitors may decrease, so results from the 2Q onwards will depend on this situation.

For new pharmacy openings, the Company is aiming for a pace of 50 pharmacies a year, centered on organic openings, while there has also been no change to its policy of proactively investigating M&A should a project appear with good conditions, such as favorable locations. Among the factors causing sales to increase in FY3/21, the effect of the increase in sales at the pharmacies newly opened in the previous fiscal period will be large. Also, while prescription dispensing fees and drug prices were revised in April 2020, it seems that the effects of these revisions on results have been minimal. Although drug prices have fallen slightly, the amount they have declined will be covered by the expected slight increase in the average unit price of technical fees.

Net sales in the 1Q are forecast to remain unchanged YoY or to decrease very slightly. Due to the effects of the lengthening of prescription periods, the prescription unit price will rise by around 20% YoY, but the number of prescriptions may decline by around 15%, even with the effects of the new pharmacy openings. For profits, at FISCO we forecast that due to the decline in dispensing technical fees, profits will decrease significantly.

(2) Pharmaceutical Manufacturing and Sales business

In the Pharmaceutical Manufacturing and Sales business, the outlook is that net sales will increase 7.9% YoY to ¥46,470mn and operating profit will rise 12.2% to ¥1,459mn. The effects of the April 2020 revisions to drug prices will be a factor reducing sales by around 2%. But the sales of the 22 items launched into the market during the previous year (8 items in June and 14 items in December) will contribute over the full fiscal year, and in addition, sales of around 25 items are scheduled to newly start in 2020 as well. In particular, the items whose sales are scheduled to start in June are generic pharmaceuticals for which a certain sales scale is expected, so it is forecast that they will contribute to the increase in sales.

The gross profit margin is expected to rise from 14.1% in the previous fiscal period to 15.2%, including due to the effects of the increase in the operating rate of Tsukuba Plant No.2, which started operating in 2018. The operating profit margin is forecast to improve only slightly, from 3.0% to 3.1%, because SG&A expenses are set to increase, including that R&D expenses will rise from ¥2,991mn in the previous period to ¥3,487mn. However, the Company is steadily progressing the sales strategy prioritizing profitability it has been working on until now, so at FISCO, we think there is room for profits to be higher than forecast should net sales trend as forecast.

(3) Medical Professional Staffing and Placement business

In the Medical Professional Staffing and Placement business, the outlook is for net sales to decrease 6.8% YoY to ¥11,855mn and operating profit to decline 8.8% to ¥1,687mn. As previous stated, this business is being impacted by the spread of the COVID-19, and demand for placements for pharmacists and doctors has fallen. The number of visitors to regional hospitals, clinics, and pharmacies has declined and management conditions have become severe. For pharmacists staffing also, it is normally the case that staff whose contracts expire in March and April have their contracts renewed, but at the present time, in many cases their contracts have been ended. Therefore, it seems unavoidable that results will deteriorate in this business segment in the short term.

However, facilities such as medical facilities and pharmacies are one important foundation of the infrastructure of people's lives, so results are forecast to recover once the market environment returns to normal. The Company assumes that the recovery will occur from the current 2H onwards, so for the full fiscal year, it is forecasting that gross profit will increase 2.9% YoY to ¥5,562mn. The improvement in the gross profit margin will be from the rise in percentage of the total provided by the placements business. However, as SG&A expenses will increase 9.1% YoY, or ¥322mn in monetary terms, profits are forecast to decrease at the operating profit stage. For SG&A expenses, the Company plans to actively invest in expenses including advertising and publicity expenses to improve the name awareness of the doctor placements business.

■ Medium- to long-term growth strategy

In the Long-Term Vision for 2030, is aiming to dramatically increase the business scope through management prioritizing a good balance

1. Summary of the medium- to long-term growth strategy

In April 2018, the Company announced the Long-Term Vision for 2030. It was described in detail in the report dated June 11, 2018, but to summarize its main points here, it is anticipated that the restructuring of the dispensing pharmacy industry will accelerate in a situation of the increase in health care costs being kept down in order to reduce the financial burden arising from the changes to the domestic social structure (such as the progression of the super-aging society) and from the rise in social security costs, and also the progress made in differentiating the functions required of pharmacies. In this situation, the image that the Company is aiming to realize is to achieve consolidated net sales of ¥1tn by 2030 by expanding the scale of the Dispensing Pharmacy business and developing the Pharmaceutical Manufacturing and Sales business and the Medical Professional Staffing and Placement business. Also, breaking down operating profit, the Dispensing Pharmacy business will provide 50%, while the Pharmaceutical Manufacturing and Sales business, the Medical Professional Staffing and Placement business, and any other businesses will provide the remaining 50%, so the aim is to build a well-balanced earnings portfolio. The features of the vision would appear to be that it depicts a growth strategy prioritizing balance, that it is a growth strategy not only for the portfolio of the Group as a whole, but also for each business segment, and that the Company is steadily progressing the growth strategy while anticipating business risks. The developments in each segment are described below.

The dispensing pharmacy industry is being further consolidated into the major players, and in this situation, the Company is aiming to actively expand its network of pharmacies while maintaining a good balance between organic openings and M&A, and between hospital adjacent-type and hybrid-type pharmacies.

2. Growth strategy for the Dispensing Pharmacy Business

(1) Effects of the revisions to the Pharmaceutical and Medical Device Act

In the business of dispensing pharmacies (also called insurance pharmacies in Japan), the business form itself, of pharmacies, is defined within the Japanese government's health insurance system. Therefore, it is considered that greater effects can be expected when the direction taken by a company is in line with the direction of the systemic reforms being advanced by the government (the Ministry of Health, Labour and Welfare). In this situation, the Pharmaceutical and Medical Device Act was revised in December 2019, which may greatly change the dispensing pharmacy industry environment. The main two points of these revisions were the nationwide lifting of the ban on online medication guidance from September 2020, and the introduction of a new pharmacy functions certification system from August 2021.

Schedule of Pharmaceutical and Medical Device Act revisions			
March 6, 2020	September 1, 2020	August 1, 2021	December 1, 2022
Cabinet approval of enactment dates	Enactment of (1) and (2)	Enactment of (3), (4) and (5)	Enactment of (6)
(1) Online medication guidance	Use of video telephone calls and other online devices to give instructions for taking medicine in accordance with rules for online medication guidance → Expansion of regions of Japan and eligibility of patients for online medication guidance		
(2) Mandatory follow-up while taking medicine	Requirement to monitor the use of drugs and provide instructions as needed after individuals receive prescriptions Pharmacists must take the initiative to supply information about an individual's use of a drug to a physician or others at other healthcare facilities		
(3) System for approval of new pharmacy functions	Start of prefectural governor approval of individual pharmacy functions to enable individuals to select pharmacies that best match their needs Approval of regional-cooperation pharmacies and specialized medical institutions cooperation pharmacies (renew every year)		
(4) Stronger governance	Strict compliance with laws/regulations and enforcement framework for companies with regulatory approval (Business oversight system, clarification of responsibilities of senior executives and on-site managers) Legal establishment of position of executive responsible for pharmaceutical operations		
(5) Electronic format for information provided with drugs	End of paper instructions packaged with drugs and replacement with an electronic format Drug packaging includes instructions for accessing the latest information about drug use and precautions		
(6) Bar code on drug containers	Bar codes are used for traceability extending from the procurement of drugs to after a customer receives instructions on how to use the drug		

Note: Prepared by Nihon Chouzai based on Revision to Pharmaceutical and Medical Devices Act (proposal)

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

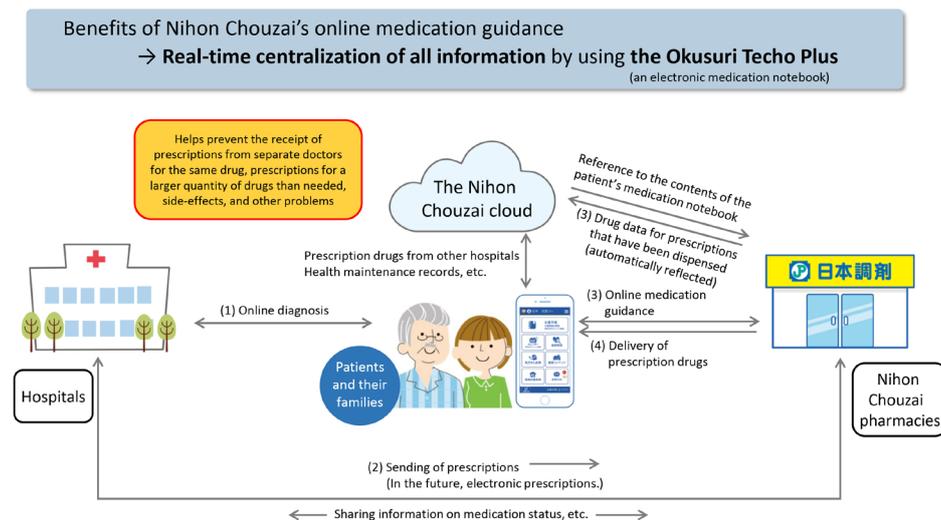
Remote medication guidance (online medication guidance from September 2020) has been provided up to the present time in the national strategic special zones. But the nationwide ban on remote health care will be lifted and it is expected that it will come to be in widespread use, and therefore it is anticipated that it will be one important service for dispensing pharmacies. In particular, following-up with patients simultaneously during the medication period will become mandatory, so responding to patients online will be an important measure for dispensing pharmacies

Medium- to long-term growth strategy

Also, in the pharmacy functions certification system, it seems that the patients themselves will be able to select the pharmacy suitable for them, and it is a system in which pharmacies will be divided into “regional-cooperation pharmacies,” which will have functions enabling responses in cooperation with other medical facilities, such as when a patient enters or leaves a hospital, and “specialized medical institutions cooperation pharmacies,” which will have functions enabling responses for specialized pharmaceutical management, such as for cancer treatment. Those pharmacies satisfying certain conditions will be certified by the prefectural governor, with certifications being updated every year. This can be said to be a measure that, in order to build the integrated care system, will strengthen the functions of family pharmacists and pharmacies in regions (regional-cooperation pharmacies) and also clarify the segregation of dispensing pharmacies that are required to carry out specialized pharmaceutical management. The main certification requirements for regional-cooperation pharmacies will include sharing information with facilities providing health care, and also achieving above a certain standard for the work structure and for at-home medical care as family pharmacists and pharmacies, and they will be requirements that were previously evaluated each time in the revisions to prescription dispensing fees, such as the regional support system additional points and the family pharmacist guidance fees.

The Company can be evaluated as making steady progress at the present time for its measures in response to these revisions. For remote medication guidance, it has been working on measures to introduce ICT since the 1990s through in-house developments, and it is a pioneer in this area within the industry. It has already established the centralization of information in real time through utilizing the Okusuri Techo Plus (an electronic medication notebook being used by around 500,000 people, as of April 2020) that it provides, and after the lifting of the nationwide ban in September 2020, it will benefit from having the first-mover advantage in this field. In order to respond to the spread of the COVID-19, in April 2020 it began providing medication guidance by telephone and using information-communication devices. Also, in the last 2 years in all its pharmacies, the Company has progressed measures for the regional support system premiums, and it is thought that this will also prove advantageous when its regional-cooperation pharmacies and other pharmacies join the certification system.

Image of remote medication guidance



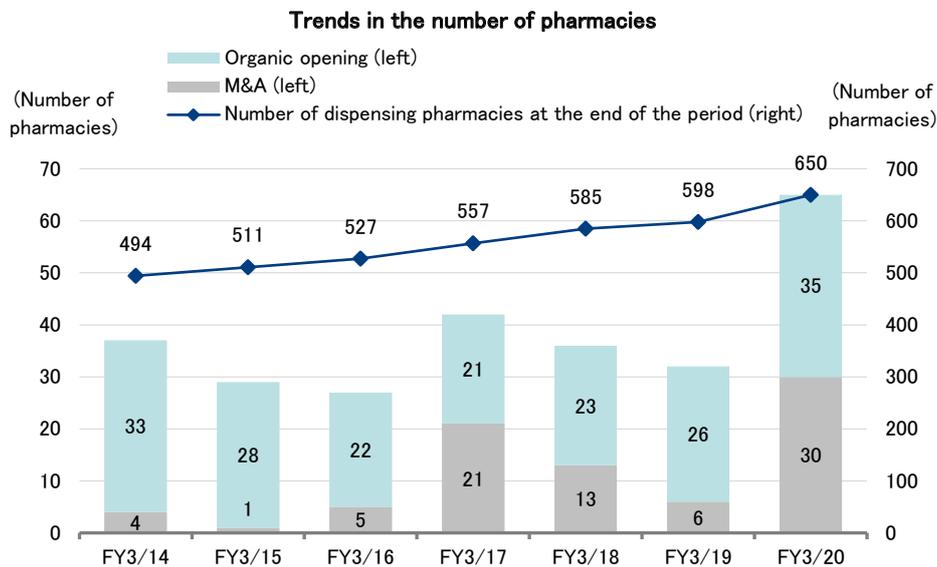
Source: Prepared by FISCO from the Company's results briefing materials

Medium- to long-term growth strategy

(2) The Company's growth strategy

At the present time there has been no change to the Company's basic growth strategy, which is a strategy that ascertains the changes to the ways of working and functions of dispensing pharmacies in the future, as described in the Vision of Pharmacies for Patients formulated by the Ministry of Health, Labour and Welfare in 2015, and also the changes to the industry's structure brought about by this Vision.

For its pharmacy-opening strategy, as previously described the Company is "opening pharmacies prioritizing a good balance." Its policy is to build a stable business structure, while aiming to expand the scale of sales, by opening 50 pharmacies a year, centered on organic openings, and also by opening them with a good balance between the hospital adjacent-type and the hybrid-type, centered on the main cities. Due to the revisions to the Pharmaceutical and Medical Device Act, it seems that going forward the consolidation of pharmacies into the major capital players will further accelerate, and it is expected that M&A projects will increase in the future for the Company as well.



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

Also, with the aim of "strengthening the management foundation," the Company is strengthening one-to-one work through training human resources and working to improve convenience for patients and work efficiency by utilizing ICT. For strengthening one-to-one work, it is progressing high quality education and training as measures that have in sight the certification system by function resulting from the revisions to the Pharmaceutical and Medical Device Act. In April 2018, it introduced an in-house certification system that it has set across multiple stages according to the pharmacists' knowledge, skills, and acquisitions of certifications, while it is also implementing various other measures, including subsidizing its pharmacists' acquisitions of external qualifications and providing hospital training for more than 100 employees a year. As a result of these measures, it ranks top among dispensing pharmacy companies for the number of pharmacists who have acquired the outpatient cancer treatment certification, and as of the end of April 2020, around 1 in 4 pharmacists who have been qualified this certification and working in dispensing pharmacies are our pharmacists. It has created a virtuous circle, in which the provision of high-quality education and training strengthens the pharmacies' functions and improves the quality of their services, which in turn leads to the expansion of the pharmacy network and the recruitment of high-quality pharmacists.

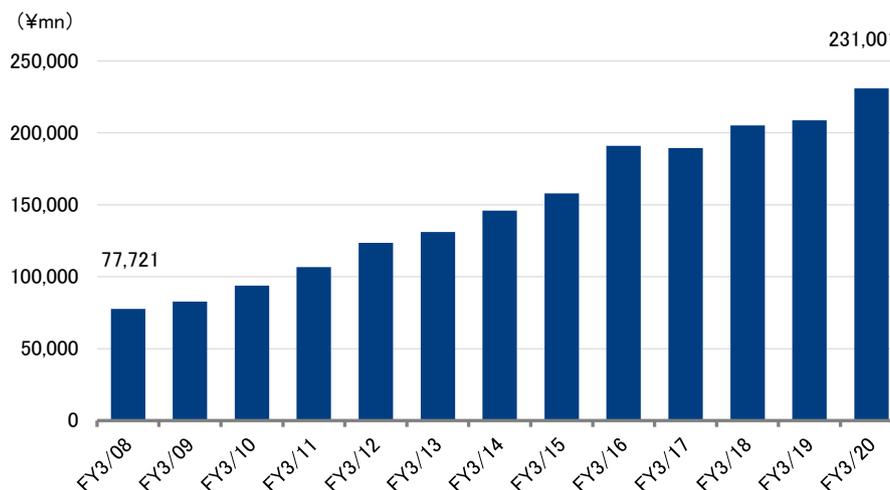
Medium- to long-term growth strategy

For the utilization of ICT, in addition to the previously mentioned Okusuri Techo Plus, the Company started a health consultation system in 2017 (health maintenance support for community residents) and in 2019, it established an online store and started selling health care products and other products. It is also progressing measures to improve work efficiency within pharmacies. Specifically, for medium-sized pharmacies with a sales scale of at least ¥500mn a year, it is installing equipment such as automated drug picking devices and automated PTP sheets dispensing devices. It plans to install them into a total of 200 pharmacies over 3 years, of 50 pharmacies in FY20, 70 pharmacies in the second year, and 80 pharmacies in the third year, and the investment amount will be approximately ¥2bn.

Pharmacies with a sales scale of at least ¥500mn a year require 5 to 6 pharmacists, but the number of pharmacists required can be reduced by 1 person by introducing equipment such as the automated drug picking device and the automated PTP sheet dispensing device. These devices are also expected to have other benefits, like reducing human error and improving the efficiency of inventory management. Pharmacists will be able to devote the extra time they have following their installation to one-to-one services, which will lead to an improvement in the quality of medical services. For this investment in equipment, the advantages of installing them are not realized unless the pharmacy's sales are above a certain scale. The Company Group's annual sales per pharmacy is approximately ¥370mn, which compares with the nationwide average of around ¥120mn, so it is thought that investing in equipment will lead to an improvement in its competitive advantage.

The Company is aiming to acquire a 10% share of the dispensing pharmacy industry by steadily progressing this strategy. Currently, its net sales are ¥231bn, which seems to be an industry share of around 2.5 to 3.0%. So, in order to achieve a 10% share, it will need to more than treble its sales scale to ¥700bn to ¥800bn. If looking only at the numbers, this appears to be a high hurdle to clear, but at FISCO we think that it is fully achievable when considering that in FY3/08, net sales in the Dispensing Pharmacy business were ¥77.7bn and they trebled in scale in the following 12 years, and also from the progress in consolidating pharmacies into the major industry players.

Trend in the Dispensing Pharmacy business' net sales



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

Medium- to long-term growth strategy

Aiming to grow earnings by increasing in-house approved products and improving productivity following the start of operations at Tsukuba Plant No.2

3. The Pharmaceutical Manufacturing and Sales business growth strategy

In the Long-term Vision toward 2030, the Company sets the target of acquiring a market share of 15% for the Pharmaceutical Manufacturing and Sales business. The significance of this value of 15% is that it means it will be one of the surviving companies, based on the view that generic pharmaceutical manufacturers will be consolidated into 5 or 6 companies in the future. Its policy is to expand the business scale by increasing in-house approved products through investing in R&D. It appears that the key to achieving the target will be that, if this business grows from sales to the Company Group's dispensing pharmacies, sales in the Pharmaceutical Manufacturing and Sales business will increase and synergies will appear in a form that is easy to understand.

In the FY3/20 sales results, sales to external customers were ¥24,899mn and sales to the Company's Group were ¥18,172mn. So internal sales are still below external sales, but in the medium term, they are forecast to grow to around the same level. This is because, as previously stated, the Company is still aiming to treble the sales scale of the Dispensing Pharmacy business by increasing the number of pharmacies in the future. This means that sales to the Company's Group may treble in size.

In addition to the growth in the scale of sales, it appears that in the future the effects of the improved productivity due to the start of operations of the Tsukuba Plant No.2 will also be realized. In March 2018, the Company completed Tsukuba Plant No.2 and it started shipping products in November of the same year, and since then, it has continued to operate steadily. Following the completion in March 2019 of the two-plant structure, of the Tsukuba Plant and the Tsukuba Plant No.2, the Company sold the Kasukabe Plant and reorganized its plants. It has introduced the latest automated production line into the Tsukuba Plant No.2, and it is highly productive. It is considered that improving cost competitiveness will lead to a rise in orders for contracted production projects, which will in turn lead to an increase in sales to external customers.

The maximum annual production capacity of Plant No.2 is 10bn tablets, but currently, of the three production lines, only 1 has been installed and is operational. In the future, the plan is to increase the production lines at the stage at which orders are expected to grow (the investment amount to increase the production lines will be ¥3bn to ¥4bn per line). Currently, the maximum annual production capacity of the Group is 8.6bn tablets, which will increase to 15.3bn tablets at the stage when Plant No.2 is fully operational. The Company does not intend to produce entirely in-house the items it develops itself, and it outsources the production of items for which production can be outsourced to external parties inexpensively with no change to the profit margin. If looking on a number-of-items basis, the ratio of outsourced production items will be just under 50%.

By increasing sales to the Company's Group and strengthening the contract production business, the Company is aiming to be among the major generic pharmaceutical manufacturers. If it realizes the expansion of sales scale, the operating profit margin, which is currently only around 3%, is forecast to rise to as high as around 10%.

Medium- to long-term growth strategy

In addition to the growth of the doctor placements business, is targeting expanding into new business fields

4. The Medical Professional Staffing and Placement business growth strategy

The Medical Professional Staffing and Placement business has realized growth up to the present time with the pharmacist staffing business serving as the core business. The Company intends to realize growth in the future by shifting from staffing to placements in the pharmacist business, while also expanding the occupations that it handles by growing the placements business for doctors and registered sales staff.

In particular, the Company's policy is to actively conduct sales for the doctor placements business as it has a high placements unit price, and it is aiming for it to provide around 20% of the sales of this business segment in the future. The companies that were the first to enter the doctor placements field have overwhelmingly large market shares and name recognition, but it is considered that the Company intends to acquire customers by utilizing the network it constructed for pharmacists staffing and its network of medical facilities and doctors.

The demand for pharmacists is shifting from staffing to placements, so to reflect this, the Company is also shifting to a pharmacist placements business. In FY3/19, it conducted upfront investment, including to increase the number of bases and the number of sales staff, and the effects of this upfront investment appeared in FY3/20 as an increase in profits. In the future also, in addition to the growth of the staffing business in which a firm, constant level of demand can be expected, and the placements business that has a high profit margin, its policy is to expand this business segment centered mainly on the doctor placements business, which is growing in scale.

Income statement and the main indicators

	FY3/17	FY3/18	FY3/19	FY3/20	FY3/21 (forecast)
Net Sales	223,468	241,274	245,687	268,520	291,813
YoY	1.9%	8.0%	1.8%	9.3%	8.7%
Gross profit	39,258	43,837	41,975	46,372	48,806
Gross profit margin	17.6%	18.2%	17.1%	17.3%	16.7%
SG&A expenses	30,738	33,250	35,242	38,779	42,302
Ratio of SG&A expenses to net sales	13.8%	13.8%	14.3%	14.4%	14.5%
Operating profit	8,519	10,587	6,733	7,593	6,504
YoY	-18.8%	24.3%	-36.4%	12.8%	-14.3%
Operating profit margin	3.8%	4.4%	2.7%	2.8%	2.2%
Ordinary profit	7,976	10,138	6,077	7,405	6,266
YoY	-19.3%	27.1%	-40.1%	21.8%	-15.4%
Profit attributable to owners of parent	4,638	6,104	3,790	6,697	3,122
YoY	-26.7%	31.6%	-37.9%	76.7%	-53.4%
EPS after adjustment for stock split (¥)	145.02	190.84	121.74	223.33	104.14
Dividend per share after adjustment for stock split (¥)	25	25	25	25	25
BPS after adjustment for stock split (¥)	1,139.35	1,297.50	1,369.52	1,569.77	-

Note: Conducted a (2-for-1) share split in April 2020, and the per share indicators have been retroactively adjusted.
 Source: Prepared by FISCO from the Company's financial results

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Medium- to long-term growth strategy

Balance sheet

	(¥mn)				
	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Current assets	84,838	82,327	81,613	80,132	87,414
Cash and deposits	32,385	21,200	28,464	29,749	32,254
Accounts receivable	26,810	27,643	21,230	17,848	21,848
Inventories	22,016	29,514	28,224	29,465	29,960
Fixed assets	72,770	96,019	104,956	98,545	98,137
Tangible fixed assets	51,997	68,513	75,662	69,806	66,082
Intangible fixed assets	10,122	16,773	17,952	16,906	19,425
Investments, etc.	10,650	10,733	11,341	11,833	12,628
Total assets	157,609	178,347	186,569	178,677	185,551
Current liabilities	68,985	66,305	70,310	69,100	70,107
Short-term debt, etc.	12,963	13,411	15,309	16,143	9,506
Fixed liabilities	56,151	75,595	74,752	68,504	68,370
Long-term debt, etc.	50,621	70,678	68,372	62,470	62,963
Total net assets	32,473	36,447	41,506	41,073	47,072
Total liabilities and net assets	157,609	178,347	186,569	178,677	185,551

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

Cash flow statement

	(¥mn)				
	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20
Cash flow from operating activities	19,327	-940	23,141	13,572	13,192
Cash flow from investing activities	-7,823	-28,444	-13,843	-1,770	-2,731
Cash flow from financing activities	7,031	18,205	-2,034	-10,516	-7,955

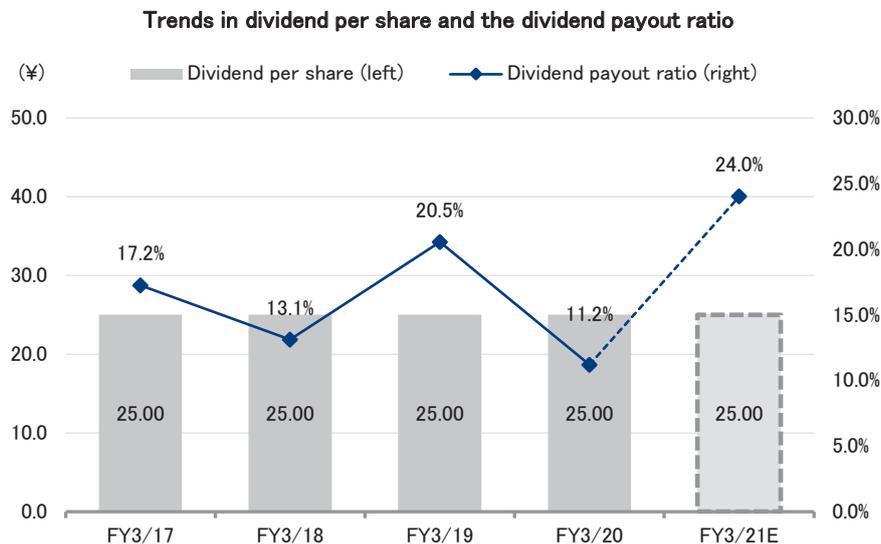
Source: Prepared by FISCO from the Company's financial results

Shareholder returns

In FY3/21, plans a dividend of ¥25, which is unchanged YoY in actual terms, and has newly introduced a shareholder benefits program

For returns to shareholders, in FY3/20 the Company newly introduced a shareholder benefits program, in addition to returns from dividends. Its basic policy is to return profits to shareholders in the form of dividends linked to management results, while also considering factors such as its demand for capital for growth and financial situation. At the present time, it seems that it is stably and continuously paying dividends even as it supplements internal reserves in preparation for the large reorganization of the dispensing pharmacy industry. It conducted a 2-for-1 share split in April 2020.

For the FY3/21 dividend per share, the Company plans to keep the dividend unchanged YoY in actual terms at ¥25.0 (dividend payout ratio, 24.0%), even while forecasting a decrease in profits. Also, for the shareholder benefits program, as of June 2020, shareholders (holding at least 100 shares) registered at the end of March 2020 will receive a coupon for the Company's online store depending on the number of shares they hold. Those holding from 100 to 499 shares will receive a coupon for ¥3,000, and those holding 500 or more shares a coupon for ¥15,000. It may review the shareholder benefits at any time in consideration of results trends and other factors.



Note: conducted a 2-for-1 share split on April 2020. Values have been retroactively adjusted.
 Source: Prepared by FISCO from the Company's financial results



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