Pharmarise HDS | 2796

TSE Standard

4Q Follow-up

Despite unforeseen events, dispensing pharmacy chain grows to over 300 stores

FY2024/5 Earnings Result Summary

FY2024/5 results of Pharmarise Holdings (hereafter, the Company) came with no surprises, as it had already issued two downward revisions to its forecast, on March 25 and June 14, with profits falling significantly short of the initial plan. While net sales exceeded the initial target of ¥53,550 mn, reaching ¥54,470 mn, operating profit came in at ¥920 mn, down ¥560 mn from the planned ¥1,480 mn. Net profit, initially projected at ¥450 mn, ended in a ¥350 mn loss, representing a shortfall of ¥790 mn.

The reasons for the profit shortfall were: 1) The reduction in basic dispensing fees due to the expanded store network, which took effect earlier than planned in April, resulting in a negative impact of roughly ¥100 mn. 2) Costs related to the acquisition of GOOD AID, coupled with rising procurement prices for pharmaceuticals. 3) An additional ¥230 mn in costs to correct the consumption tax treatment of inter-subsidiary transactions over the past three years. 4) An extraordinary loss of ¥367 mn in FY2024/5, due to goodwill impairment from certain unprofitable stores, leading to a net loss for the period, although this is considered a one-off factor.

Company forecast for FY2025/5

The Company's forecast has been set conservatively, with a focus on profit recovery in the dispensing pharmacy business which had underperformed in the previous fiscal year. Net sales are forecasted to rise from ¥54,470 mn to ¥60,880 mn, operating profit from ¥920 mn to ¥950 mn, and net profit from a loss of ¥350 mn to a profit ¥40 mn. As this is the final year of the current mid-term plan, the Company revised its targets in August to reflect the current forecast (previous targets for operating and net profit were ¥1,880 mn and ¥880 mn, respectively). This revision is mainly due to the reduction in basic dispensing fees triggered by the store network exceeding 300 stores—a factor not accounted for when the mid-term plan was initially set. However, this is viewed as an inevitable outcome of the Company's expansion strategy. The acquisitions conducted in the previous year, including GOOD AID. CO. LTD and Machihoke Pharmacy, aim to improve scale economies, positioning this fiscal year as laying the foundation for future growth.

Shareholder returns

The Company plans to maintain an annual dividend of ¥14 per share this fiscal year, which is nearly four times the forecast EPS (compared to the previous year's ¥20 dividend, which included a ¥6 commemorative dividend), reflecting its focus on dividend stability.

¥mn, %	Net Sales	YoY (%)	Operating Profit	YoY (%)	Ordinary Profit	YoY (%)	Net Profit	YoY (%)	EPS	DPS
2021/5 C	52,324	3%	1,246	21%	1,288	26%	426	(26%)	45.8	14
2022/5 C	51,608	(1%)	1,520	22%	1,517	18%	447	5%	48.0	14
2023/5 C	52,030	1%	1,438	(5%)	1,431	(6%)	333	(26%)	35.5	14
2024/5 C	54,466	5%	916	(36%)	833	(42%)	(351)	(TR)	(33.4)	20
2025/5 CE	**60,880**	**12%**	**949**	**4%**	**804**	**(3%)**	**40**	**(TB)**	**3.6**	**14**

Source: Compiled by SIR from the Company TANSHIN report. TR=Turned Red, TB=Turned Black

Focus Point

Pharmarise HD, one of the major dispensing pharmacy chain operators, is preparing for future industry consolidation. It can be argued that the company's November 2023 capital and business alliance with Suzuken will increase the possibility of future expansion.

Key Indicators	
Share price (9/9)	609
52W H (24/1/12)	722
52W L (24/8/5)	523
10YH (20/9/29)	851
10YL (16/7/14)	456
Shrs out. (mn shrs)	12.06
Mkt cap (¥ bn)	7.35
Equity ratio (24/5)	24.97%
FY24/5 P/B (act)	0.96x
FY25/5 P/E (CE)	167.7x
FY24/5 ROE (act)	-4.93%
FY25/5 DY (CE)	2.3%

Stock Price Chart 1 Year



Source: Trading view

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FY2024/5 Earnings Result

The Company had already revised its FY2024/5 results forecast downward on March 25 and June 14. Due to several unforeseen events during the year, profits came in significantly below the initial plan. Sales exceeded expectations, coming in at ¥54,470 mn versus the initial plan of ¥53,550 mn, due in part to the effect of acquisitions. However, operating profit fell short, landing at ¥920 mn, down ¥560 mn from the initial plan of ¥1,480 mn. Net profit saw a substantial decline, ending at -¥350 mn, ¥790 mn below the initial forecast of ¥450 mn.

The three main causes for the shortfall in operating and net profits were:

1) As mentioned in the last issue of the initiation report, the reduction in basic dispensing fees (change in classification) was triggered due to the store network exceeding 300 stores, as mentioned in the previous Initiation Report. This was assumed to take effect from June 2024, but it began earlier than expected, in April, leading to a negative impact of roughly ¥100 mn.

2) Acquisition costs of roughly ¥200 mn related to the purchase of GOOD AID and other companies, along with an additional ¥200 mn impact from the increase in pharmaceutical procurement costs.

3) The Company has been instructed by the Tokyo Regional Taxation Bureau to correct the consumption tax treatment of inter-subsidiary transactions for the past three years, resulting in an impact of roughly ¥230 mn on an operating profit basis.

These factors combined resulted in an operating profit shortfall of roughly ¥730 mn. This shortfall was partially offset by increases in prescription volume and sales in the retail (drugstore) business, resulting in the figures for FY2024/5.

In addition, the Company recorded an extraordinary loss of ¥367 mn in FY2024/5 due to goodwill impairment related to certain unprofitable stores. As a result, net profit fell into the red, though this is expected to be a one-off event.

Quarterly Financial Results

¥mn, %		Sales	YoY	Operating Profit	YoY	Ordinary Profit	YoY	Net profit	YoY	EPS
FY23/05	3Q	12,985	2.4%	323	52.4%	324	62.0%	136	88.9%	14.4
	4Q	13,300	2.1%	542	4.2%	541	7.6%	125	0.0%	13.3
FY24/05	1Q	13,471	4.7%	331	(4.9%)	331	(2.9%)	123	10.8%	13.1
	2Q	13,477	4.6%	379	68.4%	370	64.4%	150	TB	12.4
	3Q	13,726	5.7%	153	(52.6%)	98	(69.8%)	(96)	(TR)	(8.2)
	4Q	**13,792**	**3.7%**	**53**	**(90.2%)**	**34**	**(93.7%)**	**(528)**	**(TR)**	**(50.7)**

Source: Complied by SIR from the Company IR material.

Net sales and profit by segment

¥mn, %	FY2019/05 Full year	FY2020/05 Full year	FY2021/05 Full year	FY2022/05 Full year	FY2023/05 Full year	FY2024/05 Full year
Net Sales by Segment						
Dispensing Pharmacy	40,613	40,417	42,530	42,038	42,327	44,178
Drug/Convenience Store	9,244	8,816	7,963	7,602	7,771	8,283
Medical Mall	511	505	491	503	505	506
Storage and Management of Medical Documents	702	667	622	699	646	664
Segment Profit						
Dispensing Pharmacy	945	1,323	1,444	1,745	1,685	1,096
Drug/Convenience Store	(153)	(136)	(42)	(146)	(199)	(50)
Medical Mall	89	73	60	67	90	91
Storage and Management of Medical Documents	94	72	64	107	81	113

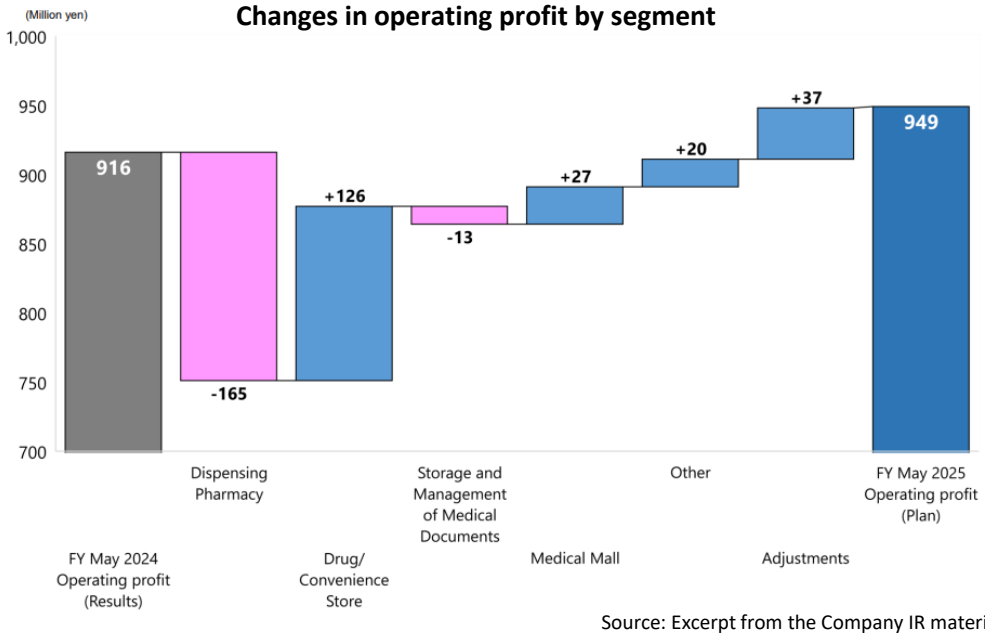
Source: Complied by SIR from the company IR material.

FY2025/5 Earnings Forecast

Company forecast for FY2025/5

As previously mentioned, the Company's performance for FY2024/5 fell significantly below expectations due to several unforeseen events, leading to two downward revisions to its earnings forecast in March and June 2024. As such, it remains key for investors to evaluate how a future recovery can be assured.

Changes in operating profit by segment



Source: Excerpt from the Company IR material.

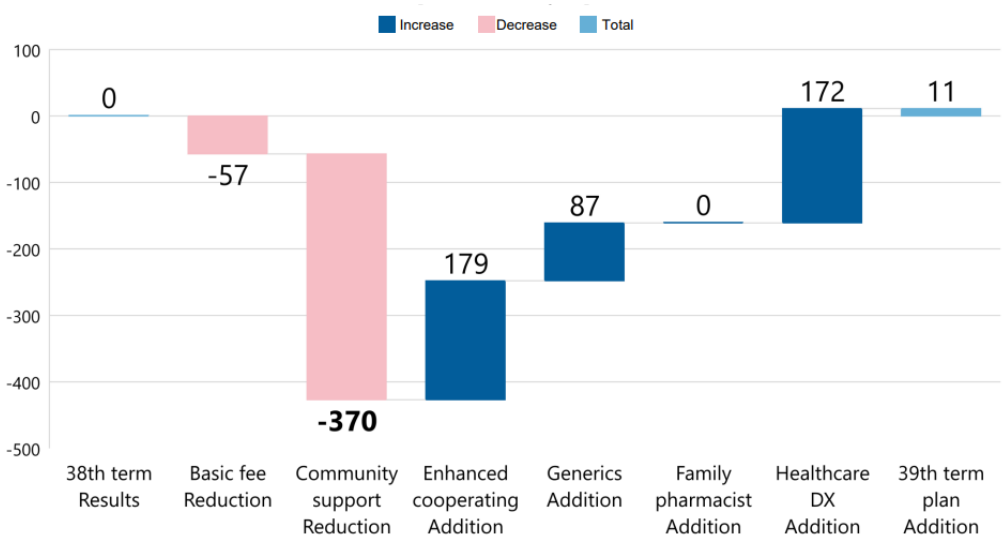
To state the conclusion first, the Company's forecast for FY2025/5 is believed to be quite conservative, reflecting its intention to firmly secure profits in the dispensing pharmacy business, which underperformed in the previous year.

The Company forecasts net sales to increase to ¥60,880 mn, up from ¥54,470 mn in the previous fiscal year, driven in part by acquisitions. Operating profit is projected to rise slightly, from ¥920 mn to ¥950 mn, while net profit is expected to recover to ¥40 mn from the previous year's loss of ¥350 mn. These forecasts are considerably more conservative than the initial targets laid out in the Company's mid-term plan, which targeted operating profit of ¥1,880 mn and net profit of ¥880 mn (in August, the Company revised its mid-term targets to align with the current forecast.)

The conservative forecast reflects several factors that were not anticipated when the mid-term plan was initially formulated. The reduction in basic dispensing fees, caused by a reclassification as the store count surpassed 300, is expected to negatively impact operating profit by approximately ¥400 mn (partially reflected ahead of schedule in FY2024/5). This should be viewed as an inevitable outcome of the Company's expansion strategy, as the basic dispensing fee is set to decrease when the store count exceeds 300. To mitigate this, the Company has been focusing on achieving economies of scale and improving efficiency, particularly through the acquisition of five companies last year, including GOOD AID and Machihoke Pharmacy (formerly Meitetsu Pharmacy). Hence, the current fiscal year can be seen as laying the groundwork for future growth.

Although the dispensing pharmacy business is expected to face a reduction of approximately ¥400 mn in technical fees (including basic fees, community support premiums, and family pharmacist registrations), the Company plans to offset much of this negative impact through the contribution of more than 40 newly acquired stores, including those from GOOD AID and facilities serving nursing homes.

Technical fee accrual plan for FY 2025/5 (full year / unit: ¥mn)



Source: Excerpt from the Company IR material.

The issue, however, is that pharmaceutical procurement costs and labor expenses have continued to rise since the previous fiscal year. While the Company's forecast for FY2025/5 seems to account for these increases to some extent, profit buffer does not appear to be substantial. This will be a key point to monitor, with clearer trends expected to emerge by the first-half results.

To summarize the Company's earnings forecast, this year will see goodwill amortization related to the acquisition of GOOD AID coincide with the negative impact of reduced basic dispensing fees due to the store count exceeding 300. It is shaping up to be a challenging year, where the key focus will be on how much of this profit shortfall can be offset through scale expansion and efficiency improvements. Operationally, the Company also faces the challenge of ensuring that the newly acquired stores achieve the same profit margins as its existing Pharmarise stores. The consolidation of dispensing pharmacy chains is expected to continue, and post-merger integration (PMI) will become increasingly important in bringing newly acquired chains up to best practice standards. The Company has recently accelerated its acquisitions, with its current dispensing pharmacy network standing at 351 stores, or 400 stores when including drugstores. Looking ahead, the dispensing pharmacy business will require significant digital transformation (DX) investments, particularly as health insurance cards transition to "My Number" cards. Amid industry consolidation, the Company is positioning itself for growth and moving towards becoming a major player in the market.

Shareholder Returns

The Company plans to maintain an annual dividend of ¥14 per share this fiscal year, which is nearly four times the forecast EPS (compared to the previous year's ¥20 dividend, which included a ¥6 commemorative dividend), reflecting its focus on dividend stability. More important are the trends in the share repurchase program. In January 2024, the Company set a buyback limit equivalent to 12.07% of its issued shares. To date, however, no shares have been repurchased. Acquiring this volume of shares on the open market could significantly reduce the float, and hence, it would be preferable for the Company to repurchase from large or strategic shareholders instead.

Share Price Insight

The stock price appears to be trading near the Company's net assets per share for FY2024/5, which stands at ¥636.25. With a dividend yield of approximately 2.3%, a PBR of 1x suggests some downside resistance. However, while the Company is expected to return to profitability in FY2025/5, ROE is just 0.6%, so it goes without saying that enhancing profitability would be key to further stock price appreciation. In addition to the previously mentioned share repurchase program, key positive drivers to watch include improving the profitability of the dispensing pharmacy chains acquired last fiscal year and continued increases in prescription volumes.

Relative Stock Price Chart vs. TOPIX (1 year)



Source: TradingView

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