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SBC Medical Group Holdings (SBC-NASDAQ)

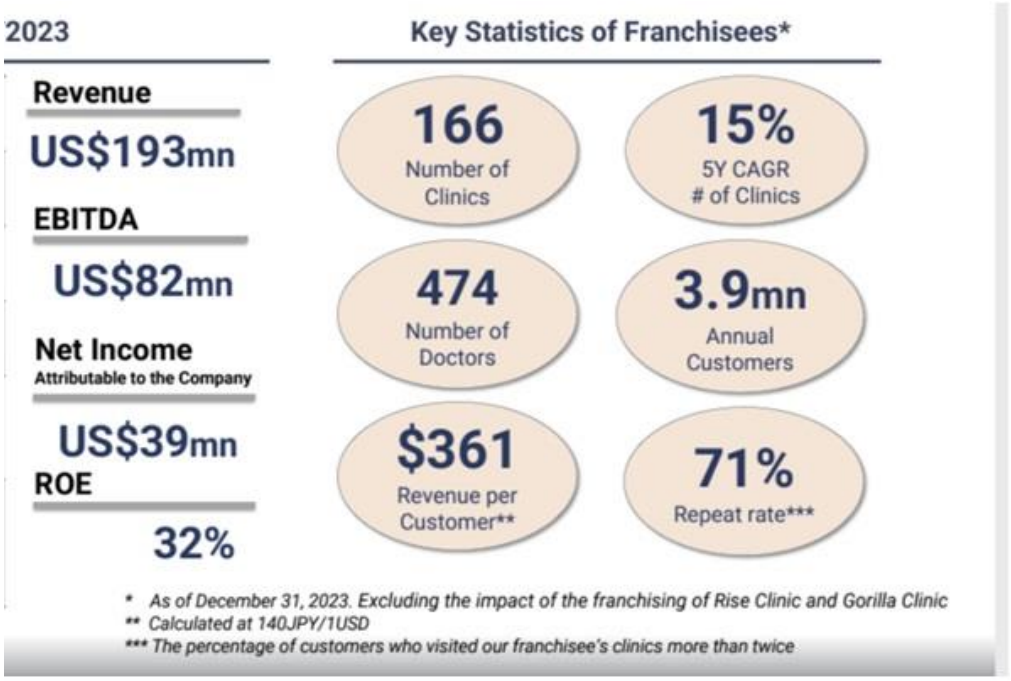
SBC: Fast Growing Solutions Provider in Expanding Aesthetic Medical Market

Research Note

OVERVIEW

Company Description and Background: Growing Player in Medical Aesthetic Market

SBC Medical Group Holdings (SBC- NASDAQ), headquartered in Irvine, California, provides end-to-end solutions for aesthetics clinics, including back office support, purchasing, branding and marketing services (see below), that enable clinics to focus on offering their customers high quality treatments and services at affordable rates.



Source: Company presentation

SBC Medical Group first began operations in 2000 when its founder and largest shareholder, Dr. Yoshiyuki Aikawa, opened the Shonan Beauty Clinic (SBC) in Fujisawa City, Japan. SBC subsequently has expanded its footprint as it continues to grow its network and revenue base. The company's growth has come from both organic measures and through strategic M&A. For example, in 2001 and 2003, Dr. Aikawa added clinics in Yokohama, Japan and Shinjuku, Japan, respectively. In 2009, SBC acquired Medical Corporation Kouwakai, Medical Corporation Naskai and launched Lange Cosmetics.

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The company came public through its business combination with Pono Capital Two, a special purpose acquisition company (SPAC), with SBC being the surviving operating entity and SBC securityholders, specifically founder Dr. Yoshiyuki Aikawa, holding about 80% of the outstanding stock, making SBC a controlled company. SBC believes its listing on the NASDAQ is an important milestone as the company embarks on a strategy to become a global player in the expanding medical aesthetic market.



Source: Company presentation

Overall, the company provides comprehensive consulting and management services to the medical corporations in its growing network and the clinics they operate. SBC's major services includes consulting and marketing solutions, administrative and procurement services and medical equipment leasing.

Leasing equipment that requires a capital intensive upfront outlay can make it easier for the clinics in SBC's franchise network to install and operate a variety of tools and thereby broaden the services they are able to offer their patients. SBC can leverage its strong balance sheet (see below) and solutions to lower the all-in capital costs for clinics to launch or expand their businesses.

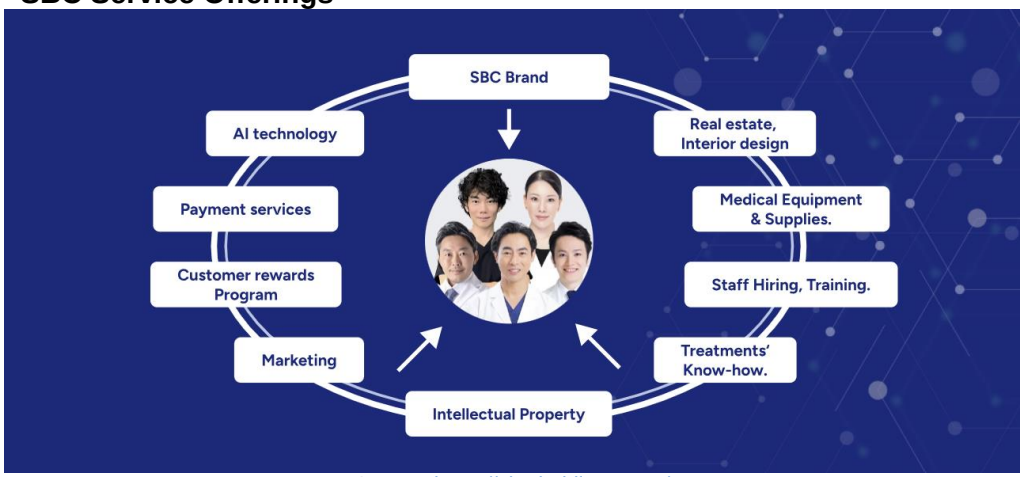
BUSINESS MODEL

Franchise Model Provides Recurring Stream of High Margin Income

SBC Medical conducts its operations through a franchise model. Through medical corporation subsidiaries, SBC served a network of 166 franchise clinics throughout Japan operating under the *Shonan Beauty Clinic* brand at year-end 2023, as illustrated above. Importantly, the franchise model provides a recurring stream of steady fee income that has climbed as the company has grown its franchise network and as SBC franchisees grow their sales and customer base.

In fact, the company's growing clinic network is the major contributor to annual revenue, which reached US$193 million in 2023. Through its medical corporation subsidiaries, SBC has an equity interest to receive franchise fee income based on the franchisee's annual revenue base. The company believes it operates the largest network of franchised clinics in Japan, giving SBC a leading role in the aesthetic medical industry. With clinics operating under additional brands including Rize Clinic and Gorilla Clinic, the company's aggregate clinic network reaches about 220 franchise clinics. Based on the number of franchisee clinics it serves, management estimates SBC's market share in the Japanese aesthetic medical market among medium to large clinic groups at about 31%.

SBC Service Offerings



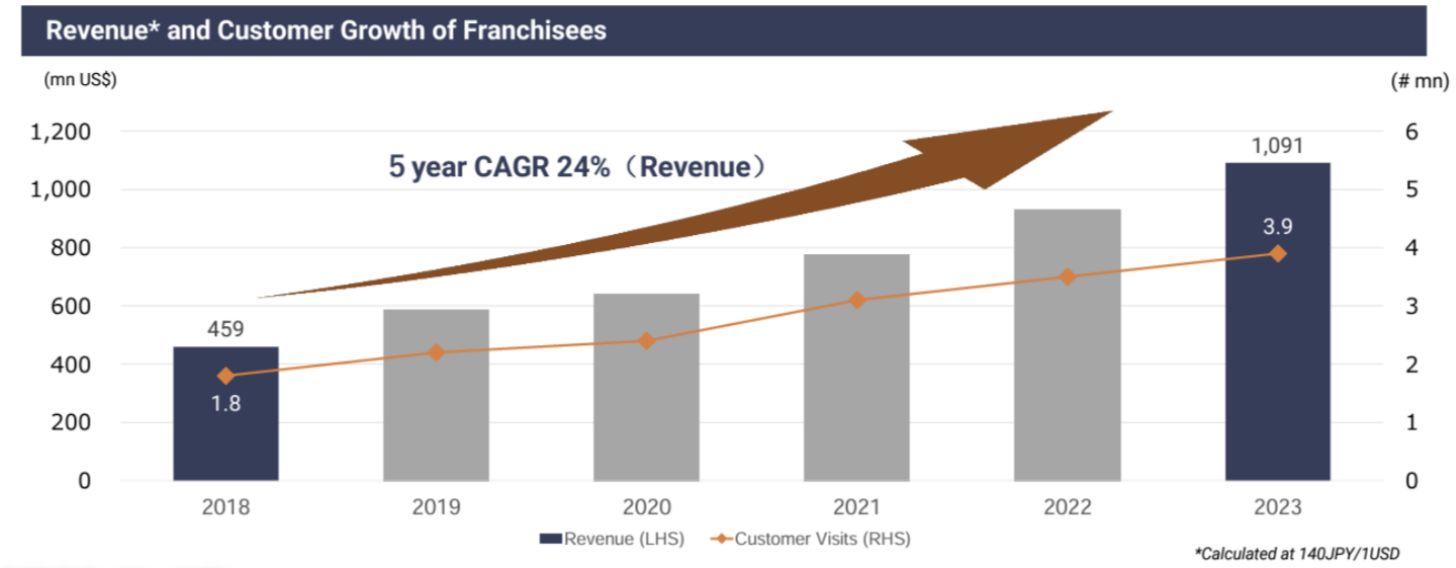
Source: https://sbc-holdings.com/

SBC Offers Technology Solutions - Technology's Growing Importance in Medical Aesthetic Space

Reflecting more than 20 years in the medical aesthetic industry, the company believes the brand has significant value that customers equate with safety, reliability and quality. Some SBC doctors also publish relevant articles that management believes further strengthens awareness of and value of the SBC brand, which is mirrored in an average repeat customer rate the SBC clinics that exceeds 70%. In addition to brand awareness, management attributes this to skilled medical professionals that boost customer satisfaction and a broad range of services franchisee clinics can offer that leverage leading-edge technology. The company offers franchisees the ability to install and operate fully digitized integrated systems, with digital services that range from booking appointments to maintaining medical records and processing and recording payments.

In fact, technology continues to be an important factor within the medical aesthetic space in a variety of back office and patient facing areas. For instance, there are tools on the market that leverage AR (augmented reality) to simulate post-procedure results and the company aspires to maintain leading-edge technology at its clinics. According to an NIH published study noted below, advances in cosmetic surgery, including technological improvements that expand capabilities and safety profile optimizations, have boosted awareness and presumably acceptance of cosmetic surgery. To encourage repeat customer visits, the company offers a rewards program that tracks customers' spending and awards customers with points they can use to obtain discounts on select services.

Moreover, SBC believes the growing number of patients treated at its franchisee clinics is a key indicator of increasing brand awareness. In 2022, the company's franchisee clinics treated about 3.5 million people, up from 3.1 million in 2021. This figure increased further in 2023 to about 3.9 million. The company plans to continue to collect and analyze medical data to facilitate its development efforts to expand its products and service offerings and enhance its growth prospects; the portfolio of products SBC clinics can leverage continues to expand.



Source: Company presentation

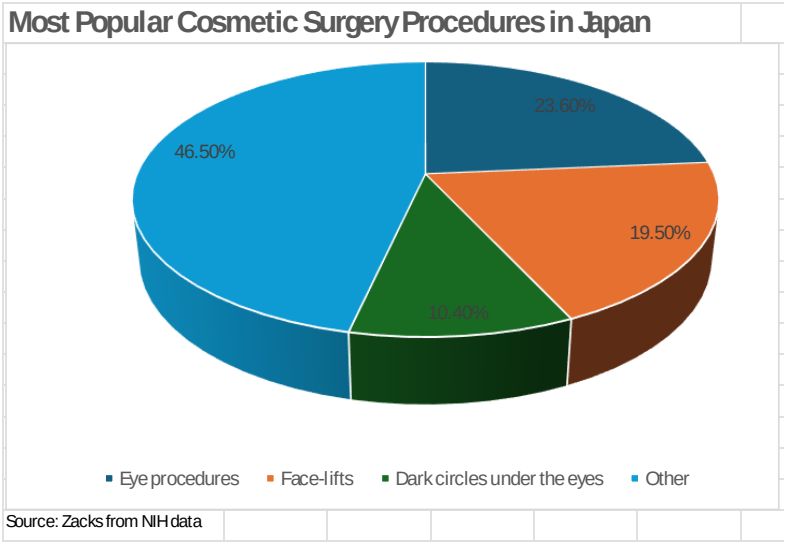
The clinics operating within SBC's franchisee network have a broad spectrum of specialties. They offer a diverse range of medical and aesthetic services within the fields of dermatology, aesthetic surgery, dentistry, hair removal and hair loss treatment, Lasik surgery and other areas. SBC Medical clinics offer regenerative medical treatments in aesthetic medicine, infertility treatment, and plastic surgery. Treatments include breast augmentation, liposuction, rejuvenation therapies, double eyelid surgery and numerous others.

DOMESTIC AND INTERNATIONAL OPPORTUNITIES

Medical Aesthetic Market: Japan has seen demand grow in recent years…

Japan has seen demand for aesthetic medical treatments grow in recently years, partially reflecting the impact of social media, with celebrities and influencers publicizing their own cosmetic procedures. Based on an analysis of data from more than 150k patients[1], a recent study published by NIH found that eye procedures were the most common procedure, followed by face-lifts and treatment of dark circles under the eyes. The study concluded that cosmetic surgery in Japan has become increasingly common in recent years. Not surprisingly, the data suggests that Tokyo had the highest number of cases (28.9% of total) compared to provincial cities.

The target market for cosmetic surgery in Japan has increasingly expanded beyond celebrities and others involved in industries where looks are important to encompass the general public. In fact, the rate of students undergoing cosmetic procedures increased significantly over the study period.



Source: Zacks from NIH data

The rising acceptance of and popularity of aesthetic medicine is partially attributable to growing demand for dermatological treatments. Women continue to be the core customer base, but demand from the male demographic is growing, as well. For example, demand among men for procedures related to hair replacement and other services has been on the rise. Significant growth is expected by tapping into middle-aged female and male markets. Moreover, overall market penetration is still relatively low (the company estimates it at 10%), implying upside if the trend of rising demand continues, as expected.

GROWTH STRATEGY

Emerging International expansion strategy

Most of the procedures that SBC's franchisees in Japan offer, such as liposuction, breast augmentation, eyelid surgery and others, are also among the most popular procedures in many international markets. In fact, liposuction was the most common surgical procedure in 2023 with more than 2.2 million performed, according to the International Society of Aesthetic Plastic Surgery (ISAPS), followed by breast augmentation and eyelid surgery. SBC therefore believes it has developed the expertise and demonstrated business model to further expand its footprint into additional markets, including the U.S., where SBC has already expanded and which remains a potential target market for expansion opportunities.

[1] Studied from September 2018 to August 2021 and again from September 2021 to February 2023

SBC believes that it can leverage its business model and solutions to support a growing network of franchisees in an expanding geographic footprint. Currently, in addition to its operations in Japan, SBC also owns and operates treatment center in Ho Chi Minh City, Vietnam and in California. The company believes its Irvine venue is a leading double eyelid clinic in California. SBC Irvine performs more than 6.3 million surgical procedures and sees roughly three million patients annually.

The clinics in Vietnam and the U.S. reflect SBC's goal to expand internationally – a strategy that is in the early stages. The company expects to be strategic in its market selection process as it expands both domestically and internationally, with the intention to launch new clinics in both new and existing markets to reinforce its market position. The company's location strategy focuses on high-traffic markets with a diverse population and above-average household income.

The company's goal is to maintain a solid pipeline of franchisee development opportunities across various clinic sizes and geographies, as it concurrently raises awareness of the SBC brand. Prior to opening new sites or taking on new franchisees, the company's strategy is to conduct demographic analysis to understand market demand.

Thus, although the cosmetic treatment market in California is highly competitive, the company believes its clinic there has achieved success by offering quality procedures that are in high demand. Specifically, according to the American Society of Plastic Surgeons, eyelid surgery, or blepharoplasty – a surgical procedure that rejuvenates the eyes by removing excess skin, fat and muscle to brighten and open the eyes -- consistently ranks among the top five plastic surgeries performed each year and California has the highest Google Relative Search Volume for related procedures, according to the NIH.



Source: NIH citing *Google* Relative Search Volume for each U.S. state

Tailwind of Strong Global Industry Growth

Globally, the aesthetic medical market was estimated to reach US$59.77 billion by year-end 2024, up from US$57.67 billion in 2023 according to Fortune Business Insights. Fortune Business Insights projects it will grow to US$81.66 billion by 2032, which represents a CAGR of 4.0% from 2024 to 2032. Growth in the U.S. cosmetic surgery market is projected to be driven by increasing demand for minimally invasive procedures. Demand for cosmetic surgery has given rise to growing demand for *medical tourism*, where people travel to international markets for various cosmetic procedures.

Women comprise the larger target market. According to data published by the International Society of Aesthetic Plastic Surgery (ISAPS), in 2022 women accounted for roughly 86.2% of the total aesthetic procedures performed globally. However, demand for aesthetic procedures by men continues to rise, reflecting age-related concerns and other factors. Rising demand for non-surgical procedures, such as dermal fillers and Botox by men has contributed to growth of the overall market and among the male demographic. According to ISAPS, roughly two million aesthetic treatments were performed on men in 2022, globally. The top surgical and non-surgical treatments that men undergo are eyelid surgery, liposuction, gynecomastia, rhinoplasty, botulinum toxin, and hair removal. Demand is highest among the 35- to 50 year old demographic, but is growing in other segments, as well.

Revenue Growth Correlated to Franchisee Expansion, Broadening Service Offerings

As SBC's franchisee network has expanded and its service offerings have grown, the company has seen strong improvements in revenue and EBITDA. SBC has recorded a 5-year revenue CAGR of 24%. Over the same period, the number of franchise clinics in its expanding network in Japan has registered a 15% CAGR. The company believes there are further growth opportunities in Japan, as noted, its recent growth notwithstanding. The overall market is expected to grow and SBC targets market share gains in various areas of aesthetic medicine. In addition to domestic expansion opportunities, management also intends to expand its footprint, as noted, in other countries such as the U.S., Vietnam and Singapore through organic measures and / or strategic M&A. In the future, SBC might also expand its services to clinics engaged in additional related medical fields.

For example, SBC's goal is to leverage the expertise it has developed through more than 20 years of operating history in order to expand into adjacent areas and within certain fields such as fertility treatment. Thus, SBC's strategy is to continue to expand its network and further update and expand the portfolio of services and products it offers its growing franchise network. At the same time, the company also continues to explore opportunities to boost skin care product sales and improve its efficiencies and customer service. Management believes it has the personnel and infrastructure to continue to scale the business and boost its operating leverage.

FINANCIAL AND OPERATIONAL HIGHLIGHTS

SBC Revenue Growth Reflects Recent Expansion Initiatives

SBC's revenue has increased as its network and service offerings have expanded. Specifically, total revenue reached US$193.5 million in 2023, up from US$174.2 million in 2022. Total 1Q24 revenues of $54.8 million increased 28% year-over-year compared to $42.9 million in the same period of 2023, while revenue of US$107 million recorded in the first half of 2024 represents a 129% advance compared to the same period of 2023. Reflecting significant operating leverage, the company's Income from operations more than doubled in the first half of 2024 to $51 million.

Financial Flexibility to Support Growth Strategies

The company has a strong balance sheet and generates steady cash flow, as noted, to support its growth strategy. SBC had cash and equivalents of US$103.7 million as of June 2024 and long-term debt of less than US$15 million. In 2023, the company generated EBITDA of US$82 million, which equates to an EBITDA margin of 42.5% on above-noted 2023 revenue of US$193 million. To enhance its financial flexibility, the company's predictable recurring cash flow could also enable SBC to obtain credit at relatively attractive rates, in our view.

Management

The company's management team has extension experience within the medical and aesthetic medical sectors. For example, Dr. Yoshiyuki Aikawa, SBC's founder and CEO and board chairman since January 20, 2023, has served as the CEO of SBC Medical Group Co., Ltd. (Japan) since January 2000 and its predecessor companies since 2016. Dr. Aikawa was the president and a director of the Japanese Society of Aesthetic Plastic Surgery from 2014 to 2015. He is also a member of the Japanese Society of Aesthetic Plastic Surgery, according to SBC, as well as Japan Laser Therapy Association, Japan Liposuction Society, Chemical Peeling Society, Japanese Society of Anesthesiologists, and Postgraduate Assembly of Anesthesiology at Harvard Medical School.

The company's COO, Yuya Yoshida, has developed expertise in business development through prior work history. From January 2016 to June 2023, he worked in Corporate Development, including as the Global Head and Director of Corporate Development in 2018, at Rakuten Group Co., Ltd. From January 2003 to 2016, Mr. Yoshida served in the financial services sectors, as a principal in M&A, and investment banking at Mitsubishi UFJ Financial Group.

Risks

Risks include that SBC Medical is a controlled company and the interests of its majority shareholder might differ from those of public shareholders. In addition, the competitive nature of the aesthetic medical industry and the need to continuously upgrade technology present risks, as well. Moreover, although SBC believes it has the bandwidth to support its ambitious growth strategy, temporarily growth might be constrained by its internal infrastructure. For example, SBC's system of internal controls failed to detect a misappropriation of funds by a former director. Subsequently, SBC has put a remediation plan in place and moreover, the company found no evidence that any other employees colluded in the misappropriations of company funds.

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