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Highlights of Major Dispensing Pharmacies' Financial Results for Fiscal Year Ended March 2016

The following is Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended March 2016 (FY2015) and earnings forecasts for FY2016 of 6 dispensing pharmacies: Qol Co., Ltd., NIHON CHOUZAI Co., Ltd., MEDICAL SYSTEM NETWORK Co., Ltd., SOGO MEDICAL CO., LTD. and TOKAI Corp. with fiscal year end in March and AIN HOLDINGS INC. with fiscal year end in April.

1. Industry Trend

The rate of separation of medical and dispensary practice has been gradually rising and reached 70% in FY2015. Along with the increased rate, dispensing pharmacy market has been growing. The growth rate tends to be low in the 1st year of a drug price revision when prices are reduced and to rebound in the 2nd year of the revision as the effects of the price cut cease. Thanks partly to a rapid expansion of prescription of therapeutic agent for hepatitis C immediately after the launch, FY2015, the 2nd year of the revision, saw a significant growth of 8.2% year-on-year in the market (Chart 1). In FY2016, where a 5.57% reduction in drug prices was made, the growth rate will remain at a low level.

The revision rate of the dispensing fee revision in FY2016 was +0.17%. However, calculation requirements for premiums for generic drug dispensing and for standard dispensing were tightened. In addition, a special treatment that basic dispensing fees can be reduced for only chain pharmacies which receive more than 40,000 prescription requests a month (which JCR assumes corporate groups with net sales of more than 5.0 billion yen) was introduced. These revisions were tough ones for Japan's major dispensing pharmacies. It is considered that major pharmacies' unit technical fees have been reduced from the fees immediately before the revision. JCR will watch to what extent they can cover the lowered fee revenue by their countermeasures.

Ministry of Health, Labour and Welfare formulated in October 2015 its "Vision for Pharmacies for Patients." Under the vision, it expects that all pharmacies will have functions as personal pharmacies by 2025 and that pharmacies centering on those located in front of large hospitals will be relocated to areas closer to the patients by 2035. Under the FY2016 dispensing fee revision, "consultancy and administration fee by personal pharmacist" was newly created in order to strengthen functions of personal pharmacies. Going forward, the revisions might be made in line with this vision. JCR considers it is necessary to watch measures to be taken by major pharmacy companies and long-term impact of such revisions on their business development.

2. Financial Results

Both total net sales and operating income of the 6 companies increased for FY2015, growing 16.6% and 32.6% year-on-year to 893.0 billion yen and 49.2 billion yen, respectively, with the operating income margin reaching 5.51%, up 0.67%. Looking at individual results, all companies reported higher net sales and operating income, and 5 companies except TOKAI achieved operating income margin growth. Primary factors for the good results for FY2015, where no major changes in the system that cause negative impact on business performance were made as the 2nd year of the drug price revision, are the increased number of customers visiting newly opened stores, increased revenue thanks to expanded use of therapeutic agent for hepatitis C and increased unit technical fees along with progress of calculations for major premiums including those for generic drug dispensing. As shown by a higher total operating income of the 6 companies by 7.1 billion yen than the forecast amount of 42.1 billion yen at the beginning of the fiscal year, the financial results for FY2015 were good in general.

On the financial front, equity ratio and D/E ratio of the 6 companies combined as of the end of FY2015 improved to 34.64% and to 0.78, up 1.27% and down 0.10 from a year earlier, respectively. This is attributable to the accumulation of equity capital as each company keeps faring well. In particular, NIHON CHOUZAI's equity capital as of March 31, 2016 increased 84.1% from a year earlier, pushing up the equity ratio of the 6 companies. While NIHON CHOUZAI and MEDICAL SYSTEM NETWORK decreased interest-bearing debt, other 4 companies increased the debt by aggressively engaging themselves in opening of their own new stores and M&As. All 6 companies had a positive free cash flow. While investment cash flow of the 6 companies was minus 49.0 billion yen with the increased cash outflow of 9.0 billion yen from a year earlier, operating cash flow grew to 69.9 billion yen for FY2015 from 45.8 billion yen a year earlier.

3. Highlights for Rating

Total net sales and operating income of the 6 companies for FY2016 are forecast at 967.5 billion yen and 50.1 billion yen, up 8.3% and 2.0% year-on-year, respectively. All 6 companies expect higher net sales. While Qol, NIHON CHOUZAI and AIN HOLDINGS expect higher operating income, MEDICAL SYSTEM NETWORK, SOGO MEDICAL and TOKAI expect lower operating income.

For the net sales, the upward trend will likely continue as the number of customers is expected to increase for the recently opened stores, but critical factors in the achievement of target figures seem to be dependent on the progress in opening new stores and the outcome of M&As. For the income, primary factors for the decrease are reduction of drug prices and dispensing fee revision. Offsetting these negative factors by increasing revenue through the increased number of stores and by efforts to raise their unit technical fees will be a challenge for them. JCR considers that there are no major differences among 6 companies in terms of factors for the increase/ decrease of operating income, but impact of the dispensing fee revision differs from company to company, depending on their individual characteristics including store locations, and the number of opening stores and improving degree of unit technical fees are creating differences among them in terms of direction of business performance. They will take time to respond to the dispensing fee revision and will improve their unit technical fees toward the fiscal year end. It is highly likely that their business performance will move in tandem with these moves. NIHON CHOUZAI and Qol plans to support their consolidated business performance by businesses other than the dispensing pharmacy business. JCR will pay attention to the future developments as to their business performance.

All 6 companies intend to keep opening new stores and implementing M&As, In particular, M&As due to shortage of successors and pharmacists remain active. Their investments may be larger than operating cash flow. Although steady performance will help build up net assets in general, total assets and interest-bearing debt will also easily increase. Given this, JCR considers it is highly likely that their financial improvement will be slow.

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(Chart 1) Year-on-Year Growth of Domestic Dispensing Fee, Number of Prescriptions and Dispensing Fee per Prescription and Drug Price Revision Rate

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015 Apr.-Nov. (YoY)
Dispensing Fee	7.9%	3.6%	7.9%	1.3%	5.9%	2.3%	8.2%
No. of Prescriptions	1.5%	4.3%	2.2%	1.5%	0.6%	1.8%	1.7%
Dispensing Fee per Prescription	6.3%	-0.6%	5.5%	-0.2%	5.4%	0.5%	6.4%
Drug Price Revision Rate	-	-5.75%	-	-6.00%	-	-2.65%	-

Source: Prepared by JCR based on Ministry of Health, Labour and Welfare "Trend in Recent Dispensing Fee (for Computerized Process)"

(Chart 2) Business Performance of Dispensing Pharmacies

(Y100 mn)

	FY	Net Sales	Operating Income	Net Income	Total Assets	Equity Capital	Interest-bearing Debt
QoI (3034)	FY2014	114,363	4,243	2,155	59,573	19,152	18,187
	FY2015	124,957	6,709	3,641	69,921	20,837	23,194
	FY2016F	138,000	6,800	3,700			
NIHON CHOUZAI (3341)	FY2014	181,844	6,647	2,778	130,141	17,635	67,893
	FY2015	219,239	10,489	6,329	157,609	32,473	66,361
	FY2016F	240,013	11,165	6,642			
MEDICAL SYSTEM NETWORK (4350)	FY2014	75,548	2,641	885	45,587	5,797	24,603
	FY2015	87,715	3,783	1,720	48,847	9,796	21,769
	FY2016F	92,000	3,270	1,210			
SOGO MEDICAL (4775)	FY2014	107,945	5,017	2,774	69,811	26,337	14,544
	FY2015	120,776	6,087	2,318	74,621	29,443	16,779
	FY2016F	126,507	6,005	3,730			
AIN HOLDINGS (9627)	FY2014	187,904	11,452	6,197	114,149	47,928	15,311
	FY2015	234,843	14,619	7,917	139,888	53,259	21,742
	FY2016F	265,000	16,300	9,000			
TOKAI (9729)	FY2014	98,159	7,092	4,586	73,865	47,690	3,957
	FY2015	105,517	7,513	5,226	80,252	52,049	4,480
	FY2016F	106,043	6,647	4,501			
Total	FY2014	765,763	37,092	19,375	493,126	164,539	144,495
	FY2015	893,047	49,200	27,151	571,138	197,857	154,325
	FY2016F	967,563	50,187	28,783			

Note: Interest-bearing debt is a total of short-term borrowings, current portion of bonds, current portion of long-term borrowings, lease obligations (current liabilities), bonds, long-term borrowings, lease obligations (non-current liabilities), and long-term accounts payable - installment purchase (non-current liabilities).

Source: Prepared by JCR based on financial materials of above companies)

<Reference>

Issuer: NIHON CHOUZAI Co., Ltd.

Long-term Issuer Rating: BBB- Outlook: Stable

Issuer: SOGO MEDICAL CO., LTD.

Long-term Issuer Rating: BBB Outlook: Stable

Issuer: AIN HOLDINGS INC.

Long-term Issuer Rating: A- Outlook: Stable

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