TSURUHA HOLDINGS INC

TSURUHA HOLDINGS INC.

Q2 Financial Results Briefing for the Fiscal Year Ending May 2022

December 21, 2021

Event Summary

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[Participants]	
[Number of Speakers]	3

Jun Tsuruha	President and Representative Director
Makoto Murakami	Executive Officer and Chief Administrative Officer
Takuya Yamazaki	Investor Relations Manager

Presentation

Yamazaki: As the time has now come, we will hold a briefing on the 2Q Financial Results Briefing for the Fiscal Year Ending May 2022 of TSURUHA HOLDINGS INC. We would like to introduce today's attendees. Jun Tsuruha, President and Representative Director.

Tsuruha: This is Tsuruha. I'm looking forward to working with you.

Yamazaki: Makoto Murakami, Executive Officer and Chief Administrative Officer.

Murakami: This is Murakami. I'm looking forward to working with you.

Yamazaki: I'm Takuya Yamazaki, the Investor Relations Manager. I will also be in charge of moderating today's session. I'm looking forward to working with you.

In today's presentation, we will be sharing the presentation materials of the financial results briefing on the screen. In addition, please refer to the financial results briefing materials, supplementary materials, and financial results summary posted on our website.

The following is a brief overview of today's proceedings. First, Murakami will explain the business results for the current fiscal year, followed by Tsuruha, who will explain the initiatives and policies for the current fiscal year. We will then move on to the question-and-answer session. We will now move on to the explanation of financial results. Please go ahead.

Financial Highlights

Revenue increased but profit decreased due to sales struggles in the latter half of 2Q

Results for 2Q of FY5/22 *Drug Eleven, including 3 months (2Q of FY5/21)

Net sales	Operating income
JPY 462.5 billion (+2.0% YoY)	JPY 22.7 billion (-18.9% YoY)

Business Conditions

- Reactionary decline from the stay-at-home demand
- Sluggish sales of seasonal products, missing target
- SG&A budget below target

Topics

- DX strategies such as digital cosmetics ledgers and data-driven sales promotion
- To meet new needs, introducing perishable foods and 100-yen products, and promoting e-commerce
- Marketing of environmentally friendly PB products

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Murakami: I will now provide an overview of the business results for 2Q of FY2022. I'm looking forward to working with you.

Please refer to page 3 of the explanatory materials. First, the highlights of the financial results.

In the first half, sales were JPY462.5 billion, up 2% from the previous year. Operating income was JPY22.7 billion, down 18.9% from the previous year.

In terms of the business overview, sales fell short of the plan due to a reactionary decline in demand for consumption-from-home and sluggish sales of seasonal products. Meanwhile, SG&A expenses are progressing below budget.

The first topic is the introduction of a digital cosmetics ledger as part of our DX strategy. We are also preparing for data-driven sales promotion through our membership application. Secondly, as a measure to improve convenience, we are continuing to promote the introduction of fresh food and 100-yen stores. In addition, for e-commerce, we have established a second shipping center in the Kanto region to meet new needs. Thirdly, as a response to sustainability, we have launched environmentally friendly private brand products.

Consolidated Performance (Vs. Plan)

Vs. Plan (millions of yen / %)

	Forecast		Results			
		Share		Share	Vs. Plan	Difference
Net sales	472,000	100.0	462,512	100.0	98.0	(9,487)
Gross profit	140,300	29.7	136,817	29.6	97.5	(3,482)
SG&A expenses	115,700	24.5	114,107	24.7	98.6	(1,592)
Operating income	24,600	5.2	22,709	4.9	92.3	(1,890)
Ordinary income	24,777	5.2	22,622	4.9	91.3	(2,154)
Net income attributable to owners of the parent	14,300	3.0	12,739	2.8	89.1	(1,560)

Net sales

- YoY change in existing stores (stores open for 13 months or more) Target +0.4% → Actual -1.0%
  - Seasonal products, including cold medicine, slumped more than forecasted
- New store openings: 70

Gross profit

- Budgetary variance in net sales, not reaching the target

SG&A expenses

- Extrabudgetary expenses paid, such as donations, but within budget

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Please see the next page. I will now explain the details of the figures.

First of all, net sales and gross profit were 98% and 97.5% of their respective targets. As 1Q progressed almost according to plan, the decline in 2Q of the current fiscal year was the reason why the first-half total did not reach the planned level. This is due to a slower than expected recovery in OTC drugs such as cold medicine and institutional cosmetics, as well as a slump in seasonal products.

Next, SG&A expenses were within budget as in 1Q. On the other hand, we also incurred unbudgeted expenses such as donations of disinfectant gel to local governments. As a result, operating income came in at 92.3% of the budget.

Consolidated Performance (YoY)

YoY change *Drug Eleven, including 3 months (2Q of FY5/21) (millions of yen / %)

	FY5/21		Results			Estimate based on former standards		
	Results	Share		Share	YoY		Share	YoY
Net sales	453,492	100.0	462,512	100.0	102.0	474,906	100.0	104.7
Gross profit	131,633	29.0	136,817	29.6	103.9	139,742	29.4	106.2
SG&A expenses	103,634	22.9	114,107	24.7	110.1	117,129	24.7	113.0
Operating income	27,998	6.2	22,709	4.9	81.1	22,612	4.8	80.8
Ordinary income	28,330	6.2	22,622	4.9	79.9	22,530	4.7	79.5
Net income attributable to owners of the parent	16,587	3.7	12,739	2.8	76.8			

- **Difference due to change in revenue recognition standards (⇒ page 30)**
  Net sales ¥12.3 billion, gross profit ¥2.9 billion, SG&A expenses ¥3.0 billion

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The following is the performance compared to the previous year.

Compared to the previous year, sales were 102%, gross profit 103.9%, SG&A expenses 110.1%, and operating income 81.1%. For your reference, the revenue recognition standard has been changed from this fiscal year, and the comparison with the previous year under the old standard is shown on the right side of the table.

Consolidated Performance (YoY) *Excludes Drug Eleven

YoY change (millions of yen / %)

	FY5/21		Results			Estimate based on former standards		
	Results	Share		Share	YoY		Share	YoY
Net sales	440,546	100.0	439,791	100.0	99.8	452,079	100.0	102.8
Gross profit	128,071	29.1	130,283	29.6	101.7	133,186	29.5	104.0
SG&A expenses	100,157	22.7	107,328	24.4	107.2	110,327	24.4	110.2
Operating income	27,913	6.3	22,955	5.2	82.2	22,859	5.1	81.9
Ordinary income	28,251	6.4	22,889	5.2	81.0	22,793	5.0	80.7
Net income attributable to owners of the parent	16,648	3.8	13,150	3.0	79.0			

- **Continued slump in seasonal products such as cold medicine sales, rebound from special demand in 1Q of FY5/21**
- **Increased one-off costs such as donations (anti-COVID-19 products), fees payable, etc.**

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Please turn to the next page. These are the YoY comparisons for the 6 existing operating companies excluding DRUG ELEVEN.

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As you can see, sales and gross profit growth was low due to a reactionary decline from the special demand for corona-related products in the previous fiscal year, as well as sluggish sales of seasonal products. On the other hand, SG&A expenses grew as usual due to factors such as store opening expenses, resulting in an operating income of 82.2% of the previous year's level.

SG&A Expenses

Consolidated *Drug Eleven, including 3 months (2Q of FY5/21) (millions of yen / %)

		FY5/21		1H of FY5/22		*Excludes Drug Eleven			
		1H	YoY		YoY	1H of FY5/22	YoY	1H of FY5/22 (Estimate based on former standards)	YoY
Personnel expenses	Amount	53,133	109.2	58,084	109.3	54,881	106.6	54,881	106.6
	Share of sales	11.7	0.0	12.6	+0.9	12.5	+0.8	12.1	+0.4
Promotion expenses	Amount	2,803	96.4	1,977	70.5	1,727	64.0	4,726	175.1
	Share of sales	0.6	(0.1)	0.4	(0.2)	0.4	(0.2)	1.0	+0.4
Expenses for rents	Amount	23,423	106.3	24,911	106.4	23,463	103.7	23,463	103.7
	Share of sales	5.2	(0.1)	5.4	+0.2	5.3	+0.1	5.2	0.0
Other expenses	Amount	24,275	109.0	29,134	120.0	27,256	116.6	27,256	116.6
	Share of sales	5.4	+0.1	6.3	+0.9	6.2	+0.8	6.0	+0.6
SG&A expenses	**Amount**	**103,634**	**108.1**	**114,107**	**110.1**	**107,328**	**107.2**	**110,327**	**110.2**
	Share of sales	**22.9**	**(0.1)**	**24.7**	**+1.8**	**24.4**	**+1.5**	**24.4**	**+1.5**

- **Personnel expenses, promotion expenses, expenses for rents, etc. … Staying within budget**
- **Other expenses…Increased cashless fees, depreciation, and supplies expenses, in addition to one-time factors such as donations and taxes**

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The next page shows the details of SG&A expenses compared to the previous year.

First of all, labor cost was 109.3% compared to the previous year due to the increase in the minimum wage, the increase in the number of employees due to the opening of new stores, and other factors. Excluding DRUG ELEVEN stores, the figure was 106.6% compared to the previous year. Next, with regard to sales promotion expenses, the progress is almost in line with the plan, except for the fact that we changed the recording of point expenses due to the change in revenue recognition standards. In addition, land rent is progressing as planned.

Other expenses grew 120% over the previous year due to one-time factors in donations and taxes, as well as increases in cashless fees, depreciation, and supplies.

Results by Operating Company (Estimate based on former standards)

1H of FY5/22 (Estimate based on former standards)

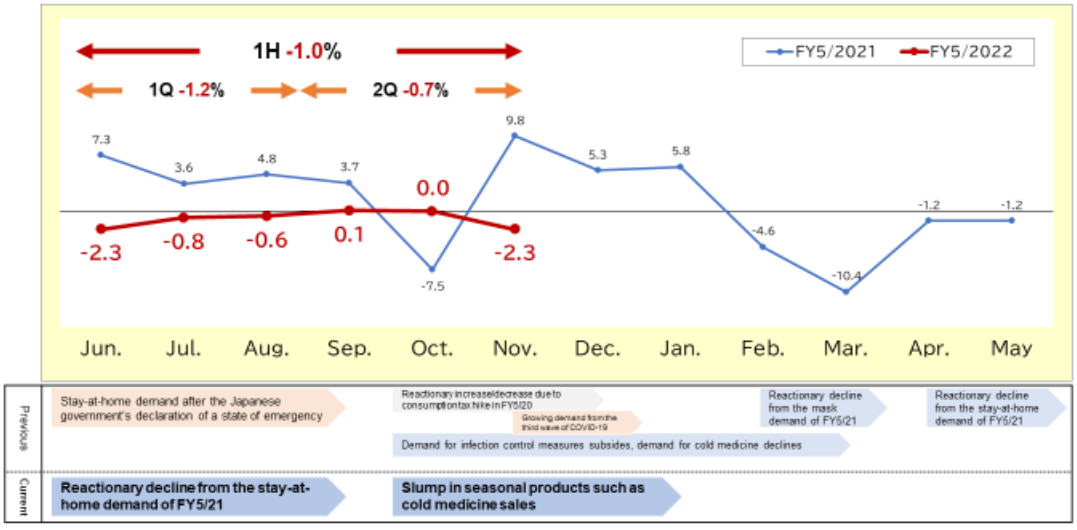
*YoY changes are not shown for Drug Eleven, as the period covered by its consolidation is different from the previous fiscal year.

		Consolidated		Tsuruha		Kusurino Fukutaro		Tsuruha Group Drug & Pharmacy Nishinihon		Lady Drug Store		Kyorindo		B&D		Drug Eleven	
			YoY		YoY		YoY		YoY		YoY		YoY		YoY		YoY
Net sales	Amount	474,906	104.7	228,887	101.5	36,344	101.0	66,830	105.5	40,998	102.7	60,785	106.2	14,852	97.7	23,014	–
	Share of sales	100.0	–	100.0	–	100.0	–	100.0	–	100.0	–	100.0	–	100.0	–	100.0	–
Gross profit	Amount	139,742	106.2	68,814	103.2	12,307	103.2	19,856	106.1	11,702	102.8	14,856	107.2	4,279	100.9	6,745	–
	Share of sales	29.4	+0.4	30.1	+0.5	33.9	+0.8	29.7	+0.2	28.5	0.0	24.4	+0.2	28.8	+0.9	29.3	–
SG&A expenses	Amount	17,129	113.0	57,413	112.0	10,982	104.9	14,929	118.2	9,291	108.4	12,348	109.7	3,761	103.5	6,700	–
	Share of sales	24.7	+1.8	25.1	+2.4	30.2	+1.1	22.3	+2.4	22.7	+1.2	20.3	+0.6	25.3	+1.4	29.1	–
Operating income	Amount	22,612	80.8	11,401	73.9	1,325	91.1	4,927	81.0	2,411	85.7	2,508	96.4	518	85.3	45	–
	Share of sales	4.8	(1.4)	5.0	(1.8)	3.6	(0.4)	7.4	(2.2)	5.9	(1.1)	4.1	(0.4)	3.5	(0.5)	0.2	–
Ordinary income	Amount	22,530	79.5	11,638	73.5	1,334	89.7	4,961	81.0	2,149	78.7	2,433	97.2	564	88.0	33	–
	Share of sales	4.7	(1.5)	5.1	(1.9)	3.7	(0.4)	7.4	(2.3)	5.2	(1.6)	4.0	(0.4)	3.8	(0.4)	0.1	–

Next are the results by company. The revenue recognition standard has changed, so please refer to page 9 for a comparison using the same standard as last year.

Each company is similarly affected by macros, such as the reaction to last year's special demand for coronavirus and sluggish seasonal products, but while prescription drugs and food products are doing relatively well, OTC and institutional cosmetics are struggling. The difference in the composition ratio makes the difference in performance.

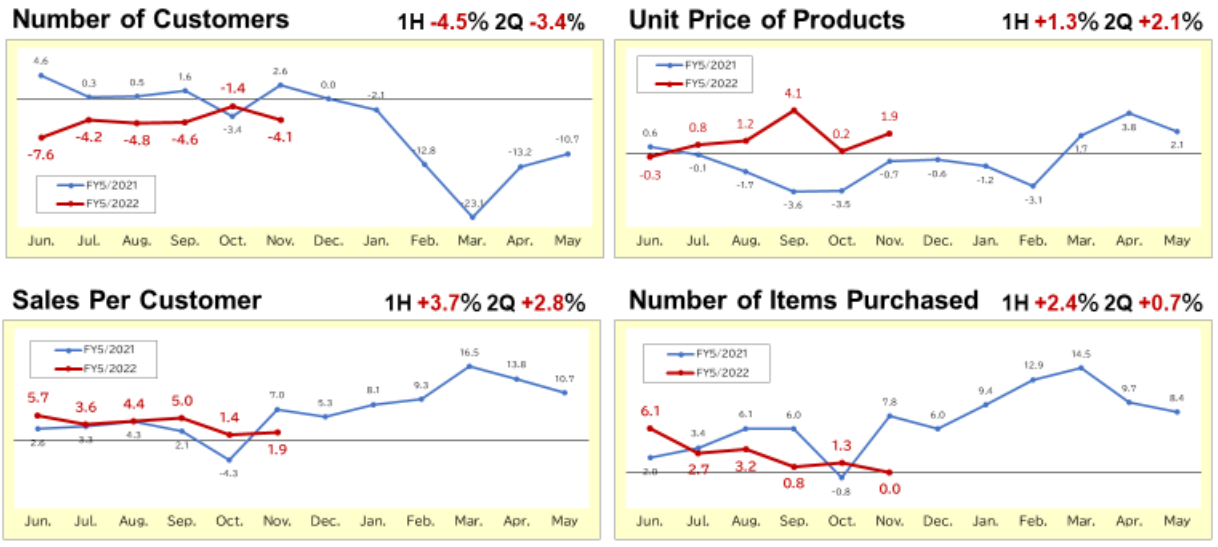
YoY Change in Net Sales (Stores Open for 13 Months or More)*Excludes Drug Eleven



The next page shows the 13-month comparable store sales trend.

As you can see, the delay in the recovery in 2Q had a negative impact of minus 1% on the cumulative first half. This result was lower than the planned figure of plus 0.4%.

Sales Data Analysis (Stores Open for 13 Months or More)*Excludes Drug Eleven



The next page is the sales analysis.

As in 1Q, the trend of decreasing numbers of customers and increasing sales per customer continued.

Sales by Operating Company (Store Openings and Closures)

by Store

	End of FY5/21	FY5/22			
		Openings	Closures	Net change	2Q-end
Tsuruha	1,305	47	15	+32	1,337
Kusurino Fukutaro	233	1	5	(4)	229
TGN	298	12	3	+9	307
Lady Drug Store	228	4	2	+2	230
Kyorindo	87	1	-	+1	88
B&D	69	3	1	+2	71
Drug Eleven	199	2	5	(3)	196
TGMD (EC HQ)	1	-	-	0	1
Total for Japan	2,420	70	31	+39	2,459

Existing store sales

	Existing store sales YoY	
	FY5/21	FY5/22
Tsuruha	102.3	97.3
Kusurino Fukutaro	98.5	99.6
TGN	108.0	100.8
Lady Drug Store	107.1	101.6
Kyorindo	103.7	102.3
B&D	103.6	95.6
Drug Eleven	*Treated as a new store during FY5/22	
Total for Japan	103.4	99.0

- **Newly opened dispensing pharmacies: 45**
- **Renovations of existing stores: 120**

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Next is the status of store openings, closings, and sales by company.

In 2Q, 41 stores were opened, bringing the total number of stores opened in the first half to 70. In addition, 12 stores were closed in 2Q, bringing the total number of stores closed in the first half to 31.

In the dispensing pharmacy business, 45 dispensing pharmacies were opened. We renovated 120 stores.

Store Openings and Closures (Sales Situation)

by Store

	End of FY5/21	FY5/22			
		Openings	Closures	Net change	2Q-end
Hokkaido	414	9	7	+2	416
Tohoku	533	19	2	+17	550
Kanto, Koshinetsu	493	18	7	+11	504
Chubu, Kansai	237	5	5	0	237
Chugoku	315	11	3	+8	323
Shikoku	212	5	2	+3	215
Kyushu, Okinawa	216	3	5	(2)	214
Total for Japan	2,420	70	31	+39	2,459
					(Others: 4 franchise stores)
International (Thailand)	22	-	3	(3)	19

Existing store sales

	Existing store sales YoY	
	FY5/21	FY5/22
Hokkaido	103.1	97.5
Tohoku	104.5	97.3
Kanto, Koshinetsu	101.9	98.1
Chubu, Kansai	99.2	100.8
Chugoku	108.3	100.4
Shikoku	105.7	101.6
Kyushu	112.8	106.6
Total	103.4	99.0

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The next page shows the status of store openings, closings, and sales by region. I will leave out the details, but we have opened many new stores in Tohoku, Niigata, Chugoku, and Shikoku.

Results by Product Group (1H of FY5/22)

*Drug Eleven, including 3 months (2Q of FY5/21)

*Including mail-order sales (millions of yen / %)

		Net sales			GPM	
			YoY	Share		YoY
Products	Pharmaceuticals	98,888	106.4	21.4	42.6	+0.1
	Prescriptions	50,190	114.3	10.9	39.6	(0.3)
	OTC	48,697	99.3	10.5	45.7	+0.9
	Cosmetics	65,894	102.0	14.3	32.4	(0.9)
	Misc. daily necessities	128,019	98.2	27.7	28.2	+1.1
	Foods	111,163	106.0	24.0	15.8	+1.3
	Other	56,440	96.1	12.2	32.9	+0.4
	Products total	460,406	102.0	99.5	29.5	+0.6
	Total	462,512	102.0	100.0	29.6	+0.6

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This is followed by the results by product group.

This page includes the results of 3 months of DRUG ELEVEN in the previous fiscal year, and the next page explains the results for the 6 existing companies excluding DRUG ELEVEN.

Results by Product Group (1H of FY5/22) *Excludes Drug Eleven

Estimate based on former standards, excluding Drug Eleven

*Including mail-order sales (millions of yen / %)

Products	Net sales	YoY	Share	GPM	YoY
Pharmaceuticals	95,731	105.7	21.2	42.8	+0.2
Prescriptions	49,056	113.2	10.9	39.4	(0.5)
OTC	46,674	98.8	10.3	46.3	+1.2
Cosmetics	62,408	99.7	13.8	34.0	+0.7
Misc. daily necessities	126,627	100.3	28.0	28.1	+0.7
Foods	112,579	108.1	24.9	14.7	+0.3
Other	52,496	95.3	11.9	33.4	+0.8
Products total	449,842	102.6	99.6	29.3	+0.4
Total	451,860	102.6	100.0	29.4	+0.4

Pharmaceuticals

- Growing demand for antipyretic analgesics
- Sales of cold medicine and nutritional supplement drinks, fell below YoY (2Q)

Cosmetics

- Slowdown in sales due to slump in seasonal products, but gross profit margin showed positive growth (2Q)

Foods

- Continuing growth in sales even after stay-at-home demand has run its course

Details of "Other" product group

	Net sales*POS basis	YoY	Products total Share
Health foods	17,252	102.5	3.7
Healthcare products Nursing care	28,674	90.3	6.1
Childcare products	10,699	95.6	2.3

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Please see the next page, page 15.

In the pharmaceutical business, sales of prescription drugs continued to be strong, and gross profit recovered to a level close to that of the previous year due to the conclusion of NHI price negotiations. On the other hand, for OTC, demand for antipyretic analgesics increased as a countermeasure for adverse reactions to vaccinations, but as in 1Q, sales of cold medicine and nutrition drinks continued to be below the level of the previous year.

In the cosmetics category, sales of both general cosmetics and institutional cosmetics were down YoY due to a slump in sales of seasonal products. As for daily necessities, demand for consumption-from-home has calmed down.

On the other hand, food products showed high growth as in 1Q.

Dispensing Division Results

Consolidated *Drug Eleven, including 3 months (2Q of FY5/21) (millions of yen / %)

	1H of FY5/22			2Q of FY5/22		
	FY5/21 Results	Results	YoY	FY5/21 Results	Results	YoY
Dispensing remuneration (million of JPY)	43,926	50,190	114.3	22,835	25,894	113.4
GPM (%)	39.9	39.6	(0.3)	42.2	42.7	+0.5
Prescriptions filled (thousands)	4,118	4,770	115.8	2,179	2,442	112.1
Unit price (JPY)	10,665	10,521	98.6	10,478	10,602	101.2

***Excludes Drug Eleven**

	1H of FY5/22			2Q of FY5/22		
	FY5/21 Results	Results	YoY	FY5/21 Results	Results	YoY
Dispensing remuneration (million of JPY)	43,339	49,056	113.2	22,247	25,311	113.8
GPM (%)	39.9	39.4	(0.5)	42.2	42.5	+0.3
Prescriptions filled (thousands)	4,042	4,618	114.3	2,102	2,365	112.5
Unit price (JPY)	10,722	10,621	99.1	10,581	10,701	101.1

Dispensing Pharmacies by Operating Company

	End of FY5/21	2Q-end	(breakdown)	
			Attached	Independent
Tsuruha	310	322	281	41
Kusurino Fukutaro	104	115	57	58
TGN	103	110	87	23
Lady Drug Store	55	57	32	25
Kyorindo	67	69	56	13
B&D	24	26	19	7
Drug Eleven	20	21	11	10
Total for Japan	683	720	543	177

- **Gross profit margin recovered** almost to the FY5/21 level following the conclusion of negotiations after the NHI price revision
- **Prescription volume rose on the (rebound from 2020's restraint on medical visits** and + dispensing pharmacy openings)

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Please see the next page, page 16. This is the result of the dispensing department.

As a reaction to the curbing of medical examinations in the previous fiscal year, 1Q continued to show high growth compared to the previous year. In addition, as I mentioned earlier, gross profit recovered to almost the same level as last year due to the conclusion of negotiations after the NHI price revision.

PB Products Results (1H of FY5/22)

*Excludes Drug Eleven (2Q of FY5/21) (millions of yen / %)

	Net sales (millions of yen)			Share of sales *Product sales excluding dispensing		GPM	
	FY5/21	Results	YoY	Results	YoY	Results	YoY
Kurashi Rhythm series	11,065	18,721	169.2	4.5	+1.7	47.0	+0.6
M's one / Medis' one	9,421	4,603	48.9	1.1	(1.3)	34.5	(6.7)
Subtotal	20,486	23,324	113.9	5.6	+0.4	44.6	+0.6
Exclusive products / Limited edition products	12,515	13,981	111.7	3.3	+0.1	41.9	(1.3)
Total	33,001	37,306	113.0	8.9	+0.5	43.6	(0.1)
*Excludes Drug Eleven	33,001	35,929	108.9	9.0	+0.6	43.1	(0.6)

- In 2Q, **rebound from** mask demand in third wave of **COVID-19 in FY5/21**
- Growing demand for **antipyretic analgesics** associated with vaccination

	SKUs			
	Kurashi Rhythm series	M's one / Medis' one	Exclusive products / Limited edition products	Total
Pharmaceuticals	119	18	604	741
Cosmetics	74	9	182	265
Daily necessities	318	41	398	757
Foods	11	89	625	725
Health foods	52	0	137	189
Medical supplies	215	40	113	368
Childcare products	6	1	16	23
Total	795	198	2,075	3,068

- **Developing private brand products for Drug Eleven**
  - Kurashi Rhythm and M's one Total about **640** SKUs

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See the next page, page 17. These are the results of private brand products.

Total private products was JPY37.1 billion. This was a 113% increase over the previous year. Compared to 1Q, the YoY comparison has slowed down, but this is due to the reactionary decline of the demand for masks caused by the third wave of the pandemic last year, as described in the materials.

This concludes my explanation. President Tsuruha will continue to explain our future initiatives and policies.

Tsuruha: I would now like to explain our initiatives for the second half of the fiscal year, starting on page 18. I'm looking forward to working with you.

Full-Year Plan for FY5/22

*Drug Eleven, including 11.5 months (FY5/21)

(millions of yen / %)

	FY5/21		FY5/22		Estimate based on former standards		
	Results	Share	Forecast	Share	Forecast	Share	YoY
Net sales	919,303	100.0	956,000	100.0	975,700	100.0	106.1
Gross profit	266,721	29.0	286,500	30.0	287,700	29.5	107.9
SG&A expenses	218,344	23.8	235,300	24.6	236,500	24.2	108.3
Operating income	48,377	5.3	51,200	5.4	51,200	5.2	105.8
Ordinary income	47,688	5.2	51,367	5.4	51,367	5.3	107.7
Net income attributable to owners of the parent	26,283	2.9	28,280	3.0	28,280	2.9	107.6

*Former standards

Assumptions for existing store sales

- Stores open for 13 months ormore・・・Full- year: **+2.3%**

Major effects of changes in revenue recognition standard

- Outsourced sales・・・
  Net amount of fees/commissions recognized as net sales
- Points granted・・・
  Deducted from net sales at time of points **granted** (at the time of **use** before)

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Page 19. This is the full-year plan for the current fiscal year.

At this point, the plan is to leave it unchanged. Again, the budget is based on the application of the changed revenue recognition standards from this fiscal year, so please also check the estimate based on the old standards for your reference.

Forecast of Store Openings and Closures for FY5/22

by Region

	End of FY5/21	FY5/22			
		Openings	Closures	Net change	Stores at year-end
Hokkaido	414	17	12	+5	419
Tohoku	533	40	5	+35	568
Kanto, Koshinetsu	493	38	7	+31	524
Chubu, Kansai	237	15	5	+10	247
Chugoku	315	19	4	+15	330
Shikoku	212	15	5	+10	222
Kyushu, Okinawa	216	14	10	+4	220
Total for Japan	2,420	158	48	+110	2,530

(Others: 4 franchise stores)

by Operating Company

	End of FY5/21	FY5/22			
		Openings	Closures	Net change	Stores at year-end
Tsuruha	1,305	95	28	+67	1,372
Kusurino Fukutaro	233	10	4	+6	239
TGN	298	25	3	+22	320
Lady Drug Store	228	12	2	+10	238
Kyorindo	87	4	-	+4	91
B&D	69	5	-	+5	74
Drug Eleven	199	7	11	(4)	195
TGMD (EC HQ)	1	-	-	0	1
Total for Japan	2,420	158	48	+110	2,530

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Page 20 shows the plan for store openings and closings for the current fiscal year.

With the opening of 158 stores and the closing of 48 stores, the net increase was 110 stores, bringing the total number of stores planned for the end of this fiscal year to 2,530. As mentioned earlier, in the first half of the year, we opened 70 stores and closed 31 stores. We are proceeding as planned.

Digital Strategy

Development of data infrastructure and
Creation of business improvement synergies using IT

Simplify store operations, secure opportunities to serve customers, and improve the efficiency of headquarters operations through the introduction and use of digital tools

Leveraging Digital Cosmetics Ledger

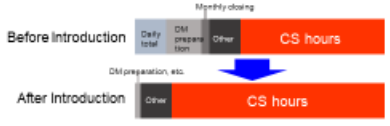
Full rollout since November

Started operation in almost half of the stores

Secure customer service time by improving administrative efficiency

Contribution to new member registration and sales growth in cosmetics

Monthly work schedule for a cosmetics staff



Automation of monthly total reporting
Labor-saving customer management
= Ensuring customer service hours

*Other=Non-cosmetic operations such as cash register and store management

Support system for shift creation

Expansion to operating companies

Tsuruha and Lady Drug Store...
Introduced in all stores
(Total: 1,760 stores)

Kusurino Fukutaro...
Now in test operation (33 stores)

Drug Eleven...
Scheduled to start preparations for introduction in 2H of FY5/22 for FY5/23

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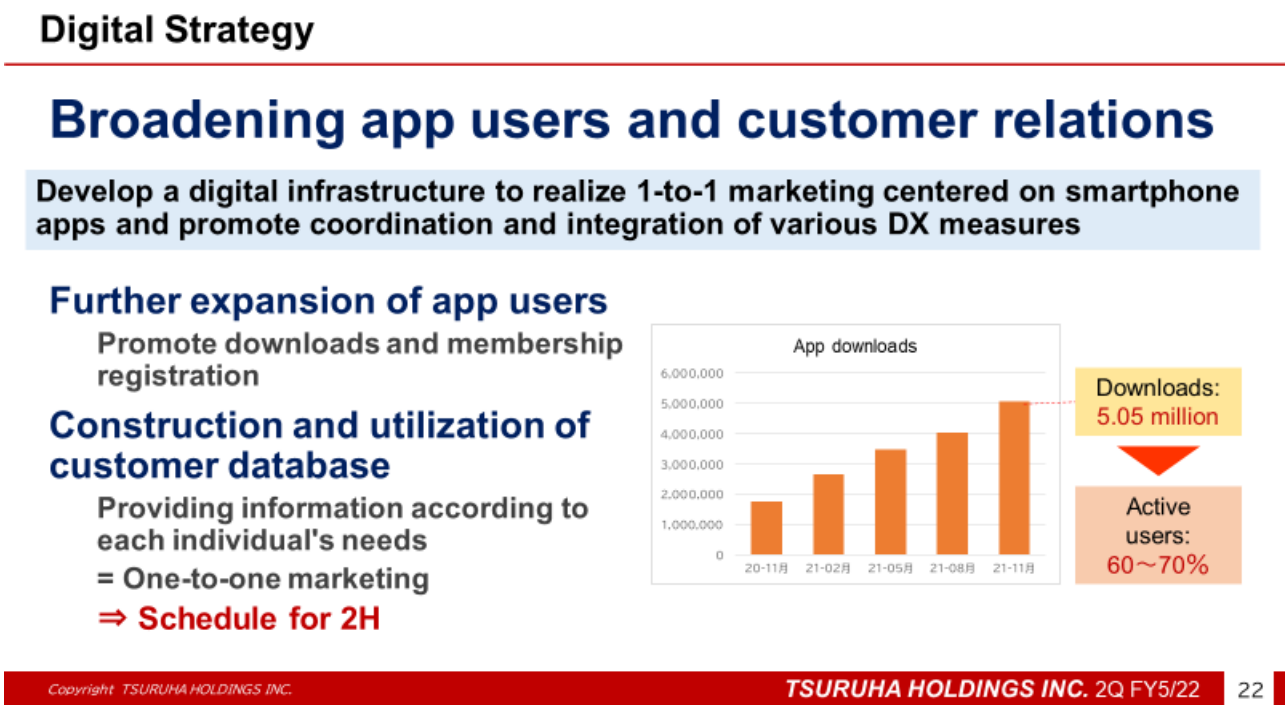
On page 21, you will see our initiatives for the second half of the fiscal year, starting with our digital strategy.

The digital cosmetics ledger was introduced at the start of this fiscal year. In 1Q, we introduced the system to about 200 stores, and have been working on improving the operation methods and technical aspects. Now that we have some idea of what to expect, we are in the process of introducing the system to about 1,300 stores. This is a way to increase sales and attract new members by streamlining the work of cosmetics staff and creating more time for customer service.

In addition, we will now be able to manage our products based on the customer's needs, rather than the manufacturer's needs, which will allow us to serve our customers more closely. In addition, the data will allow all stores to know the customer's information, and if the customer goes to a store other than the one where the purchase was made, the other stores will be able to respond in detail. In addition, the ledger will make it easier to utilize customer purchase history data, understand the product usage cycle of customers, and help non-cosmeticians respond to customers. These effects are to be expected.

Next is the shift preparation support system, which has already been introduced at all TSURUHA and LADY stores. We are in the process of introducing the system to Kusuri no Fukutaro and DRUG ELEVEN. As I have explained each time, we would like to control labor costs by not only shortening shift preparation time, but also optimizing overtime hours and working hours of part-time workers, improving disparities among stores through visualization, and managing man-hours on a daily basis instead of monthly.



Page 22 is regarding app membership.

The app membership has now reached 5.05 million downloads. We will continue to promote app members toward our goal of 7 million downloads at the end of this fiscal year. We are currently building a database for 1 to 1 marketing initiatives. In the second half of the year, our goal is to gain successful experience in making recommendations that match the attributes of our customers. Specifically, we categorize the attributes of our customers into 8 types and tailor our approach accordingly.

On the other hand, we will also start to classify customers based on their most recent visit, date, and frequency of visits, and promote visits to customers who are infrequent visitors or those who are likely to leave the membership. We will conduct a series of demonstration tests in the second half of the fiscal year, and by the

first half of the next fiscal year, we will automate these efforts and improve the accuracy so that all stores will be able to do so.

Initiatives to Increase Convenience

Respond to new lifestyles

In addition to pursuing the convenience of one-stop shopping at brick-and-mortar stores, aiming to expand sales channels including e-commerce

Introduce meats and fresh produce

Further expand stores carrying meats and fresh produce

- Stores introducing perishable foods **859** at 2Q-end

Introduce 100-yen products

Introduce at same time as renovations to existing stores

- Introduced to **52** stores in 1H (Tsuruha, TGN)

E-commerce growth

Improve business infrastructure to expand EC sales

- Newly established **Kanto distribution center**
  - → Dividing centers by shipping address and sales site
  - → Shipping cost reduction and shorter delivery time

Consideration of strategies for integration with brick-and-mortar stores

- Leverage **store network**
  - → In-store pickup
  - → Consideration of the use of in-store inventory (shipped from each store)

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On page 23, we will continue to introduce meat, fruits, and vegetables as well as 100-yen products to improve customer convenience in one-stop shopping.

We have already introduced meat, fruits, and vegetables at 859 stores and have introduced 100-yen products at 52 stores, mainly under TSURUHA and TGN. The number of customers has increased by about 108% to 112% in each store. We would like to add categories like this to increase the purpose of shopping and take measures to increase the number of customers.

In e-commerce, we added a new delivery base in the Kanto region in November. We have just started operation, but full-scale enhancement of sales promotion will come after the new year. However, we will improve our shipping capacity and reduce delivery costs. We will also continue to study the strategy of integrating real stores, store locations, and services that utilize store inventory.

Private Brand Strategy

Development expansion with a focus on Kurashi Rhythm

Promote product development and sales by leveraging scale merits with a focus on the Kurashi Rhythm series and Tsuruha Group Shared Brand

Further expand product lineup

Kurashi Rhythm: End of 2Q **795** SKUs

→Target: End of 5/22 **850 SKUs**

- **Strategically priced** products to combat national brands
- **Unique (only-one) products** with exceptional quality

Expand sales using recommendations and proposal strengths

All PB sales: **37.1** billion yen in 1H

→FY Target: **70 billion yen**

1H POS results by PB product category (millions of yen / %)

	Net sales		GPM
		Share	
Pharmaceuticals	10,410	27.9	63.4
Cosmetics	1,848	5.0	46.7
Misc. daily necessities	10,647	28.5	33.1
Foods	5,312	14.2	20.4
Other	9,087	24.4	45.9
Total	37,306	100.0	43.6

*For POS results, the product classifications on P14 and P15 are not supported.

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Page 24, the private brand strategy.

We are expanding our business with a focus on Kurashi Rhythm of the TSURUHA Group. Our plan for the end of this fiscal year is 850 SKUs for the kurashi-rhythm brand. We currently have 795 SKUs, so development is progressing smoothly as planned.

We have also been promoting the introduction of our products to each of our operating companies as a topic for this fiscal year. Introduction is progressing smoothly, with almost all our operating companies introducing almost all of our products. The overall sales target for PB is JPY70 billion for the full year. In the first half of the year, we also made progress in the development of PB products with major food manufacturers such as Nissin and Kagome. We would like to continue to actively promote and expand joint development with these major food manufacturers in the future.

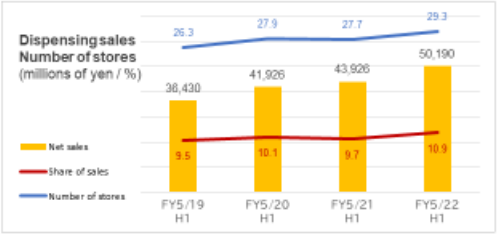
Dispensing Business Strategy

Promote new store openings of attached pharmacies and expand share of sales

In addition to promoting the opening of new pharmacies, mainly by attaching them to existing stores, improve the pharmacist's expertise to contribute to the medical field

Promote new store openings

Newly opened in 1H: **45**
→ Full-year plan: **91**



Improve pharmacists' professionalism and job performance

Academic research & Presentation activities

- Within Tsuruha and at various conferences
  Presentations of research and papers

In-company academic presentation conference
*Taken in 2019

The 15th Annual Meeting of the Pharmacy Society of Japan Excellence Award
Hiroshi Matsui, Group Pharmacy and Pharmaceutical Affairs Department, Tsuruha HD
"The effectiveness of face-to-face instruction by pharmacists in improving patient perceptions of antimicrobials"

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Page 25, Dispensing.

In the dispensing business, we plan to open 91 dispensing stores this fiscal year. In the first half of the fiscal year, we opened 45 stores, which is on schedule.

As mentioned here, one of our pharmacists was awarded the Outstanding Presentation Award at the Annual Meeting of the Pharmacy Society Japan, and we will continue to communicate the improvement of our pharmacists' expertise both internally and externally to motivate them, as well as to recruit further human resources.

Initiatives for Sustainability

Five Materiality

Bring Richness and Surplus to Customers' Lives

- Providing best services
- Supporting the beauty and health of all customers
- Launching products contributing to a healthy and enriched lifestyle
- Increasing customers' life-span by providing healthcare services
- Playing an essential role as a lifeline for local customers

Provide Comfortable and Rewarding Work Environment for Each Individual

- Creating a work-life balanced where workers of all ages, nationalities, and genders are welcomed and rewarded
- Establishing a workplace to cultivate human resources
- Valuing the health of employees

Create Global Environment for Next Generation

- Reducing the environmental impact toward a carbon-free society
- Switching to and introducing environmentally friendly products
- Minimizing waste

Collaborate with Business Partners

- Working to strengthen ongoing collaboration through fair trade
- Driving sustainability throughout supply chains (Compliance)

Drive Governance

- Implementing an effective governance system and risk management
- Disclosing timely and reliable information

Define KPIs by the end of FY5/22

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On page 26, you can see our efforts to promote sustainability.

This is the content of the materiality report that was released in September. We will continue our efforts to promote sustainability based on our management philosophy of providing affluence and comfort to our customers' lives. We are currently discussing the KPIs required for each item within the company, and we will disclose them as soon as they are decided.

Initiatives for Sustainability

Development of environment-friendly PB products

Kurashi Rhythm "nocoo"
Plastic bag with handles
Contains natural materials,
reducing plastic usage by 40%

Solar power generation system for own use

Installation of a solar power generation system on the roof of stores
Allocating electricity for own use in stores
→ Reduce CO_2 emissions
To be installed in 23 stores (during FY5/22)
(under construction)

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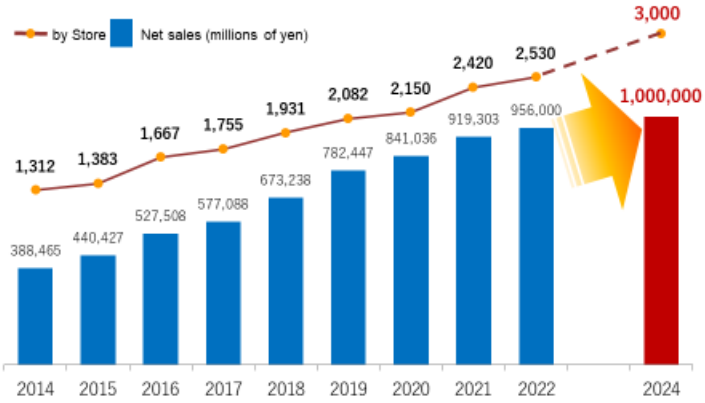
Page 27, this is an example of an initiative.

We would like to move forward with the development of environmentally friendly PB products. It also provides examples of solar equipment. This fiscal year, we plan to install them in 23 stores.

Mid-Term Targets

FY 5/24 Mid-Term Targets Stores: **3,000** Net sales: **1** trillion



New medium-term management plan under preparation will announced around the time of the financial results presentation for FY22/5

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Finally, please turn to page 28.

Our current mid-term targets are sales of JPY1 trillion and 3,000 stores by May 2024, which are currently in progress.

I would also like to report that we are currently working on a new mid-term plan that will be released around the time of the announcement of the financial results at the end of this fiscal year, which is scheduled for June next year.

In the new medium-term plan, we are currently discussing not only management and key strategies, but also financial policies, capital efficiency, cash flow, and shareholder returns, and we will make preparations to disclose them in the new plan.

This concludes my report. Thank you very much.

Question & Answer

Yamazaki [M]: We will now move on to the question-and-answer session. We have received your questions so we will unmute you now. Please wait a moment. Please go ahead.

Questioner A [Q]: Thank you very much for your explanation. I would like to ask you 3 simple questions.

First point 1, the usual question. What are the results of the operating income ratio by region?

Secondly, in the first half of this fiscal year, especially in 2Q, the sales trend has not recovered. I think Mr. Murakami mentioned earlier that the product mix basically determines whether a company is doing well or poorly in each region, but, from President Tsuruha's point of view, to what extent are external factors, such as the competitive environment and other weather factors, having an impact? Or, if you think that there were internal factors that would have been necessary to increase sales, we would like to know about them as well.

You have not changed your plan for the full year, but what measures are you planning to take in the second half to improve the sales trend? This is my second point.

The third and final point is that you mentioned earlier that you are planning a medium-term business plan, and I would like to hear about the following from either President Tsuruha or Mr. Murakami. I understood that capital policy and financial efficiency are also being discussed, and while we can wait for the content of these discussions until next year, please tell us what the background to the decision to start such discussions was? I would like to know what kind of directors are involved, and what kind of discussions took place within the company that led to the decision to create this kind of mid-term plan. Please let me know about these 3 points.

Yamazaki [A]: Thank you very much. Please let me start with the first question.

Operating income by region will be the figure for each region of TSURUHA at the store level, excluding new stores. We will announce the same figures as we did in previous years. In the first half of the year, Hokkaido's total sales rose from 9.1 in the previous year to 7.9 in the current year. The Tohoku region increased from 6.5 in the previous year to 5.3 this year. The Kanto region increased from 5.6 in the previous year to 3.9 this year. The Chubu and Kansai regions went from minus 5.9 in the previous year to minus 4.6 this year. As for the level by company, please refer to the documents.

Tsuruha [A]: Now then, let me answer your second question. In the first half of the year, the competitive environment that you mentioned in your question really varies by region. Roughly speaking, the competition from drugstore openings in new areas is fierce. When it comes to new areas, the awareness of drugstores is lower, and it starts to come to pricing. We are also affected by this and have to adapt ourselves to the environment.

While there is such price competition taking place in new areas, companies with a high ratio of prescription drugs and food products were able to cover the slump in 2Q. However, the ratio of dispensing drugs to total sales is still not very large, as is the case with TSURUHA, and the deficits could not be covered entirely. As you may have guessed, the return of pharmaceuticals and cosmetics was worse than we had expected, and seasonal products were even more sluggish. I think this had a bigger impact than competition.

For the second half of the year, I think that the difficult situation will continue, but although sales of cold medicine are still slightly below the previous year's level, they are beginning to recover a little. As it bottomed out in January, February, and March of this year, the hurdle is low, and I have high expectations. However,

the truth is that it is very difficult to make a forecast for the next 6 months at this stage because there are so many external uncertainties.

In any case, although the current situation is difficult, we would like to continue with the measures we are currently taking, including DX, strengthening dispensing, PB products, and line-robbing. We are advancing such things in the mid- to long-term. This was my answer to your second question.

Third, regarding the impetus for the creation of the third medium-term management plan, we have some idea of how we will achieve our goal of JPY1 trillion by 2024, and since we have only disclosed medium-term plans for sales and the number of stores, we have begun to discuss internally the need to disclose our policies to various stakeholders. That is the background. That's all.

Questioner A [M]: I understand very well. Thank you very much.

Yamazaki [M]: Thank you very much. One person raised his hand.

Questioner B [Q]: I'm looking forward to working with you.

I think the return of sales, especially of cold medicine and cosmetics, is a little weak. What is your outlook for the next year? Also, as far as the gross profit margin in 1Q is concerned, is it correct to say that you are taking a different approach to price competition locally? Just to confirm, this is the first question.

Secondly, at the beginning of the fiscal year, it was expected that your expenses would be quite high this year due to the increase in the number of new stores. Based on the fact that labor costs and the minimum wage will increase in the next fiscal year, should we expect that the cost of opening new stores will increase by 3 or 4 percentage points in relation to the growth rate of the number of stores? It's a little early, but please tell us about the next fiscal year and beyond.

Tsuruha [A]: Thank you. I will reply. I think the first question is about whether we should take a different approach when it comes to price competition. It depends on the situation, and we have to closely look at the localities. I think it's important to look at this in detail.

However, prices of food products and raw materials are also rising, so although it varies slightly from company to company, we have heard that price competition is loosening up a bit. Thus, we do not want to unnecessarily sell cheaper than we could have sold. I'm sorry, but the answer to your question is that we will monitor the localities and observe the situation.

With regard to the second question, we are planning to open more than 150 stores this fiscal year, and we are basically planning to open the same number of stores in the next fiscal year as well. Thus, we expect that the cost of opening new stores will be about the same. That's all.

Questioner B [Q]: I understand that there are costs associated with opening new stores, but there are also various factors such as the increase in costs associated with the cashless system and labor costs. Please tell me more about it.

Murakami [A]: I would like to add something. When you look at the ratio of new store sales to total sales, the cost goes up even more than that, the reason for that being that the ratio of cashless payments is now about 38%. Also, since we are promoting DX, there is an expense item that requires some depreciation.

We have been discussing how to improve the efficiency of our expenses and how to control labor costs. We have been discussing this issue in our briefings since the year before last. Also, as for the cashless system mentioned earlier, the department is looking into ways to reduce costs. That is all.

Yamazaki [M]: What do you think? Was that sufficient?

Questioner B [M]: Yes, thank you very much.

Yamazaki [M]: Thank you very much. Next, please.

Questioner C [Q]: I'm looking forward to hearing from you. 2 points, please.

The first point is a continuation of what you have said earlier. I would like to ask you how the prices of food products and daily sundries are changing, given the rising prices of raw materials and transportation. In addition, I would like to know your thoughts regarding future selling prices for both food products and daily sundries. This is the first point. May I also make a second point?

Yamazaki [M]: Please continue.

Questioner C [Q]: As you explained earlier, how much of an effect have you seen from the support system for shift creation and other measures to control SG&A expenses and man-hour? Can you reveal any monetary amount? What kind of effects do you expect for the future? Please comment on that. I'm looking forward to hearing from you.

Tsuruha [A]: Now, I would like to answer your first question. We are currently receiving requests to raise the prices of raw materials. As for food products, it depends on the product, the region, and the timing, but basically, prices tend to slide along with the cost of goods, and prices tend to increase while maintaining the profit margin. However, this is also a matter of watching customer and competitor trends.

In terms of daily sundries, we have not yet heard of any price increase for NB products. However, we have received a request for a slight price increase on the materials side for PB products. Food products are often mentioned in the news and in the press, so I think it is a category that is relatively easy for customers to understand. However, for PB products, it is difficult to convey to customers that we will raise prices, so we will do it carefully by watching the movements of our competitors.

As for your second question about the effects of the SG&A control and the support system for shift creation: To be honest, it is difficult to show any monetary amounts in terms of labor cost reduction. The reason for this is that we can control the amount of money by reducing overtime hours and the appropriate amount of hours for part-time workers, but we also need to consider how to increase productivity and sales with the new time we gain. That's all.

Questioner C [Q]: Thank you very much. On the other hand, what you have just explained means that the effects of the support system for shift creation and the control measures are steadily progressing, is that correct?

Tsuruha [A]: Yes, that's right. TSURUHA has been introduced for about two years now, and we have been able to control the situation in the field, so we are going to roll out this system horizontally across the group as needed. This means that it is becoming more effective.

Questioner C [M]: I understand. Thank you.

Yamazaki [M]: Thank you very much. Next, please continue.

Questioner D [Q]: I am always very grateful for your help. Thank you for your explanation.

I'd like to ask for a supplement to the previous answer. The first is regarding SG&A expenses, which is on page 7 of the presentation materials. I would like to confirm this because it is difficult to compare the 2, since they

are displayed in the old and new standard. Since the revenue recognition standard is for point promotion expenses, if we reclassify the JPY114.1 billion for this fiscal year to the old standard, is it correct to assume that sales promotion expenses will be positive?

Yamazaki [M]: I would like you to clarify which part of the difference between the old standard and the new standard.

Questioner D [Q]: In terms of the breakdown of SG&A expenses, is it correct to assume that the difference lies in sales promotion expenses? I think it is about JPY3 billion.

Effects of Changes in Revenue Recognition Standards

1H of FY5/22 (millions of yen / %)

	Before reclassification (based on former standards)			After reclassification (new standards = disclosed values)	
		Share	YoY		Share
Net sales	474,906	100.0	104.7	462,512	100.0
Gross profit	139,742	29.4	106.2	136,817	29.6
SG&A expenses	117,129	24.7	113.0	114,107	24.7
Operating income	22,612	4.8	80.8	22,709	4.9

Reclassification effects

Points granted (TSURUHA) changed from recording provision for point card certificates to deferred revenue recognition

Points granted by other companies changed from posting expenses to reducing the transaction price

Revenue recognition on sales purchases changed from gross to net basis

(Millions of yen)

Net sales (12,394)
- Points granted (TSURUHA) (2,134)
- Points granted (competitors) (770)
- Sales purchases on consignment, etc. (9,488)

Cost of sales (9,469)
- Sales purchases on consignment, etc. (9,496)

Gross profit (2,925)

SG&A expenses (3,022)
- Points granted (TSURUHA) (2,251)
- Points granted (competitors) (770)

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Yamazaki [A]: May I start? Let me answer.

The details of the impact are on page 30, so please have a look at it, but as you just pointed out, the relevant part is sales promotion expenses. Under the old standard, the portion of points awarded, which became a provision in the form of a reserve for points, was recorded as an expense. The amount was recorded quarterly via the reversal method. This is no longer the case with the new standard, so there will be a difference in that area.

In addition to the change in revenue recognition standards, the point system has also changed slightly this fiscal year. In the past, tickets were issued when 500 points were accumulated, but now they can be used in units of 1 point. In other words, you can accumulate more and more points even if you have more than 500 points. In fact, the way points accumulate now, they tend to surpass 500 points. Customers are accumulating more points than ever, so if we apply the conventional method of accounting for reserves, we will have to account for about JPY3 billion.

I understand that the difference is equivalent to the increase in sales promotion expenses, which is about JPY3 billion.

Questioner D [Q]: If you were to break it down into items, what would they look like? If you were to divide the SG&A expenses under the old standard.

Yamazaki [A]: I think the answer to your question was on page 7, but there are personnel expenses, sales promotion expenses, land rent, and others.

Questioner D [Q]: I see. So, the point system was changed, and there was a huge increase due to this. If you add back the JPY3 billion, sales promotion expenses would increase to about JPY5 billion in the first half, which is a huge increase, so I was wondering why.

Yamazaki [A]: That's right. Originally, reserves were about JPY300 million in the previous year. I think that's where it's all piling up.

Questioner D [Q]: I see. I understand. So, this is a transitory part of the system that has been changed.

Yamazaki [A]: Yes. That's right.

Questioner D [Q]: Then, even if you correct it to sales promotion expenses, the growth in other areas continues to be high. Looking at this portion alone, it seems that donations and depreciation are increasing more than planned, but is that so?

Murakami [A]: I will explain. In terms of the comparison to last fiscal year, the item disclosed this fiscal year is the donation that I explained. However, in the previous fiscal year, due to deductions and other factors, there were no sales promotion expenses, so the total impact of these taxes, public charges, and donations is approximately JPY1 billion. In addition to this, depreciation, amortization, and cashless expenses are a little higher than these items. Thus, the base rate is 120%, but excluding DRUG ELEVEN, the rate is 116.6% for the 6 companies. Was that sufficient?

Questioner D [Q]: I understand. If that’s the case, I would like to confirm: Are the overall SG&A expenses in line with the plan, including the other category? I mean compared to the internal plan. Is the other category not slightly above the plan?

Murakami [A]: That's right. In that sense, the other part of the company is managed a little more closely, but this is a slight plus. However, when you look at the total SG&A expenses, the figures have been contained.

Questioner D [Q]: I understand. Is there any possibility that the other expenses will continue to follow the same trend in the second half of the year? Taxes and depreciation.

Murakami [A]: For the full fiscal year, the impact of the first half of the fiscal year will remain, but in the second half of the fiscal year, the taxes, public dues, and donations that I just mentioned are not planned for the second half, so I understand that those aspects will not continue.

Questioner D [Q]: I understand. Thank you. One more thing related to sales promotion expenses: In DX, you talked about using 1 to 1 marketing, and you said that this would be effective from the first half of the next fiscal year. Will it be effective in terms of reducing the number of leaflets? Is it possible to expect a fairly large reduction in the amount of funds spent?

Tsuruha [A]: Yes, as you said, of course we are replacing leaflets with digital flyers and reducing the number of leaflets, but if this app can make sales promotion more effective, we will naturally shift to it. However, of course, there are customers who do not have the app, so I don't think it will disappear completely, but it is quite possible that there will be a shift towards that direction.

Questioner D [Q]: How about the reduction in the amount of flyers? I heard that you could save about JPY500 million or JPY1 billion annually.

Tsuruha [A]: I'm not sure yet, honestly, but I'll examine it closely in the future.

Questioner D [Q]: So, you don't know yet. I understand. One last point: the details of the NHI price revision for April 2022 are gradually being revealed, and there have been reports in the press. I would like to know the scale and image of this reduction, and whether it will be the same as before and thus not a major fluctuation factor.

Murakami [A]: I would like to answer. The details are usually finalized in February or March of each year, so I can't give you a definitive answer, but I can say that it is in line with our expectations to some extent. However, as the additional fee for generic systems will be reduced in the future, we will work on value-added products such as additional fees for regional systems to replace them.

Questioner D [M]: I understand. Thank you very much.

Yamazaki [M]: Thank you very much. I think we had another person.

Questioner E [Q]: I'm looking forward to hearing from you. Two points, please.

First, I would like to know about your thoughts on prescription drugs. In the new medium-term plan to be announced next fiscal year, will there be any numerical target in terms of annexation rate percentages? Nowadays, there is a growing demand for pharmacies with a high level of specialization, such as pharmacies that cooperate with local communities and specialized institutions. How will you position yourself in this regard?

Secondly, I would like to know about DX. Rather than reducing labor costs, I think you mentioned that you would like to improve the quality of customer service. Do you have any percentage goals in terms of sales per employee? That's all.

Tsuruha [A]: Thank you. The dispensing business will of course be included as one of the key strategies in the new medium-term management plan to be announced. The question is whether it will be based on annexation rate, sales scale, or both. We are still discussing these matters, but we would like to disclose some numerical values. In addition, we are still working on the specialization in community pharmacies, and our policy is to aim for specialization in this area as much as possible.

Regarding DX, we have not yet been able to verify any figures for sales per employee etc. To be honest, it is difficult to classify and verify figures in the context of DX and sales promotion. However, I think we should have some guidelines and standards. I would like to tell you if any figures can be scrutinized, but there are no figures that can be announced at this time. That's all.

Questioner E [M]: Thank you very much.

Yamazaki [M]: Thank you very much. Was that all? As there are no further questions, we will conclude the question-and-answer session.

This concludes the financial results briefing for the first half of the FY2022 of TSURUHA HOLDINGS INC. Thank you very much.

Company Representative [M]: Thank you very much.

[END]

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Document Notes

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