

MEDICAL DATA VISION CO., LTD (3902 JP)

QUARTERLY EARNINGS WERE IN LINE. A LONG-TERM RISK REMAINS WITH LAUNCH OF B2C BUSINESS

FY23 Q2 RESULTS SUMMARY

Medical Data vision [MDV] reported FY23 (Dec year-end) 1H gross profit [GP] of ¥2,345mil (-0.7% YoY) and recurring profit [RP] of ¥700mil (-9.7% YoY) on sales of ¥3,002mil (+5.1% YoY).

The gross profit margin [GPM] continues to contract, declining from 82.6% in FY22 1H, to 82.4% in FY22 and down to 78.1% in FY23 1H. This is due to a +32.6% (+¥161mil) YoY rise in FY23 1H COGS to ¥657mil related to 1) higher insurance association data acquisition costs (+¥76mil YoY), and 2) a rise in costs associated with the launch of cloud-based services, such as fee-paying MDV Act and Alpha Salus (+¥51mil YoY). In addition, personnel cost included in SG&A costs rose +8.5% YoY to ¥907mil as (1) the firm took on more engineers and marketing staff, and (2) employees were awarded a +5% pay rise.

The firm also reported non-operating expense of -¥21mil in Q2 from equity method investment on SENSING, a software company that develops a contactless vital sensing technology. As a result, despite the YoY rise in sales, RP fell -9.7% YoY.

MDV (3902 JP): Earnings Summary (Cumulative)							
(¥mil)	FY22			FY23			
	1H	FY	YoY (%)	1H	YoY (%)	FY CE	YoY (%)
Sales	2,856	6,104	7.6	3,002	5.1	7,200	17.9
GP	2,360	5,030	8.3	2,345	-0.6	N/A	N/A
GPM (%)	82.6	82.4	+0.5ppt	78.1	-4.5ppt	N/A	N/A
SG&A	1,576	3,271	7.3	1,625	3.1	N/A	N/A
SG&A / Sales (%)	55.2	53.6	-0.2ppt	54.1	-1.1ppt	N/A	N/A
OP	784	1,758	10.3	719	-8.2	1,800	2.4
OPM (%)	27.5	28.8	+0.7ppt	24.0	-3.5ppt	25.0	-3.8ppt
RP	775	1,750	9.9	700	-9.7	1,800	2.8
RPM (%)	27.1	28.7	+0.6ppt	23.3	-3.8ppt	25.0	-3.7ppt
NP*	521	870	-20.0	445	-14.7	1,200	37.9
Dividend (¥)	N/A	6.0	7.1	N/A	N/A	6.5	8.3

Source: Nippon-IBR based on MDV's FY21, FY22 & FY23 Q2 earnings results material
* NP attributed to the parent's shareholders

PERFORMANCE BY SEGMENT

MDV's business portfolio is largely divided into two segments:

(1) Data Network Services: The business model continues to be in transition from an on-premise data solutions service provider to offering a cloud-based service. FY23 1H segment GP fell -20.7% YoY to ¥348mil on sales of ¥723mil (-1.1% YoY).

Under the on-premise business model, MDV received a one-off installation fee and a monthly subscription fee thereafter from data solutions services such as EVE to DPC hospitals – i.e., those with a Diagnosis Procedure Combination / Per Diem Payment System [DPC / PDPS] fee payment

EXECUTIVE SUMMARY

- Medical Data vision [MDV] reported FY23 (Dec year-end) 1H GP of ¥2,345mil (-0.7% YoY) and RP of ¥700mil (-9.7% YoY) on sales of ¥3,002mil (+5.1% YoY).

- The GPM fell from 82.4% in FY22 to, 78.1%, on a +32.6% YoY rise in 1H COGS to ¥657mil, due to 1) a rise in the cost to acquire insurance association data (+¥76mil YoY), and 2) higher costs for the launch of cloud-based services such as fee-paying MDV Act and Alpha Salus (+¥51mil YoY).

- MDV's FY23 guidance remains unchanged and calls for GP of ¥5,555mil (+10.4% YoY) and RP of 1,800mil (+2.8% YoY) on sales of ¥7,200mil (+17.9% YoY). RP growth is much lower due to rising costs (personnel and subcontractors).

- For FY23, MDV's strategic focus will be on 1) the shift to cloud-based services in the Data Network Service segment, 2) maintaining its market share in the medical big data analysis market, and 3) the launch of the remodelled Karteco app to further enhance the growth potential of BtoC businesses. Of the three, the launch of B2C remains a risk as monetisation is yet to be established.

- MDV is currently running a three-year medium-term management plan that covers FY23~FY25. The final target is for RP of ¥2,500mil+ (CAGR of +16.1%+) on sales of ¥10,000mil (CAGR +16.7%+) solely from organic growth of its existing businesses.

- MDV plans to (1) allocate 5~8% of sales to R&D, (2) add 20~30 new staff every year, and (3) pay 20%+ of net profit as a dividend.

system, hereinafter referred to as DPC – to support their data management needs.

In FY23 Q2, MDV earned quarterly stock (recurring) revenue of ¥212mil (-3.6% YoY / -7.8% QoQ) from on-premise services which tend to have a low seasonality in March as some users cancel at the end of financial year. Quarterly flow revenue, which is earned from one-off initial fees, was ¥61mil (-9.0% YoY / -15.3% QoQ).

With the promotion of the firm's cloud-based service, MDV Act, the number of hospitals which now subscribe to this service has surpassed the 1,000-mark to reach 1,047 facilities as of FY23 Q2 – an increase of +22 hospitals during Q2. However, the number of hospitals on board is falling slightly short of MDV's target to get 1,200 users signed up in FY23, as is the number of hospitals that deploy fee-paying services of MDV Act (as of 1H 507 hospitals vs. FY23 target of 600).

The new fee-paying services MDV Act offers are the most used functions under the existing DPC system. Out of 507 hospitals that use fee-paying services of MDV Act, some 10% are new customers. MDV reckons that although the total number of hospitals that subscribe MDV Act might be in short of its target for 1,200, demand for the cloud-based system is strong, hence management expect the shift from the on-premise system to the cloud-based MDV Act will continue, which will bring in new customers.

The number of health check facilities that introduced MDV's solutions Alpha Salus, reached 93 facilities vs the FY23 target of 109. Also in this segment, MDV included quarterly revenues from new businesses of ¥60mil (-13.0% YoY / -30.2% QoQ on a like-for-like basis) in FY23 Q2. However, the majority of revenue from new businesses has been separated out to the Other Services segment from FY23.

Data Network Service New Sales Breakdown (Quarterly) in new segment group					
(¥mil)	FY22		FY23		
	Q1	Q2	Q1	Q2	YoY
Data Network Total	374	357	388	334	-6.4
Flow Revenue (initial fees)	67	67	72	61	-9.0
Recurring Revenue (monthly subscription fees)	222	220	230	212	-3.6
New Businesses (subsidiaries)	83	69	86	60	-13.0
Other services	116	122	147	124	1.6

Source: Nippon-IBR Based on MDV's FY22 & FY23 Q2 earnings results materials

(2) Data Utilisation Services: MDV's model for this business focuses on providing various analytical services based on information collected through its Data Network Service Solutions. Segment GP for FY23 1H was ¥1,778mil (+2.5% YoY) on sales of ¥2,007mil (+6.4% YoY).

The GPM declined from FY22 1H2's 92.0%, and FY22's 91.7% to 88.6% in FY23 1H, primarily on the back of higher costs related to the surging demand for insurance patients' data – MDV must acquire anonymised insurance associations' data from DeNA (2432 JP) and JAST (4323 JP) – which subsequently led to a deterioration in the sales mix. MDV expected a decline in the number of sales and marketing staff in FY23 1H, which subsequently led to lower ad-hoc Medical Data Survey Analysis sales of ¥758mil (+11.8% YoY / -5.8% QoQ) in Q2. QoQ decline in Q2 sales of the ad hoc service is also due to low seasonality.

Total segment sales landed better than expected at ¥984mil (+13.8% YoY / -3.7% QoQ), thanks to demand boosted by increase in insurance associations' data. As a result, MDV analyzer, a web-based system which analyses numbers of patients, prescription trends and dosing periods in DPC hospitals, now added with data samples from insurance associations, saw an increase in Q2 sales by +21.5% YoY / +4.1% QoQ to ¥226mil.

KPIs for the Data Utilisation segment include the following:

- Sales trend of insurance data: This reached ¥153mil in 1H vs the FY23 target of ¥500mil.
- Sales of the data trial field: This is a powerful tool which helps clinical trials become more efficient. 1H sales were ¥16mil vs the FY23 target of ¥80mil.
- Numbers of samples in MDV's databases: The amount of data from DPC hospitals stored in MDV's Sakura databank increased to 44.06mil patients, up from 42.32mil as of the end of FY22, and 43.22mil as of FY23 Q1.
- Number of samples gained through insurance associations' data: MDV focuses on increasing the variety of samples by gaining accesses to insurance associations' data through its alliance with DeNA (2432 JP) and JAST (4323 JP). This rose to 19.46mil in Q2 from 17.97mil patients as of the end of FY22 and 19.11mil in Q1.

Data Utilisation Services: Sales Breakdown by Service (Quarterly: Adjusted to new segment)									
(¥mil)	FY22						FY23		
	Q1	Q2	Q3	Q4	YoY (%)	QoQ (%)	Q1	Q2	YoY (%)
Data Utilisation Total	1,020	865	935	1,182	2.0	26.4	1,022	984	13.8
MDV analyzer	186	186	176	186	6.3	5.7	217	226	21.5
Ad-Hoc	833	678	759	996	1.2	31.2	805	758	11.8

Source: Nippon-IBR Based on MDV's FY23 Q2 earnings results material

FY2023 OUTLOOK

MDV's FY23 guidance remains unchanged and calls for GP of ¥5,555mil (+10.4% YoY) and RP of 1,800mil (+2.8% YoY) on sales of ¥7,200mil (+17.9% YoY). The RP growth is much lower than that of sales due to higher costs: Of the ¥1,095mil rise expected in absolute sales, COGS will likely rise +¥570mil YoY primarily due to the need to acquire insurance associations' data, and a +¥126mil YoY rise in personnel costs, especially for marketing staff and subcontractor costs (+¥243mil YoY).

Assumptions and forecasts for each segment are as follows:

Data Network Service

MDV is guiding for Data Network Service GP of ¥850mil on sales of ¥1,584mil [NB: the YoY performance is not valid as the segment's sales breakdown was changed]. Management's two main strategies for growth include: 1) Getting all clients to shift to its cloud-based services, and 2) expanding sales of Alpha Sarus, a cloud-based system for medical exams. We discuss these further below:

1) Shift the client base to the cloud-based services.

FY23 will be a transformation year for the Data Network Service segment. MDV had originally sold on-premises type services, such as EVE, targeting 1,764 DPC hospitals. The aim for FY23 is to shift the entire client base over to the firm's cloud-based service platform, which can be loaded with services such as MDV Act.

One of the basic services MDV Act offers – a function through which hospitals can observe the list of indicators required for hospital management analysis. – is currently provided for free. However, on the cloud platform, MDV plans to develop several fee-charging services that each client can choose depending on what they need.

Given the legacy system EVE charges a subscription fee of ¥50,000/month, MDV is confident that a similar level can be charged for MDV's first cloud-based package of fee-paying services. The major difference, however, is that the cloud-based service does not charge the initial one-off fee of ¥4mil.

Since MDV Act also targets smaller hospitals, which, in the past, found the initial fee an obstacle, the firm plans to roll out a SaaS model with the cloud-based services. Moreover, having patient data from hospitals that are not DPC hospitals will further enhance the depth and variety of data.

KPIs for the cloud services include: (1) the number of users. In FY23, the firm aims to raise the number of users to 1,200 hospitals from 993 in FY22, and (2) the number of fee-paying customers for MDV Act platform. Of the 1,200 users, MDV aims to monetise 600 users by offering them fee-charging services.

2) Increase the number of medical check facilities that use System Be Alpha's cloud system, Alpha Salus:

In FY22 Q4, segment sales were boosted from the full contribution of the subsidiary's cloud-based online health check data and follow-up service, Alpha Salus, that targets medical check facilities. In FY23, MDV aims to further increase the number of users to 109 facilities from 94 in FY22. By linking Alpha Salus with Karteco, data of healthy people will be added to the Sakura Data Bank, thus providing a larger pool of data.

Data Utilisation Service

MDV is guiding for FY23 Data Utilisation Service GP of ¥4,014mil (+9.4% YoY) on sales of ¥4,780mil (+19.4% YoY). In this segment, MDV focus is to maintain its market share in this growing medical big data analysis market. In addition to data from DPC hospitals, MDV can now add data from insurance associations and medical check facilities. The firm is also working in alliance with DeNA and JAST as they have access to insurance associations' data. However, the change in sales mix due to the sourcing of data from the insurance associations, will likely lead to a decline in segment GPM from the previous level of over 90% to a figure above 80%.

BtoC Services

MDV plans to launch a BtoC service, the Karteco app, which was renewed for practicality and usability by patients. The ultimate goal of Karteco is to offer preventive medicine information to patients by enabling them to access to their own medical records and medical check results. A user of Karteco can readily access their health data, book online triage consultations – the service will direct the patient to an appropriate medical care provider – and use specialised sensing technology to obtain vital data, such as take a pulse, check respiratory count, and the general state of one's sympathetic and parasympathetic nervous system.

MDV plans to introduce a subscription model in the Karteco services. Initially, the firm considered building a blockchain, with Karteco being a part of it. However, for the time being, Karteco itself can function as a versatile app through which patients can access data and purchase goods and services. Revenue will be derived from 1) a monthly subscription fee and, 2) commission payments from service providers who gain customers via Karteco.

Although the firm aims to roll out the service in FY23, any potential earnings from the Karteco service is not currently included in the FY23 guidance. Focusing on the BtoC business growth signifies that MDV's business model shifted from gathering data to using the data to launch various data and evidence-based preventative medicine services to consumer.

Earnings Guidance						
(¥mil)	FY20	FY21	FY22		FY23 CE	
	FY	FY	FY	YoY (%)	FY CE	YoY (%)
Sales	4,579	5,672	6,104	7.6	7,200	17.9
OP	1,146	1,594	1,758	10.3	1,800	2.4
RP	1,148	1,592	1,750	9.9	1,800	2.8
RPM (%)	25.1	28.1	28.7	+0.6ppt	25.0	-3.7ppt
NP*	700	1,087	870	-20.0	1,200	37.9
Dividend (¥)	3.6	5.6	6.0	7.1	6.5	8.3

Source: Nippon-IBR based on MDV's FY21 & FY22 earnings results material
* NP attributed to the parent's shareholders

THE FY23~FY25 MEDIUM-TERM MANAGEMENT PLAN

MDV announced its first medium-term management plan that covers the three years from FY23~FY25. The final year target calls for RP of ¥2,500mil+ (CAGR of +16.1%+) on sales of ¥10,000mil (CAGR of +16.7%+), solely from organic growth of the firm's existing businesses. During the three years between FY20~FY22, the firm enjoyed CAGR of approx. +15~16% while investing on developing cloud systems, increasing subsidiaries, proactively forming alliances with companies in other sectors such as SBI Holdings (8473 JP) and DeNA's insurance subsidiaries, and hiring engineers.

MDV set KPI for both segments during the plan's three-year tenure. Those KPIs are:

- **Data Network Service KPI:** Get the number of hospitals that deploy the cloud-based services to exceed 1,200 sites and to promote Alpha Salus, a cloud-based health check data system, to 300 health check centres.
- **Data Utilisation Service KPI:** Maintaining sales CAGR of +16%. Currently, MDV has a market share of 32%. Some 80% of the medical big data analysis service is generated from providing services to pharmaceutical companies. To capture growth, MDV plans to tap the insurer data analysis market by obtaining an extra data from the alliance with DeNA.

During the medium-term plan, MDV aims to plant steppingstones for long-term growth while solidifying its existing businesses. The firm reckons that the numerical target can be achieved by the following three strategies:

- **Shifting to a cloud-based database and promoting health checks to enhance the variety of data:** Management sees the need for these existing services to become cloud-based as an important step to develop further solutions. As such, MDV's Sakura Databank is fully cloud-based, enabling its services to have data links with other service providers and create new services. The firm is expanding its customer base from hospitals to associated health check centres which cater for individuals. By linking the health check information to Karteco, an information interface that is used by individuals, MDV will extend its services to BtoC.
- **Maintaining market share in the evidence-based medicine [EBM] data market:** According to Fuji Keizai Group's report "*Current state and the future prospects of medical AI and medical big data markets 2022*", the part of medical big data market that MDV's Data Utilisation services target is estimated to grow to ¥19,000mil (+13.5% CAGR over the three years) in Japan in 2025, from an estimated market size of ¥13,000mil in 2022. To maintain its 30~40% market share, the firm will need to expand its Data Utilisation services not only to pharmaceutical companies but to insurance firms, and potentially to overseas customers as well.
- **Investing on healthcare BtoC data businesses:** MDV sees the next growth area to be the healthcare BtoC business. In 2015, MDV started providing its personal health record [PHR] service Karteco, an app which can be used by patients for free to access their health records. Under the medium-term management plan, the firm will redefine Karteco and launch the health check data and vital data analysis services which will form important parts of the preventive medicine and healthcare markets.

According to Fuji Keizai Group's report "*Trends in the data health planning, health management, and PHR-related market and cutting-edge health insurance, 2021*", the health check data, vital data and lifestyle data analysis markets together have an estimated size of ¥13,170mil, which is estimated to grow to ¥16,070mil (CAGR of +6.9% over three years).

Although MDV's exposure to this market is currently marginal, the firm aims to monetise Karteco through a subscription model and potentially increase ARPU per user by connecting various services to the Karteco platform. Among the three business focuses, the launch of B2C remains a risk as monetisation is yet to be established. However, any potential revenue from Karteco is currently not included in the next medium-term plan.

GROWTH INVESTMENTS AND SHAREHOLDER RETURN

There are primarily three areas to which the firm's financial resources will be allocated:

- 1) **Human resources:** MDV plans to hire 20~30 new staff members every year between FY23~FY25. Management think it is crucial to hire engineers to realise the medical data infrastructure that will be attractive for other companies to participate in. The firm does not limit the human resources by nationality, gender and age and tries to hire those with a variety of skills and expertise.
- 2) **R&D:** MDV plans to spend approx. 5~8% of sales every year on R&D and will concentrate funds on MDV Act and health check system-related fields during FY23~FY24.
- 3) **Shareholder returns:** MDV's shareholders return policy offers an annual dividend pay-out ratio of 20%+. Over the past two fiscal years, the firm also implemented share buybacks (¥589mil in FY20 / ¥889mil in FY21) which generated total shareholder returns of +104.5% and +101.8%, respectively. In FY23, the firm plans to pay an annual dividend of ¥6.50/share and maintain a pay-out of approx. 20%+ of net profit. For the medium-term plan, MDV has not yet detailed its shareholder return policy.

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