COMPANY RESEARCH AND ANALYSIS REPORT

Gakken Holdings Co., Ltd.

9470

Tokyo Stock Exchange Frist Section

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Index

Summary

Steadily increasing profits through expansion of healthcare and nursing business scope and structural reforms in educational business

Gakken Holdings <9470> is a comprehensive services company in the fields of education and healthcare & nursing. In the educational field, it operates private supplementary schools and publishes children's books, study-aid books, textbooks for elementary and junior high schools, and other materials. In the healthcare and nursing field, it operates serviced apartments and facilities for the elderly, and conducts parenting support businesses, such as running nursery schools. The Company acquired Medical Care Service Company Inc. (MCS), the top operator of group homes for the elderly with dementia, in September 2018 and has been broadening business scope by actively undertaking M&A.

1. Reported FY9/19 sales and operating income growth exceeding guidance due to M&A effects

In FY9/19 consolidated results, the Company reported ¥140,559mn in net sales (+31.3% YoY) and ¥4,523mn in operating income (+23.8%), the 10th straight year of sales increase and 5th straight year of operating income improvement. These results also exceeded the Company's revised guidance (¥138,000mn in net sales, ¥4,200mn in operating income). The main driver of steep sales and profit gains, despite lower sales and profits in the educational domain on income setbacks in prep school and publishing businesses, was due to the effect of making MCS a subsidiary in the healthcare and nursing domain. MCS added ¥30,333mn in net sales and ¥1,392mn in operating income.

2. Likely to continue sales and profit increases in FY9/20 due to improved profitability in educational business

The Company's FY9/20 consolidated guidance targets ¥143,000mn in net sales (+1.7% YoY) and ¥5,100mn in operating income (+12.8%). This outlook aims to raise profitability and restore profit increase in the educational domain by realizing benefits from structural reforms, including removal and consolidation of unprofitable schools in prep school business and narrowing in publishing business, and increasing sales of elementary school textbooks. Meanwhile, the Company expects a decline in operating income for the healthcare and nursing domain, despite an increase in sales on ramped-up openings of serviced apartments for the elderly and group homes for the elderly with dementia, because of higher initial investments, including personnel costs. Since the Company conservatively estimates personnel costs, however, it has upside room in earnings if operations proceed smoothly.

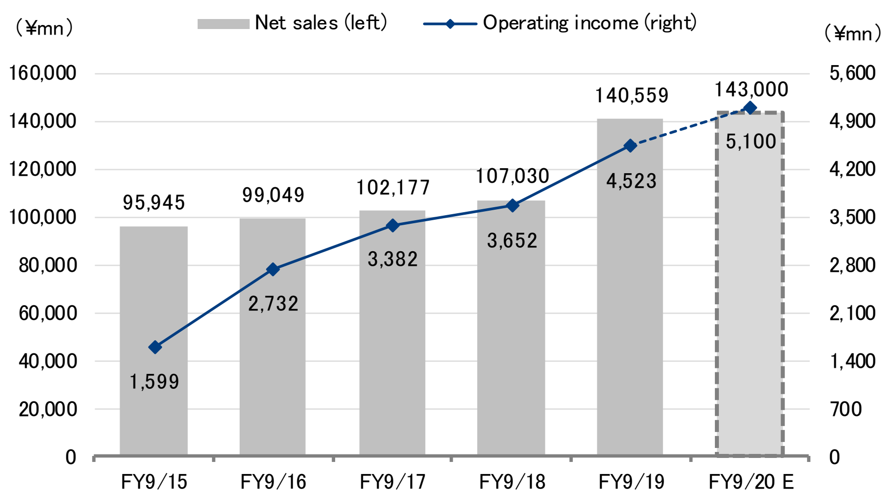
3. If educational business gets on a growth path, the pace of profit expansion may accelerate

While progress with Gakken 2020, a two-year medium-term management plan started in FY9/19, is generally proceeding smoothly in terms of overall results, the educational field is undershooting the initial plan for profits. Main reasons are slumping profits in prep school business because of tougher competition to recruit students amid decline in the youth population and emergence of personalized tutoring schools and other rivals and steady shrinkage of publishing business related to inroads by the Internet and e-books. Additionally, it is taking some time to expand successful cases in G-PAPILS business, an independent-style personalized learning school that utilizes AI technology attracting attention as a new initiative. The Company plans to expand profits in the educational field by resolving these issues and strengthening businesses with growth opportunities, such as English learning and STEAM businesses. In the healthcare and nursing field, the Company should be capable of achieving stable growth in an expanding market by adding more serviced apartments for the elderly, group homes for the elderly with dementia, and other sites and enhancing group collaboration. For this reason, if the education sector is on a growth path, the pace of growth in the overall business performance may accelerate, and the trend is noteworthy.

Key Points

- Attained a 10th straight year of sales increase and 5th straight year of operating income improvement in FY9/19
- Likely to continue sales and profit gains in FY9/20 on recovery in educational business profitability with structural reform benefits
- Targets improvement in enterprise value driven by sustainable growth with the educational field and healthcare & nursing field as growth engines

Results trends



Source: Prepared by FISCO from the Company's financial results

Business overview

Operates in two main areas – education and healthcare/nursing

1. Company history and business segments

The Company started with the establishment of Gakushu Kenkyusha, a publisher of educational books, in 1946 with a corporate motto from the founder that "postwar reconstruction fundamentally relies on education." While the Company initially developed business through a schools sales channel of schools, it expanded scope in the 1970s by building the sales channel of bookstores sales channel and setting up direct sales to households. It obtained broad support for Kagaku and Gakushu learning materials with notes for elementary students and steadily grew into a comprehensive publishing company in the educational field by widening to encyclopedias, dictionaries, medical books, and other areas. The Company expanded business to the educational services field from the 1980s with its launch of prep school business.

In the 2000s, the Company pursued streamlining reforms in educational business in response to weaker profits from impacts by decline in the youth population and a publishing recession and also started elderly care business in 2004 with the goal of developing a second major business area. It subsequently moved forward actively in acquisitions and business alliances and transitioned to a holding company format in 2009. The Company has worked on rebuilding the business foundation and restoring profitability in recent years. At the end of FY9/19, it had 51 consolidated subsidiaries, 16 non-consolidated subsidiaries, and eight affiliates (including one equity-method affiliate*).

* Owns a 37.7% stake in Ichishin Holdings <4645>.

The Company adjusted business segments over the years in keeping with business growth, exits, and other changes, and has been disclosing income results in four business segments under two business domains (educational domain and healthcare nursing domain) since FY9/17.

The educational domain consists of three business segments – educational services that mainly manages Gakken Classroom started in 1980 and other schools, educational content that has roots in the Company's founding area of educational-related publishing, and educational solutions that primarily handles publications for kindergartens and nursery schools and textbooks for elementary and junior high schools.

The healthcare and nursing domain, meanwhile, has a single business segment – healthcare and nursing services. This segment covers the senior residence business that began with the establishment of Gakken Cocofump Co., Ltd. (now Gakken Cocofump Holdings Co., Ltd.) in 2004, the parenting support facility management business for nursery schools and other facilities, the publishing business for specialty books aimed at nurses and doctors*1, and the MCS*2 business acquired as a subsidiary in September 2018 (operates group homes for the elderly with dementia and other elderly care facilities, etc.).

*1 Moved the publishing business for specialty books aimed at nurses and doctors operated by Gakken Medical Shujunsha Co., Ltd. and e-learning service, etc. for nurses provided by its subsidiary to the educational content business from FY9/20.

*2 Acquired 61.8% of outstanding shares for ¥8.9bn.

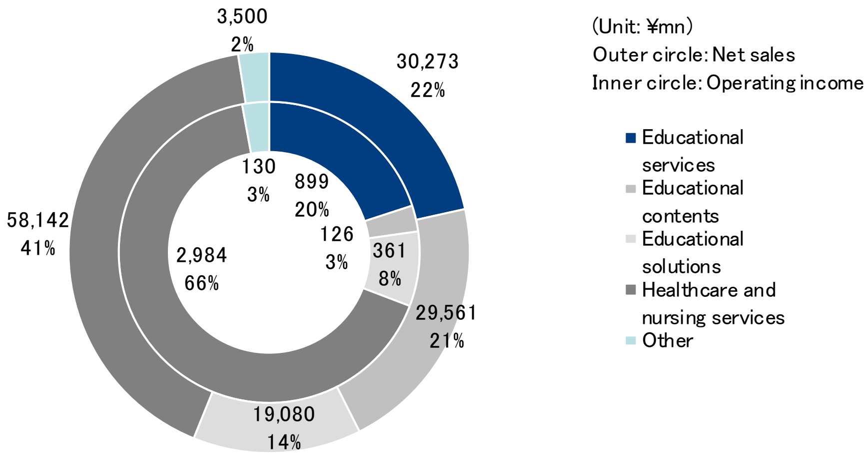
Business content and major subsidiaries

Business domain	Business segment	Business content	Major subsidiaries
Educational domain	Educational services business	1) Operate Gakken Classroom mainly for elementary students and promote franchise business, 2) operate prep schools mainly for junior and senior high school students and provide home tutor dispatching service	Gakken Juku Holdings (intermediate holding company) Gakken Educational Gakken L Staffing Gakken Study et Sozogakuen, Waseda School, ING ZENKYOKEN, Bunri gakuin, Koto Shingakujuku
	Educational content business	1) Publish studying materials, children's books, and other publications, 2) plan, develop, and sell stationery goods and educational toys and goods, and 3) produce and sell digital content	Gakken Plus Gakken Sta:Ful TOKYO GLOBAL GATEWAY BUNRI (moved to educational services business from FY9/20)
	Educational solutions business	1) Produces and sells publications for kindergartens and nursery schools, nursery goods and supplies, etc., 2) produces and sells textbooks for elementary and junior high schools, supplements, etc., and 3) produces and sells publications and teaching materials for senior high schools and colleges	Gakken E-mirai Gakken Associe (absorbed by Gakken E-mirai in October 2019) JTEX Management Center
Healthcare and nursing domain	Healthcare and nursing business	1) Operate serviced apartment for the elderly, nursing homes, and other elderly care facilities, 2) operates kindergartens, nursery schools, etc., 3) publish specialty books for nurses and doctors, and 4) operate group homes for the elderly with dementia	Gakken Cocofump Holdings Gakken Cocofump Gakken Cocofump Nursery Medical Care Service Gakken Medical Shujunsha (moved to the educational contents business from FY9/20)
Other	Other	Provide logistics services, provide group shared services, etc.	Gakken Logistics Gakken Products Support

Source: Prepared by FISCO from the Company's securities report and results briefing materials

The Company's income breakdown by business segment in FY9/19 was educational domain at 57% and healthcare & nursing domain at 41% in net sales and educational at 31% and healthcare & nursing at 66% in operating income. Healthcare and nursing substantially increased its presence, versus FY9/18 levels of 23% in net sales and 28% in operating income, thanks to growth by existing businesses and a large boost from acquiring MCS as a subsidiary.

Composition by business segment (FY9/19)



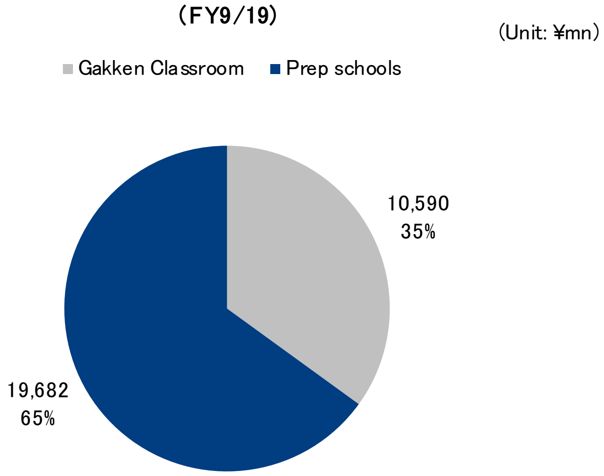
Source: Prepared by FISCO from the Company's financial results

Operates Gakken Classroom business for elementary students and prep school business

2. Educational services business

The educational services segment is the group's core business at 22% of net sales and 20% of operating income (FY9/19 results; same below). Segment activities include 1) operate Gakken Classroom mainly for elementary students and promote franchise business, 2) operate prep schools mainly for junior and senior high school students and provide home tutor dispatching service.

Educational services segment sales breakdown by sub-segments (FY9/19)



Source: Prepared by FISCO from the Company's financial results

(1) Gakken Classroom business

Gakken Classroom is a grade-less learning class that is operated by Gakken Educational Co., Ltd. and utilizes a franchise system. The Company started this business in 1980. While it covers from toddlers to junior high school students (some senior high school students), more than half of attendees are elementary school students. Gakken Classroom had 16,135 approved classrooms with 416,431 student members (number of students is counted as the total for all subjects) at the end of September 2019. The Company runs this business abroad too, mainly in the Asian region.

Kumon Method Classroom service operated by the Kumon Institute of Education Co., Ltd. is the primary rival, and the market for a grade-less learning class service is split between Gakken Classroom and Kumon Method Classroom. While Kumon Method Classroom leads in numbers of classrooms and students, Gakken Classroom's main characteristics and strengths are 1) low monthly fees, 2) educational service that emphasizes reading comprehension in accordance with course guidelines, and 3) content that balances math and Japanese.

The Company utilizes a franchise business model in which the majority of sales comes from royalty income (a certain percentage of revenue) and membership fees paid by franchise owners (classroom operators). While sales growth stalled over the past few years, including the impact of steady decline in the youth population, this business remains a stable profit source for the group with operating margin in the 6% range.

(2) Prep school business

While educational services business primarily focused on increasing the number of Gakken Classroom, it has also been expanding prep school business through aggressive acquisitions and business alliances since the mid-2000s. This initiative obviously aims to strengthen the Company's presence in the education field and targets maximization of customer LTV by assembling prep schools within the group and thereby keeping students who attended Gakken Classroom at a younger age from leaving for other prep schools for entrance exam studies as they become junior and senior high school students. Regarding M&A, smooth business succession is smoothly carried out.

The group's prep schools, which operate under their own brands as subsidiaries, currently include SIGN-1 (Saitama), Asunaro Gakuin (Miyagi), and Taishi Seminar (Fukushima) of Gakken Study et Co., Ltd., EDIC and Sogaku Seminar (Hyogo) of Sozo gakuen Co., Ltd., Waseda School Co., Ltd. (Kumamoto), ING Co., Ltd. (Osaka, Nara, Wakayama), ZENKYOKEN Co., Ltd. (Kitakyushu area), Koto Shingakujuku Co., Ltd. (Keihanshin area), and Bunri Gakuin Co., Ltd. (Yamanashi, Shizuoka).

Gakken L Staffing Co., Ltd. operates Gakken's home tutor dispatching business in ordinance-designated city areas nationwide. It also operates the Clantete kindergarten and elementary integrated education and day care center through GI Village Co., Ltd., a joint venture with Ichishin Holdings, and prep schools with the Waseda Academy brand for Japanese students in Singapore, Taiwan, Vietnam, and other overseas locations.

The Company had a total of 489 classrooms with 50,964 students as of end-September 2019. Since group firms run these businesses directly, trends in the number of classrooms, number of students, and average student spending are variables for income results. Sozo gakuen, Waseda School, and Bunri Gakuin have relatively large profit impacts among the subsidiaries.

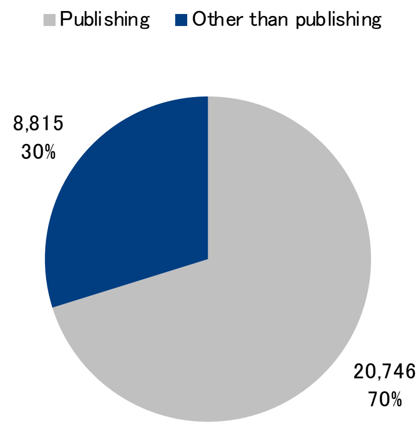
Operates publishing business mainly for education-related books and provides various services that leverage longstanding knowledge and knowhow related to education.

3. Educational content business

Educational content business provides 21% of net sales and 3% of operating income. It consists of publishing business and other non-publishing businesses.

Sub-segment net sales breakdown of educational contents business (FY9/19)

(Unit: ¥mn)



Source: Prepared by FISCO from the Company's financial results

(1) Publishing business

Gakken Plus Co., Ltd. and BUNRI Co., Ltd.* are the main companies that handle publishing business and sell children's books, study-aid books, and various publications for adult learning through the agent and bookstore route. Books for elementary and junior high school students are a large share of study-aid books. While publishing business is profitable as a whole, some individual magazines and books incur losses and the Company plans to continue weeding these out.

* While BUNRI produces and sells learning materials for elementary and junior high school students with focus on workbooks, the Company moved it to the educational services segment from FY9/20 because sales to prep schools had risen to roughly 50% of overall sales.

(2) Businesses other than publishing

Other businesses besides publishing are those that utilize the Gakken brand and content accumulated from past years. Main areas include electronic publishing and distribution, educational ICT services, advertising, and property licensing at Gakken Plus, stationery and educational toy sales at Gakken Sta:Ful Co., Ltd., and operation of the experience-style English learning facility TOKYO GLOBAL GATEWAY (TGG) by TOKYO GLOBAL GATEWAY Co., Ltd. TGG opened a facility in Tokyo's Odaiba area in September 2018 after being selected as an operator for Tokyo's "English Village" vision. This facility is available to roughly 1.23mn students at elementary, junior, and senior high schools and special assistance schools in Tokyo, as well as students from outside of Tokyo, and can provide experience-style English lessons to about 200,000 people a year (it is also available to individuals and areas outside of Tokyo).

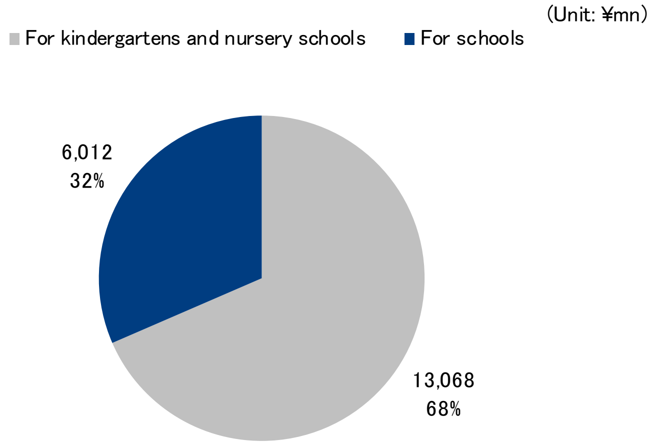
Medical and nursing publications and e-learning business for nurses handled at Gakken Medical Shujunsha and subsidiary Gakken Medical Support Co., Ltd. moved from healthcare and nursing services to educational content segment from FY9/20.

Sells products to kindergartens and nursery schools and operates toddler classes, publishes textbooks for elementary and junior high schools, and conducts educational seminars for companies

4. Educational solutions business

Educational solutions contribute 14% of net sales and 8% of operating income. This segment has two sub-segments – toddler educational business and school educational business (including corporate seminar business).

Sub-segment net sales breakdown of educational solutions business
(FY9/19)



Source: Prepared by FISCO from the Company's financial results

(1) Toddler educational business

The toddler educational business sells published materials (picture books, etc.) for kindergartens and nursery schools, day care goods, supplies, and uniforms and operates toddler classrooms at Gakken E-mirai Co., Ltd. Toddler classrooms are the toddler version of in-school learning centers at which instructors who have completed the required training at the company provide edification, science, English, and other lessons at kindergartens.

(2) School educational business

School educational business covers publishing of textbooks for elementary and junior high schools (physical and health education, moral education), instruction guides for teachers, and special assistance teaching materials, as well as produces and sells essay and practice test materials for senior high schools in addition to job practice tests and learning materials for colleges at Gakken E-mirai. This business also provides hiring assistance services to companies. Other activities include instructor dispatching service for corporate seminars at JTEX Management Center Co., Ltd. (JMC) acquired as a subsidiary in February 2018.

Income for the school educational business increasingly relies on textbooks for elementary and junior high schools and instruction guides for teachers. The Ministry of Education, Culture, Sports, Science and Technology assesses school textbooks in a four-year cycle. For public schools, boards of education in each municipality select school textbooks that are approved by the assessment. Sales share fluctuates depending on these trends. While income should be healthy in FY9/20 and FY9/21 because of new publications of two school textbooks in each year, sales are likely to weaken in the next two years because of the absence of instruction guide sales.

School textbook publication schedule

	Fiscal year	2017	2018	2019	2020	2021	2022	2023
Elementary school health	Assessment		△				△	
	Selection			●				●
	Usage start				◎			
Junior high school health and physical education	Assessment			△				△
	Selection				●			
	Usage start					◎		
Elementary school moral education	Assessment		△				△	
	Selection	●		●				●
	Usage start		◎		◎			
Junior high school moral education	Assessment	△		△				△
	Selection		●		●			
	Usage start			◎		◎		

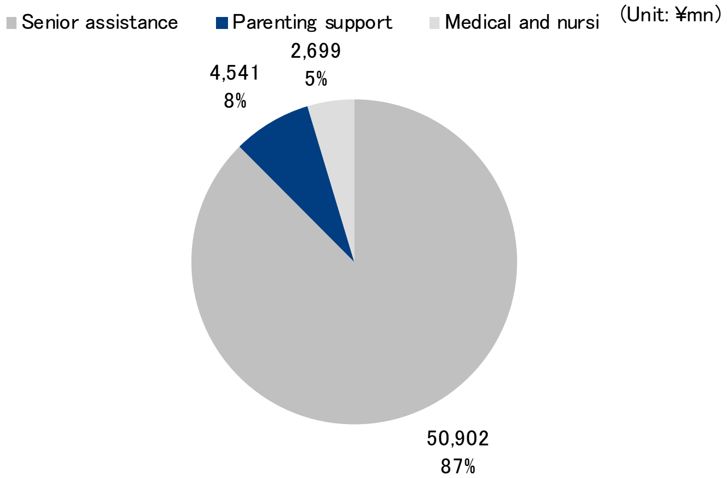
Source: Prepared by FISCO from the Company's results briefing materials

Operates serviced apartment for the elderly, group homes for the elderly with dementia, and other elderly care businesses and provides parenting support services

5. Healthcare and nursing services

Healthcare and nursing services has grown into a major business at 41% of sales and 66% of operating income. The Company's acquisition of MCS as a subsidiary in September 2018 is contributing significantly. This segment consisted of three sub-segments through FY9/19 – elderly care business, parenting support business, and publishing business for doctors and nurses. As mentioned earlier, the Company moved the publishing business for doctors and nurses (including e-learning business) to the educational contents business from FY9/20.

Sales breakdown for healthcare and nursing services business by sub-segment (FY9/19)



Source: Prepared by FISCO from the Company's financial results

(1) Elderly care business

Elderly care business has built a network of serviced apartments for the elderly nationwide under the Cocofump brand and also plans, develops, and operates paid nursing homes, day care service for the elderly, and other care services at subsidiary Gakken Cocofump Co., Ltd. The Company, as its primary business, operated 136 (with a total of 6,457 units) serviced apartments for the elderly, nationwide as of end-September 2019. From a regional perspective, the Tokyo metropolitan area has just over 70% (on a unit basis) and others are located in Chubu and Western Japan areas (Shizuoka, Aichi, Ishikawa, Kyoto, Osaka, Okayama, Ehime, and Kumamoto).

Serviced apartments for the elderly mainly utilize a sub-leasing scheme. The Company itself does not own the land nor building and almost entirely focuses on facility operation. It has steadily expanded the business because this model facilitates streamlining of the balance sheet and rapid site deployment.

Meanwhile, MCS mainly operates group homes that serve as residence-type elderly care facilities for dementia care. It was managing 269 homes (5,156 residence rooms) nationwide at the end of September 2019 and is the industry leader in terms of number of rooms. MCS also operates nine paid nursing homes with care services, 12 small-scale, multi-function residence elderly care facilities, and 13 other elderly care facilities. It has four business sites in China too. Through subsidiaries, it provides meal service, cleaning service, sales and rental service for nursing goods, and other businesses that support facilities.

The Company decided to acquire MCS as a subsidiary because of its strong synergy effect in realizing a "Gakken's Community-based Integrated Care System" that connects children, the parenting segment, and seniors across generations for the purpose of supporting a healthy life from the age of zero to over 100. Specifically, it aims to 1) secure destinations for people living at serviced apartment for the elderly when they need to leave the apartment due to advanced dementia, and raise the occupancy rate, 2) enhance facility development capabilities by leveraging area commonalities, and 3) realize benefits in personnel recruitment through shared hiring activities and boost the retention rate.

Occupancy rate and operating staff personnel costs are the main factors that affect profits in the elderly care business. Increase in the number of new sites in a short period results in temporary decline in the occupancy rate along with initial investment burden, such as operating staff hiring and personnel costs. Upturn in the dispatched staff percentage due to manpower shortages pushes costs higher too.

(2) Parenting support business

Parenting support business operates nursery schools and after-school children's club facilities at Gakken Cocofump Nursery Co., Ltd. The Company had 64 parenting support sites (3,896 attendees) at the end of September 2019 with all of them located in the Tokyo metropolitan areas. The nursery school business model mainly utilizes sub-leasing, similar to serviced apartments for the elderly. After-school children's club business fundamentally handles consigned operation of public-sponsored facilities. A key issue in the day care business is finding nursery teachers. Challenges include the high costs caused by the low percentage of nursery teachers hired as full-time employees and some cutbacks in subsidies from local governments.

Performance trends

Attained a 10th straight year of sales increase and 5th straight year of operating income improvement in FY9/19

1. FY9/19 results summary

In FY9/19 consolidated results, the Company reported ¥140,559mn in net sales (+31.3% YoY), ¥4,523mn in operating income (+23.8%), ¥4,755mn in ordinary income (+18.8%), and ¥1,940mn in profit attributable to owners of parent (-36.6%), the 10th straight year of sales increase and 5th straight years of operating and ordinary income improvement. These values exceeded the Company's revised guidance. Operating and ordinary incomes reached the highest levels since transition to the holding company format in 2009. The main driver of steep sales and profit gains, despite lower sales and profits in the educational domain, was the addition of MCS as a subsidiary in the healthcare and nursing domain.

While profit attributable to owners of parent fell, this occurred because of removal of reversal profit in income taxes adjustment value booked in FY9/18, increase in the tax burden rate, and a ¥458mn YoY rise in profit attributable to non-controlling interests related to the acquisition of MCS as a subsidiary. Profit missed guidance mainly because of the higher tax burden ratio. ROE was 5.0%, steadily rising toward the Company's 8% goal.

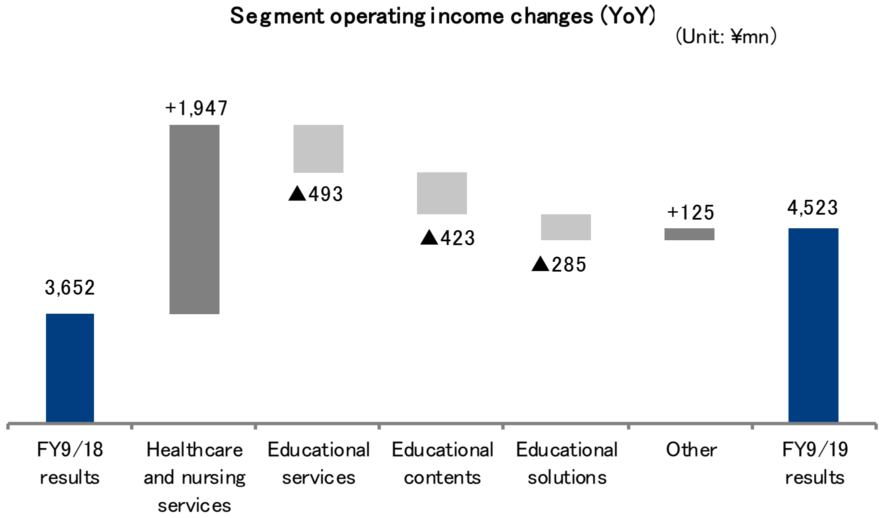
FY9/19 consolidated results

(Unit: ¥mn)

	FY9/18		FY9/19				
	Results	Vs. sales	Revised plan	Results	Vs. sales	YoY change	Vs. plan
Net sales	107,030	-	138,000	140,559	-	31.3%	1.9%
Operating income	3,652	3.4%	4,200	4,523	3.2%	23.8%	7.7%
Ordinary income	4,002	3.7%	4,400	4,755	3.4%	18.8%	8.1%
Profit attributable to owners of parent	3,058	2.9%	2,650	1,940	1.4%	-36.6%	-26.8%
ROE	8.1%		6.1%	5.0%			

Source: Prepared by FISCO from the Company's financial results and its results briefing materials

Segment operating income changes (YoY)



Source: Prepared by FISCO from the Company's results briefing materials

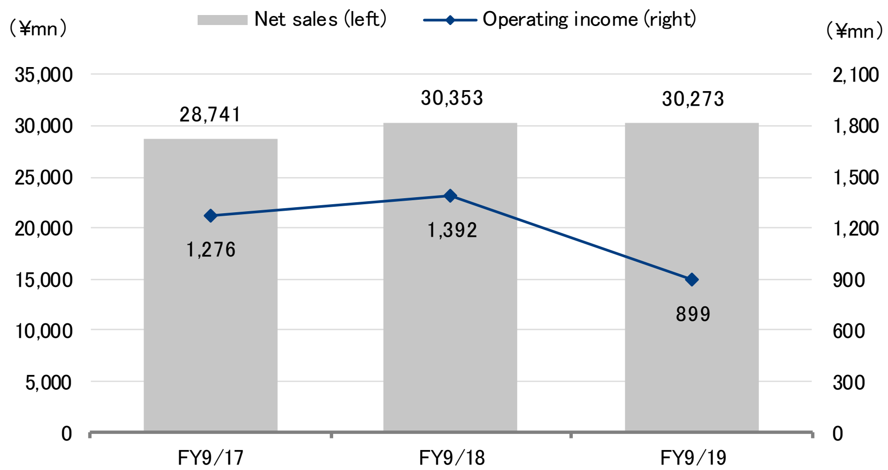
Steep gains by the healthcare and nursing domain, sales and profits fell in the educational domain due to structural reforms

2. Trends by business segment

(1) Educational services business

In the prep school industry, despite continuation of a difficult market environment with tougher competition to recruit students amid decline in the youth population and other trends, new opportunities are increasing too with growing needs for English and programming education as part of FY3/21 educational system reforms and ramp-up of learning services that utilize AI. Within these conditions, educational services reported ¥30,273mn in net sales (-0.3% YoY) and ¥899mn in operating income (-35.4%).

Results trends in educational services business



Source: Prepared by FISCO from the Company's financial results

Gakken Classroom business delivered modest sales and profit gains at ¥10,590mn in net sales (+0.2% YoY) and ¥653mn in operating income (+1.4%). Sales improved on steady recovery in numbers of approved classrooms and course members in the new fiscal year. Stronger results in toddler business and efforts to promote English courses paid off. Furthermore, we think fee hikes at the main rival that accentuated the cost appeal of Gakken Classroom contributed to member gains as well. In income, higher sales sufficiently offset increases in cost of sales, logistic costs, and other expenses. As of end-September 2019, course member volume was up by 5,177 people YoY to 416,431 people and approved classroom volume rose by 161 sites to 16,135 sites.

Prep school business, meanwhile, had a 0.5% YoY dip in net sales to ¥19,682mn and sharp 67.2% decline in operating income to ¥245mn. Sales weakened due to decline in student volume in the new fiscal year, despite opening new schools and proceeding with moves and consolidations, amid a highly competitive environment. Income fell due to the sales decline and increases in school opening costs, rent, and labor costs. As of end-September 2019, student volume was down by 614 people YoY to 50,964 people and classroom volume rose by 11 sites to 489 sites.

Breakdown of educational services business

(Unit: ¥mn)

		FY9/17	FY9/18	FY9/19	YoY change
Net sales	Gakken Classroom	10,072	10,570	10,590	19
	Prep schools	18,670	19,782	19,682	-99
Operating income	Gakken Classroom	641	644	653	9
	Prep schools	636	747	245	-502

Source: Prepared by FISCO from the Company's financial results

Gakken Classroom
Number of course members, number of approved classrooms

	Sep. 2016	Sep. 2017	Sep. 2018	Sep. 2019	Change
Number of course members	418,760	411,626	411,254	416,431	5,177
Number of approved classrooms	15,474	15,826	15,974	16,135	161

*Number of course members: Number of members based on the number of courses
*Number of approved classrooms: Gakken Classroom has two approval categories – math/Japanese and English. This indicates the number of classrooms based on approvals.
Source: Prepared by FISCO from the Company's results briefing materials

Prep schools Number of students, number of classrooms

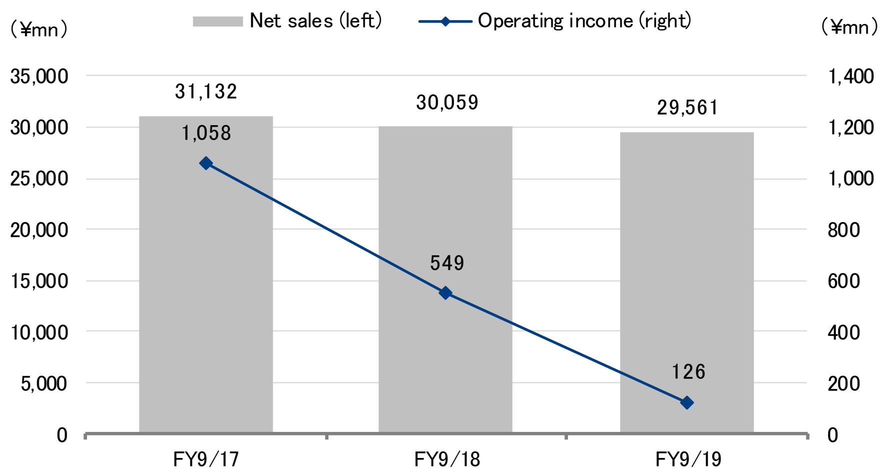
	Sep. 2016	Sep. 2017	Sep. 2018	Sep. 2019	Change
Number of students	44,003	47,191	51,578	50,964	-614
Number of classrooms	381	442	478	489	11

Source: Prepared by FISCO from the Company's results briefing materials

(2) Educational content business

Educational content business continued to post weaker sales and profits at ¥29,561mn in net sales (-1.7% YoY) and ¥126mn in operating income (-77.0%). The Company is currently implementing income structural reforms, mainly for publishing business, amid sustained contraction of the magazine and book market due to the shrinking youth population and inroads by the Internet.

Results trends in educational contents business



Source: Prepared by FISCO from the Company's financial results

Publishing business reported ¥20,746mn in net sales (-3.9% YoY) and ¥1,614mn in operating income (-18.7%). Sales dropped on slumping volumes for periodicals, magazine books, and practical books. Income weakened because of sales decline and recognition of about ¥300mn in inventory valuation losses for study-aid books related to revisions in instruction guidelines.

The number of new publications dropped by 18 titles YoY to 718. While the Company increased new publication of children's books and study-aid books, it is also making revisions to unprofitable areas and cutting new releases of magazine books and other books. The return rate for books and periodicals has modestly improved too. Despite weaker sales due to progress in revising unprofitable areas, profitability stayed at the year-ago level, excluding impact of decline in inventory value.

Other businesses besides publishing reported ¥8,815mn in net sales (+4.0% YoY) and an operating loss of ¥1,488mn (widening ¥51mn YoY). Sales climbed on increase in facility usage fees with the launch of the experience-style English learning facility TGG and rise in stationery and toy sales. In income, however, operating losses moved upward, even with improvement in stationery and toy income, because of initial investments in English education business, including TGG and online English conversation service.

Breakdown of educational contents business

(Unit: ¥mn)

		FY9/17	FY9/18	FY9/19	YoY change
Net sales	Publishing	24,209	21,584	20,746	-837
	Other than publishing	6,922	8,475	8,815	339
Operating income	Publishing	2,194	1,986	1,614	-371
	Other than publishing	-1,137	-1,436	-1,488	-51

Source: Prepared by FISCO from the Company's financial results

Number of new publications*

	FY9/16	FY9/17	FY9/18	FY9/19
Children's books	200	227	188	195
Study-aid books	158	83	103	132
Magazine books	207	146	131	110
Other books	445	356	314	281
Total	1,010	812	736	718

*Data for Gakken Plus excluding periodicals and musical scores
Source: Prepared by FISCO from the Company's results briefing materials

Publication return rate*

	FY9/16	FY9/17	FY9/18	FY9/19
Books	34%	32%	32%	31%
Magazines	42%	38%	38%	38%
(Periodical portion)	37%	35%	36%	35%

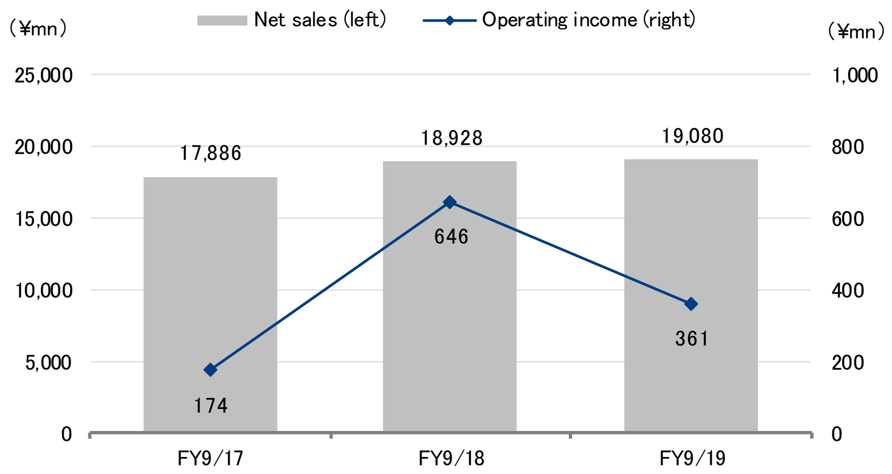
*Data for Gakken Plus excluding musical scores
Source: Prepared by FISCO from the Company's results briefing materials

(3) Educational solutions business

Educational solutions business reported ¥19,080mn in net sales (+0.8% YoY) and ¥361mn in operating income (-44.1%). Toddler educational business had ¥13,068mn in sales (-0.1%) and ¥495mn in operating income (-23.0%). Sales fell slightly on sluggish sales of picture books and suppliers and decline in the number of toddler class members. Income weakened on the drop in toddler class members and higher teaching material costs and logistics expenses.

School educational business, meanwhile, reported ¥6,012mn in net sales (+2.8% YoY) and a ¥134mn operating loss (income fell by ¥137mn YoY). Sales moved upward again, despite decline in the number of moral education course books (because of the change to 3rd-year junior high school students this year versus 6th-year elementary school students), with a boost from consolidated contributions by JMC, which operates corporate seminar business. Income, however, dropped to an operating loss for the first time in two years due to a large impact from decline in school textbook volume.

Results trends in educational solutions business



Source: Prepared by FISCO from the Company's financial results

Breakdown of educational solutions business

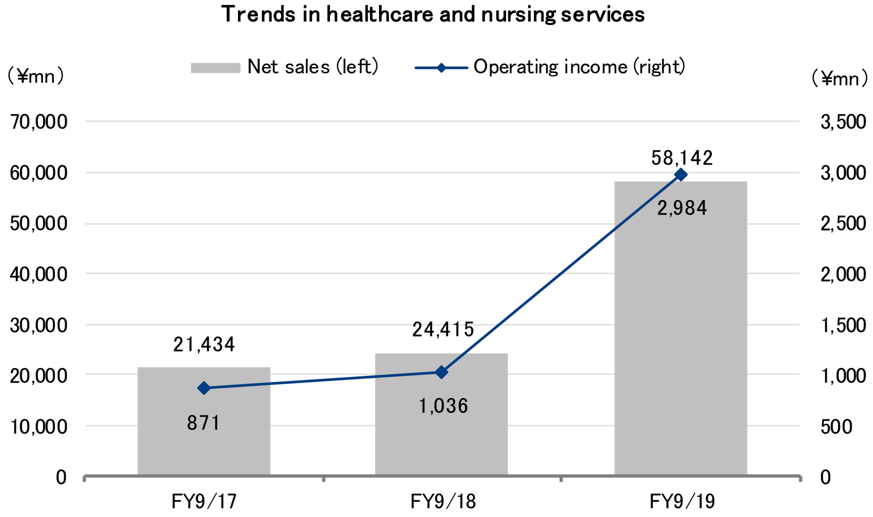
(Unit: ¥mn)

		FY9/17	FY9/18	FY9/19	YoY change
Net sales	Toddler educational	13,374	13,079	13,068	-11
	School educational	4,512	5,848	6,012	163
Operating income	Toddler educational	378	643	495	-148
	School educational	-203	3	-134	-137

Source: Prepared by FISCO from the Company's financial results

(4) Healthcare and nursing services

Healthcare and nursing services reported sharply higher sales and profits at ¥58,142mn in net sales (+138.1% YoY) and ¥2,984mn in operating income (+188.0%). While MCS provided ¥30,333mn in net sales and ¥1,392mn in operating income, existing healthcare and nursing businesses, excluding MCS, also performed well at ¥27,809mn in net sales (+13.9%) and ¥1,592mn in operating income (+53.7%).



Source: Prepared by FISCO from the Company's financial results

Breakdown of healthcare and nursing services

(Unit: ¥mn)

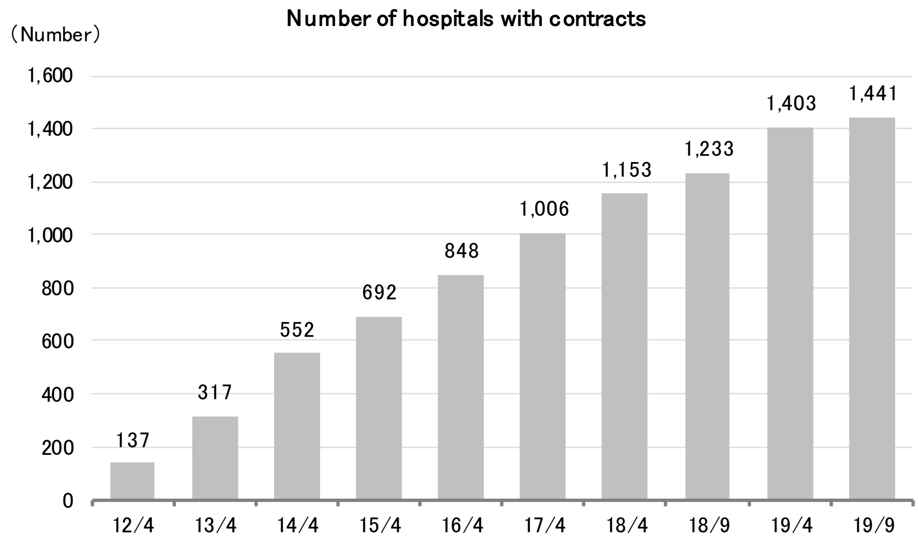
		FY9/17	FY9/18	FY9/19	YoY change
Net sales	Elderly care	16,073	18,301	50,902	32,601
	Cocofump, etc.	16,073	18,301	20,569	2,268
	MCS	-	-	30,333	30,333
	Parenting support	3,077	3,648	4,541	893
	Medical and nursing publishing	2,283	2,466	2,699	232
Operating income	Elderly care	474	562	2,434	1,872
	Cocofump, etc.	474	562	1,042	480
	MCS	-	-	1,392	1,392
	Parenting support	98	105	73	-31
	Medical and nursing publishing	299	369	476	106

Source: Prepared by FISCO from the Company's financial results

Elderly care business (Cocofump, etc.) reported upbeat results at ¥20,569mn in net sales (+12.4% YoY) and ¥1,042mn in operating income (+85.4%). Increase in the number of serviced apartments for the elderly by 11 buildings versus the previous period-end to 136 buildings and a higher occupancy rate at existing facilities fueled higher sales and profits. Residence units climbed 8.2% YoY to 5,934 units as of the end of September 2019. In MCS business, despite the absence of new group home for the elderly with dementia openings, the occupancy rate at end-August 2019 rose to 97.4%, versus 96.6% a year earlier, and progress reducing unit costs through improved efficiency in personnel assignments supported healthy results.

Parenting support business reported ¥4,541mn in net sales (+24.5% YoY) and ¥73mn in operating income (-30.5%). Profits fell on a rise in sales. While sales improved with the launch of three new nursery schools (bringing the total number of schools to 43 sites) and consigned operation of 10 after-school children's club facilities (raising the total to 20 sites), income weakened on decline in the number of children at certified schools and higher labor expenses and facility costs.

Medical and nursing publishing business reported ¥2,699mn in net sales (+9.4% YoY) and ¥476mn in operating income (+28.7%). The number of hospitals with contracts for nurse e-learning business expanded at a healthy pace with an increase of 208 contracts from the year-ago level to 1,441 contracts at the end of FY9/19, driving higher sales and profits in this business.



Source: Prepared by FISCO from the Company's results briefing materials

Healthy financial standing, FCF restored a surplus for the first time in two years

3. Financial conditions and cash flow overview

Looking at financial condition at the end of FY9/19, total assets were down by ¥593mn versus the previous period-end to ¥99,349mn. Main changes in current assets were a ¥2,274mn rise in cash and deposits and a ¥628mn decline in inventory assets. In fixed assets, tangible fixed assets dropped by ¥1,077mn due to monetizing properties of serviced apartments for the elderly (¥2,759mn) and investment securities value was down by ¥974mn.

Liabilities increased by ¥118mn versus the previous period-end to ¥59,371mn. While notes and accounts payable, long-term account payable, and liabilities related to retirement benefits declined, interest-bearing debt rose by ¥1,267mn. Total net assets fell by ¥711mn versus the previous period-end to ¥39,978mn. While retained earnings increased by ¥1,099mn, treasury shares rose by ¥796mn (decline factor) and valuation difference on available-for-sale securities shrunk by ¥1,118mn.

Looking at cash flow trends, cash and cash equivalents rose by ¥2,343mn versus the previous period-end to ¥19,838mn at end-FY9/19. Cash flow from operating activities contributed ¥5,353mn in funds mainly on higher income in healthcare and nursing services. Cash flow from investment activities, meanwhile, depleted funds by ¥2,825mn as the net result of purchases and sales of tangible and intangible fixed assets and investment securities. Free cash flow hence had a surplus of ¥2,527mn, the first gain in two years. Cash flow from financial activities depleted funds by ¥352mn, despite income from long-term loans, mainly because of ¥898mn in outlays to acquire treasury shares and ¥657mn in dividend payments.

In business indicators, we think the Company sustained financial health, despite slight weakening of safeness indicators, such as the interest-bearing debt ratio and capital ratio on increase in interest-bearing debt, thanks to its extensive cash and cash equivalent holdings. For profitability, while ROE declined on increase in the effective tax rate and other trends, ROA and operating margin stayed at roughly the same levels at the previous fiscal year. As explained earlier, the Company is currently in the process of implementing business structure reforms in the educational domain and has room to raise profitability through reorganization and consolidation of group subsidiaries.

Consolidated balance sheet and business indicators

(Unit: ¥mn)

	FY9/16	FY9/17	FY9/18	FY9/19	YoY change
Current assets	46,130	46,538	53,087	54,811	1,724
Cash and deposits	15,394	15,738	18,911	21,185	2,274
Fixed assets	30,253	30,325	46,854	44,538	-2,316
Total assets	76,384	76,863	99,942	99,349	-593
Total liabilities	42,920	40,659	59,252	59,371	118
Interest-bearing debt	16,898	14,858	29,222	30,489	1,267
Total net assets	33,464	36,203	40,689	39,978	-711
Total liabilities and net assets	76,384	76,863	99,942	99,349	-593
Financial indicators					
(safety)					
Equity ratio	41.8%	46.9%	39.5%	38.7%	-0.8pt
Interest-bearing debt ratio	52.9%	41.2%	74.1%	79.3%	5.2pt
(Profitability)					
ROA	3.8%	4.6%	4.5%	4.8%	0.3pt
ROE	4.2%	9.8%	8.1%	5.0%	-3.1pt
Operating margin	2.8%	3.3%	3.4%	3.2%	-0.2pt

Source: Prepared by FISCO from the Company's financial results

Cash Flow Statement

(Unit: ¥mn)

	FY9/16	FY9/17	FY9/18	FY9/19
Cash flow from operating activities	3,166	5,099	3,145	5,353
Cash flow from investing activities	-4,028	473	-14,898	-2,825
Free cash flow	-861	5,573	-11,753	2,527
Cash flow from financing activities	-1,210	-5,119	14,431	-352
Cash and cash equivalents at the end of FY	14,340	14,826	17,494	19,838

Source: Prepared by FISCO from the Company's financial results

Business outlook

Guides for further sales and profit gains in FY9/20 on recovery on educational domain profitability from structural reform benefits

1. FY9/20 outlook

The Company's FY9/20 consolidated guidance targets ¥143,000mn in net sales (+1.7% YoY), ¥5,100mn in operating income (+12.8%), ¥5,300mn in ordinary income (+11.5%), and ¥2,800mn in profit attributable to owners of parent (+44.3%). It projects continued sales growth led by elderly care business and higher operating income due to the profit improvement effect from structural reforms in the educational domain. Profit attributable to owners of parent is headed for a steep increase on improvements in extraordinary gain and the tax burden ratio versus the previous fiscal year.

Compared to numerical goals from the Gakken 2020 Medium-Term Management Plan announced in November 2018, the Company raised net sales by ¥3,000mn and operating income by ¥100mn on growth in elderly care business and lowered Profit attributable to owners of parent by ¥500mn due to a higher tax burden rate.

FY9/20 consolidated outlook

(Unit: ¥mn)

	FY9/19		FY9/20				Differences with the initial plan
	Results	Vs. sales	Initial plan*	Revised plan	Vs. sales	YoY change	
Net sales	140,559	-	140,000	143,000	-	1.7%	3,000
Operating income	4,523	3.2%	5,000	5,100	3.6%	12.8%	100
Ordinary income	4,755	3.4%	-	5,300	3.7%	11.5%	-
Profit attributable to owners of parent	1,940	1.4%	3,300	2,800	2.0%	44.3%	-500
EPS (yen)	208.71		357.23	303.10			-54.13
ROE	5.0%		7.7%	-			-

*Initial plan refers to goals from the Gakken 2020 Medium-Term Management Plan released in November 2018
Source: Prepared by FISCO from the Company's financial results and its results briefing materials

As explained above, the Company moved some group companies to other segments from FY9/20. Specifically, it transferred medical and nursing publishing business handled by Gakken Shujunsha, Gakken Medical Support, and one other company from the healthcare and nursing services to educational contents and BUNRI from educational content to educational services segment.

Medical and nursing publishing business aims to promote creation of new businesses by sharing production capabilities and sales knowhow for e-learning for the entire educational content business and to support a Gakken's Community-based Integrated Care System from an educational perspective and promote integration with healthcare and nursing services. BUNRI, meanwhile, and sells teaching materials for prep schools and seeks to strengthen assessment business handled by Beacon Co., Ltd. Assessment business provides a service of conducting mock tests for prep school students and scoring the tests and analyzing and evaluating results. Its tests focus on thinking, determination, and expression capabilities, rather than past knowledge-centric mock tests.

Aims to revive profitability in the educational domain by promoting structural reforms and expand the healthcare and nursing domain with aggressive investments

2. Outlook by business segments

Outlook by business segment

(Unit: ¥mn)

			FY9/19 Results	FY9/20 Initial plan*	FY9/20 Revised plan	FY9/20 Plan after segment transfers	YoY change
Educational domain		Net sales	78,914	79,500	78,000	81,000	2.6%
		Operating income	1,386	2,780	2,300	2,650	91.2%
		Operating income margin	1.8%	3.5%	2.9%	3.3%	
	Educational services	Net sales	30,273	31,000	30,000	34,500	14.0%
		Operating income	899	1,200	1,000	1,200	33.5%
		Operating income margin	3.0%	3.9%	3.3%	3.5%	
	Educational contents	Net sales	29,561	29,500	28,000	26,500	-10.4%
		Operating income	126	580	600	750	495.2%
		Operating income margin	0.4%	2.0%	2.1%	2.8%	
	Educational solutions	Net sales	19,080	19,000	20,000	20,000	4.8%
		Operating income	361	1,000	700	700	93.9%
		Operating income margin	1.9%	5.3%	3.5%	3.5%	
Healthcare and nursing domain	Healthcare and nursing services	Net sales	58,142	57,500	62,000	59,000	1.5%
		Operating income	2,984	2,200	2,700	2,350	-21.2%
		Operating income margin	5.1%	3.8%	4.4%	4.0%	
Other		Net sales	3,500	3,000	3,000	3,000	-14.3%
		Operating income	152	20	100	100	-34.2%
		Operating income margin	4.3%	0.7%	3.3%	3.3%	
Total		Net sales	140,559	140,000	143,000	143,000	1.7%
		Operating income	4,523	5,000	5,100	5,100	12.8%
		Operating income margin	3.2%	3.6%	3.6%	3.6%	

*Initial plan refers to goals from the Gakken 2020 Medium-Term Management Plan
Source: Prepared by FISCO from the Company's results briefing materials

(1) Educational services business

Educational services business targets are ¥34,500mn in net sales (+14.0% YoY) and ¥1,200mn in operating income (+33.5%). Excluding additions from the BUNRI transfer (¥4,500mn in net sales and ¥200mn in operating income), this guidance expects 0.9% decline in net sales and an 11.2% increase in operating income.

Gakken Classroom business aims for stable growth by promoting subscription to the English course, programming course, and other areas, just as in the previous fiscal year. Prep school business, meanwhile, faces lower sales because of revisions to unprofitable schools, though aims to improve profitability sharing operational knowhow from Sozogakuen and other vibrant prep schools within the group and pursuing cost cutbacks.

(2) Educational content business

Educational content business targets are ¥26,500mn in net sales (-10.4% YoY) and ¥750mn in operating income (+495.2%). These targets include negative impact from the BUNRI transfer (¥4,500mn in net sales and ¥200mn in operating income) and positive impact from adding the medical and nursing publishing business (¥3,000mn in net sales and ¥350mn in operating income).

The outlook projects restoration of profit increase, despite likely decline in publishing business sales from ongoing revision of money-losing areas, mainly due to non-recurrence of ¥300mn in inventory valuation decline for study-aid books booked in the previous period. It also factors in smaller TGG losses by raising the operating rate and optimizing the management process in non-publishing business. The Company announced the sale of anime-related business* to IID, Inc. (6038) on February 1, 2020.

* Publishes anime monthly magazine Animedia launched in 1981 by Gakken Plus, voice-actor monthly magazine Seiyu Anime, and monthly Megami Magazine, publishes magazine books, and operates Cho! Animedia, an Internet media site. Gakken Plus continues to sell publications after the business sale.

(3) Educational solutions business

Educational solutions business targets are ¥20,000mn in net sales (+4.8% YoY) and ¥700mn in operating income (+93.9%). The main driver of anticipated sales and profit increases, despite sluggishness in toddler educational business due to the shrinking youth population, is the start of school textbook sales for two courses (health and moral education) for elementary schools in the school educational business (this business only supplied one course (moral education) for junior high schools in the previous period).

(4) Healthcare and nursing services business

Healthcare and nursing services business targets are ¥59,000mn in net sales (+1.5% YoY) and ¥2,350mn in operating income (-21.2%). Comparison with the previous period excluding medical and nursing publishing business results puts the growth rates at +6.4% for net sales and -6.3% for operating income. While sales should continue moving upward on expansion of site count in elderly care business, the Company expects weaker profits because of investment costs for opening new sites and higher personnel costs. However, we think it conservatively estimates personnel costs and anticipate upside if operations proceed smoothly.

The new site plan aims to add 17 serviced apartments for the elderly (vs. 11 sites in the previous period) and seven group homes for the elderly with dementia (vs. none). In serviced apartments for the elderly, it targets a 15.7% YoY rise in total units to 7,470 units and a 17.4% increase in occupied units to 6,969 units (lifting the occupancy rate from 91.9% at the previous period-end to 93.3%). Group home for the elderly with dementia occupancy, meanwhile, is slated to drop slightly from 97.4% at the previous period-end to 97.0%, mainly because of skewed timing for opening new sites to 2H.

The Company expects continued sales growth in parenting support business too with two new nursery schools and an additional eight sites versus the previous period-end in consigned operation of c after-school children's clubs.

Pursuing improvement in enterprise value through sustainable growth driven by the educational domain and healthcare / nursing domain as growth engines

3. Progress of the medium-term business plan

Gakken 2020, the Company's Medium-Term Management Plan that started in FY9/19, pursues improvement in enterprise value through sustainable growth driven by the educational domain and healthcare and nursing domain as growth engines along with reinforcement of the management foundation, enhanced capital efficiency, and higher shareholder return.

As the first-year assessment, overall results proceeded roughly on track with expectations and the healthcare / nursing domain, in particular, achieved robust income expansion by broadening business scope, as explained above, and led the Company's growth. In the educational domain, meanwhile, the Company faces issues, such as needing some time to assess and cultivate new businesses and income from existing businesses (prep schools, etc.) missing the initial plan. It has outlined policies for improved profitability of continuing to strengthen monitoring and revamping the business portfolio.

In issues and measures for individual business segments, the Company intends to build a robust management foundation capable of achieving sustainable growth by implementing the measures. Prep school business, in particular, currently operates over 10 brands via multiple companies and has substantial room for improvement from the standpoint of group management. We think the Company possesses healthy growth potential, even with headwind from the shrinking youth population, if it successfully constructs a framework that maximizes customer LTV by leveraging the strength of group coverage from toddler education (nursery schools, kindergartens, etc.) through Gakken Classroom for younger elementary school students and prep schools that cover elementary, junior, and senior high school students.

Business strategies (issues and measures)

Business segment	Issues	Measures
Educational services	• Decline in prep school student volume • Establishment of a success model for G-PAPILS utilizing AI • Expansion of assessment business	• Group deployment of operational knowhow from vibrant schools • Improvement in G-PAPILS product capabilities and enhanced sales • Income improvement and strengthening collaboration between production and sales division
Educational content	• Careful assessment of money-losing businesses • Insufficient content development and sales strength • Improvement in English business profitability (TGG, online English conversation)	• Enhanced investment decisions and monitoring • Utilization of medical publishing business (e-learning) knowhow • Customer acquisition with enhanced sales activities and rigorous cost management
Educational solutions	• Decline in school textbook sales share • Accessing funds for free toddler education • Strengthening BtoB business	• Reinforcing school textbook production and sales operations • Increase in toddler classroom members • Bolstering corporate seminar business and e-learning (corporate, teacher credential renewal classes, etc.)
Healthcare and nursing services	• Insufficient number of elderly care facility openings • Measures to address manpower shortages (certified care workers, nursery teachers, nurses)	• Strengthening development operations (concentration of development information and knowhow) • Personnel system revisions (compensation, career plans, training)

Source: Prepared by FISCO from the Company's results briefing materials (including some additions by FISCO)

The Company intends to focus on EdTech and English education as longer-term initiatives in its mission as an educational company. EdTech areas include G-PAPILS, a next-generation independent personalized prep school that uses video distribution and AI, and Gakken Nursing Support, an e-learning service for nurses. The G-PAPILS strategy calls for steady improvement in quality through accumulation of learning data and business expansion. It is also possible to provide high value-added solution service by utilizing accumulated learning data in assessment business. In e-learning service, meanwhile, the Company holds a top industry share in the segment for nurses and is achieving healthy growth. It aims to broaden business scope by applying accumulated knowhow for the nurse service to certified care worker, teacher license renewal course, and corporate seminar applications.

In English education, it plans to bolster the publication line-up to meet growing demand for elementary school English teaching materials and workbooks and reference books for Eiken tests in response to entrance exam reforms. It also hopes to monetize TGG, one of the largest experience-style English learning facilities in Japan.

Key points in the next medium-term management plan that begins FY9/21 include the Company's specific reinforcement measures in the educational domain, action program for "business strategy monitoring, organizational personnel reforms, income structure reforms, portfolio changes, financial strategy, investment assessment, and marketing enhancement" as measures to strengthen the business foundation, and ESG and SDG initiatives.

Shareholder returns

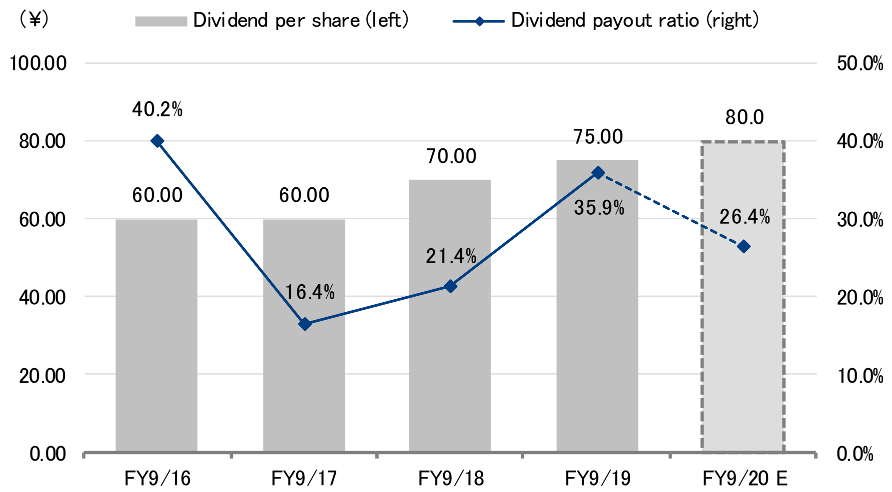
Plans a third straight dividend hike in FY9/20, and announces a stock split

The Company positions shareholder return as an important management issues and utilizes dividends and a shareholder benefit program. While it has not defined a specific dividend target, the Company aims to realize sustainable improvement in shareholder value through well-balanced implementation of a stable dividend and profit expansion with aggressive investment in growth areas.

The Company plans to raise the dividend a third straight time in FY9/20 with a ¥5.0 YoY increase to ¥80.0 (26.4% dividend payout ratio). It also announced a 1-to-4 stock split at the end of March 2020. While management hopes to increase the number of individual shareholders in the child-raising generation, the shares have moved above ¥7,000 in the past year. The Company hence decided to conduct a stock split and thereby lower the price to a level at which even individuals can readily buy shares.

The shareholder benefit program lets shareholders as of end-September each year select desired products, according to the number of shares owned, from group magazines, books, magazine books, character goods, and other items in a catalogue. There is also a ¥1,000 book card gift as a long-term ownership benefit for shareholders who own 300 or more shares continuously for a period of at least three years. Management is currently reviewing benefit content after the stock split.

Changes in dividend per share and dividend payout ratio



Note: Conducted a 10-to-1 reverse stock split in April 2017. Updated retroactively
Source: Prepared by FISCO from the Company's financial results

FISCO

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