

Operation Overview and Outlook

Since its foundation in 1950, our company has achieved rapid growth as a specialized manufacturer of pharmaceuticals listed in the *Japanese Pharmacopoeia (JP)*. In recent years, we have continued to expand our business by prioritizing the manufacture and sales of medical disinfectants and magnesium oxide preparations (laxatives) as the two main pillars of our business as they represent evolving products in the field of *JP* pharmaceuticals.

As part of our efforts to expand business, for the last two decades, we have been investing aggressively in both tangible and intangible resources. As examples of tangible resources, we completed the Shin-Sayama Distribution Center with an automated distribution system in 2000, obtained a new site for our plant in Iruma, Saitama, in 2002, and constructed the first building of the Iruma Plant, which is dedicated to the manufacture of new products, in 2003 and completed the second building in 2007. We extended the second and first buildings in 2009 and 2012, respectively. Since then, we have carried out aggressive capital investments in such areas as the machinery upgrades needed to manufacture high-quality ethical pharmaceuticals at the Sayama and Iruma plants.

As instances of intangible resources, with the aim of providing scientific information to medical institutions, we launched *Carlisle*, a publication on healthcare-associated infections, in 1996 and *Y's Square*, a website providing information on hospital infection control, in 1998. Since then, we have been actively engaged in publishing academic books on information of infection prevention measures and held seminars for healthcare professionals. These have served to strengthen customer trust and enhance our brand power.

The current environment surrounding ethical pharmaceutical manufacturers remains tough as a result of the promotion of medical cost management policies by the public administration, along with the rising cost of raw materials. By focusing on the development of products that address the needs of those on the medical frontlines and enhancing patient quality of life, we have been able to expand the manufacture and sales of new products and achieve business growth. MaglaxTM Tablet (currently called "Magnesium Oxide Tablet 'Yoshida'"), a magnesium oxide preparation launched in 1999, has grown to be one of our main products. We maintain a healthy balance between the two segments of laxatives (magnesium oxide preparations) and disinfectants, and this is the source of our ability to secure stable sales. We also launched MaglaxTM Granules 83% (currently called "Magnesium Oxide Fine Granules 83% 'Yoshida'") in 2006, another dosage form of the magnesium oxide preparation, and HexizacTM AL Solution 1% in 2010, a chlorhexidine antiseptic preparation that has enjoyed increasing recognition in recent years. We will continue to focus on such areas as new product development and improvements to existing products.

In 2021, while demand for disinfectants leveled off after rising in 2020 because of the COVID-19 pandemic, a succession of new low-priced products entered the disinfectant field facilitated by a government policy of encouraging entry from other industries. This led to substantial disruption of the balance between supply and demand. As a result, sales in the disinfectant segment decreased sharply. At the same time, because of worsening business conditions for medical institutions during the COVID-19 pandemic, the magnesium oxide preparations business—one of our main segments—was drawn into a price war (characterized by rising rebate rates, roughly equivalent to rising discount rates), and sales in this segment rose only slightly from the previous period. This minor increase was not enough to make up for the large-scale decrease in sales in the disinfectant segment. Even as sales levels remained challenging and profit levels were much lower than in the previous year when they benefited from special demand for disinfectants, we were able to keep the decrease in operating profit to a level only slightly lower than in 2018 and 2019, thanks to further efforts to reduce expenses. At the same time, because of the COVID-19 pandemic, sales of former brand-name products that now switched to generics did not grow as much as had been expected, and we were forced to dispose of inventories of former brand-name products for which the expiration dates were approaching. This led to the recording of an additional 59 million yen in losses from the disposal of inventories as extraordinary losses. The shareholders (equity) capital ratio at the end of the period ended December 2021 was up 7.4 points from the previous period to 73.7%. We borrowed 1.4 million yen from our main banks in March 2020 using a credit line in the same amount and retained an equal amount as cash on hand as preparation for uncertainties in the demand for funds during the COVID-19 pandemic. We repaid this loan at the end of last year as the pandemic subsided to some degree.

Despite some restrictions on sales information provision activities as the COVID-19 pandemic persisted during 2022, we recorded net sales of 9,381 million yen (up 162 million yen from the previous period for a growth rate of 1.8%). While the performance of disinfectants and other products in the infection control segment was favorable, the laxatives (magnesium oxide preparations) segment faced challenges due to severe competition from competing products. Operating profit was 271 million yen (up 115 million yen from the previous period, for a growth rate of 65.7%). Some of the main factors behind the growth in profits from the previous period are reviewed below:

- I. Substantial growth from the end of the previous period in inventories of Company products (We endeavored to build up inventories of Company products in preparation for the temporary suspension of production due to plans for upgrading and the repair of machinery and equipment on multiple production lines in 2023.)
- II. Substantial reductions from the previous period in the funding burden related to equipment dedicated to our use at OEM manufacturers
- III. Higher added value [gross sales – external purchases (raw materials costs + outsourcing costs + product purchases)] accompanying the increase in gross sales from the previous period

IV. A slight decrease in rebates resulting from the focus on delivering products at fair prices (invoice prices)

We consider the factors I and II above to be extraordinary factors. We recognize the financial situation for regular business operations to be a difficult one due in part to skyrocketing raw-material prices.

In 2023, normal everyday living returned at last as more than three years of the COVID-19 pandemic came to an end with the reclassification of COVID-19 from a class 2 to a class 5 infectious disease on May 8 under the Act on the Prevention of Infectious Diseases and Medical Care for Patients with Infectious Diseases. However, business conditions in the ethical drugs industry remain challenging because of the pressure of skyrocketing raw material prices. These business conditions forced net sales down by 300 million yen year-over-year due to factors that included the (a) failure of price hikes to permeate as expected in price negotiations with drug wholesalers, medical institutions, and others authorized to decide on delivery prices to medical institutions and other facilities, despite having focused on fully reflecting in invoice prices the price hikes on unprofitable products authorized by the Ministry of Health, Labour and Welfare and increasing the invoice prices on other low-profit products (characterized by rising rebate rates, roughly equivalent to rising discount rates), (b) discontinuing the sale of some unprofitable products, and (c) further intensification of competition (aggressive pricing substantially lower than drug prices) in the important product line of laxatives (magnesium oxide preparations). Operating profit, an indicator of our strength in our main businesses, was largely unchanged from the previous period (down 9 million yen) mainly because of such factors as (1) lower than initially anticipated increases in raw materials costs (which will fully impact the next period's results), (2) efforts to cut expenses, including labor costs, and (3) substantial increases in inventories of Company products from the end of the previous period. However, since factors (1) and (3) merely reflect carryover to 2024, we recognize that financial results continue to involve uncertainty.

In 2024, we expect sales and income growth in the infection control segment (disinfectants and other products) to cover sluggish performance in the laxatives (magnesium oxide preparations) segment. As such, we expect to be able to record a reasonable level of operating income by absorbing the effects of such factors as those under (1) and (3).

We will do business while keeping in mind at all times our mission as a manufacturer and seller of ethical drugs of “consistently fulfilling our responsibility to supply high-quality ethical drugs” in 2024 as well.

In addition, we will continue to carry out appropriate sales information-provision activities in accordance with the intent of the Guidelines for Sales Information Provision Activities for Ethical Drugs that came into effect in April 2019.

While potential demand for magnesium oxide preparations is strong, it is a fact that competition has been intensifying recently. We will strive to recover sales, which have experienced slow growth over several periods, by steadily implementing a variety of measures related to magnesium oxide preparations. As for the disinfectant business, the high level of recognition that we achieved in the academic information field is increasingly bearing fruit in the form of business outcomes. Moreover, in order to sustain long-term growth, we will continue to actively promote R&D activities that accurately ascertain the needs of the medical frontlines and bring new products to market. Our financial footing is quite strong (with equity capital of 11,380 million yen and an equity ratio of 74.9% at the end of December 2023), and we have not identified any causes for concern regarding funding.

Masahiro Endo, President

Yoshida Pharmaceutical Company Limited

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