Meiko Network Japan

4668 Tokyo Stock Exchange First Section

26-May-15

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FISCO Ltd. Analyst
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Posting Record Quarterly Net Sales, Operating Income, Ordinary Income, and Net Income

On April 10, 2015, Meiko Network Japan Co., Ltd. announced its consolidated results for the first half (from September 2014 through February 2015) of the fiscal year through August 2015 (H1 FY8/15). Consolidated H1 net sales increased 19.5% year on year (YOY) to ¥9,368mn. Operating income was up 6.5% YOY to ¥2,117mn. Both these figures were record semiannual highs. Operating income rose for the first time in two years. Earlier in the year, the company acquired MAXIS Education, the largest franchisee in the Meiko Gijuku business, as a wholly owned subsidiary. This acquisition added ¥1,639mn to net sales and ¥267mn to operating income. Net sales were ¥387mn higher than planned at the start of the term. This is approximately twice the increase we had conservatively forecast for the MAXIS acquisition.

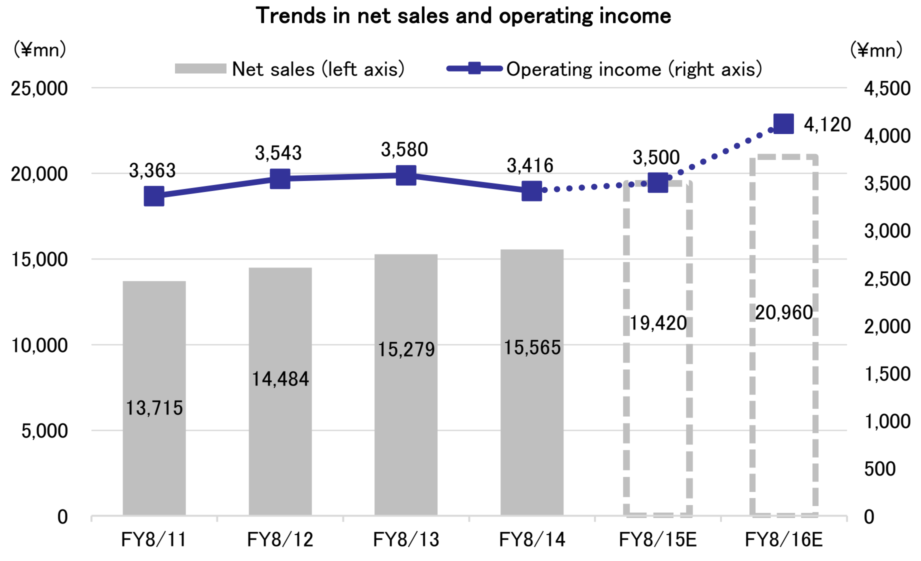
The company has retained its consolidated full-year forecasts for FY8/15 of net sales increasing 24.8% YOY to ¥19,420mn and operating income rising 2.5% to ¥3,500mn. That is apparently because the Meiko Gijuku FC business segment has not yet to fully recover, as competition has stayed intense in the private tutorial schools market. The company will thus push ahead in FY8/15 with establishing new schools while overhauling existing ones. The company could enhance results if initiatives since this term begin to gradually bear fruit. These include initiatives to revitalize the organization by integrating the Meiko Gijuku Directly Operated Business Division and Meiko Gijuku Franchised Business Division, setting up a customer support center, and deploying new information systems to streamline school operations.

The company has deployed such new operations as Waseda Academy Kobetsu Schools, Meiko Soccer Schools, and Meiko Kids Schools. The latter offers considerable growth potential because demand is increasing for childcare. It opened three schools in spring this year, and admissions have generally been steady. Meiko Kids Schools plans to continue expanding. Waseda EDU Japanese Language School is another acquisition which became a wholly owned subsidiary, and is doing well in serving overseas students.

The company has an active stance on returning profits to shareholders. For FY8/15, the company plans to raise its dividend per share by ¥2 to ¥34.00 (dividend payout ratio 41.5%), and plans to raise its dividend payout ratio to around 50% gradually. The company also introduced a shareholder reward program, under which each shareholder of 100 shares or more as of the end of August receives a ¥3,000 QUO card as a gift. Based on the company's closing share price on April 17, 2015, of ¥1,434, the total yield to holders of a minimum unit of shares is in the 4% level, significantly higher than the average dividend yield for listed Japanese companies of approximately 1.5%.

Check Point

- Meiko Network Japan posted record semiannual results and increased operating income for the first time in two years.
- The company has maintained a robust financial position.
- The company is positioned to steadily expand sales and profits and generate dividend growth.



Description of Businesses

The Meiko Gijuku business is a leader in the private tutorial school field and a prime source of sales and profits

Meiko Network Japan's main business is Meiko Gijuku Schools. Some of these schools are operated directly, but most are franchised. Meiko Gijuku is the leading brand of private tutorial schools in Japan. Through a subsidiary, Tokyo Ishin Gakuin (Tokyo Medical School Preparatory Institute), Meiko Network Japan also operates a preparatory school business specializing in preparation for medical university. In addition, the company engages in various other education-related businesses.

Among its other businesses outside tutorial and supplemental education are Meiko Soccer Schools for children. There is also Waseda Academy Kobetsu Schools, which provides tutorial instruction to junior high school and high school students seeking entry into prestigious high schools and universities. Meiko Kids Schools provides nursery care for preschool children and after-school care for elementary school children. Abrakadoodle Art Studios teaches art to preschool and elementary school children. Waseda EDU, which serves overseas students, is a subsidiary acquired in October 2014. The company's subsidiary YouDEC Co. publishes a magazine featuring information about the content of entrance examinations for junior high schools and high schools, produces model examination questions, sells educational materials to students of private schools, and offers private instruction to students at their schools. In addition, YouDEC's subsidiary, Koyo Shobo Co., is involved in the academic publishing business.

As detailed in the bar chart below, in H1 FY8/15 the Meiko Gijuku business supplied the majority of Meiko Network Japan's total consolidated sales and profits. The company's policy described in its medium-term strategy calls for extending the growth of the Meiko Gijuku business while developing other educational businesses.

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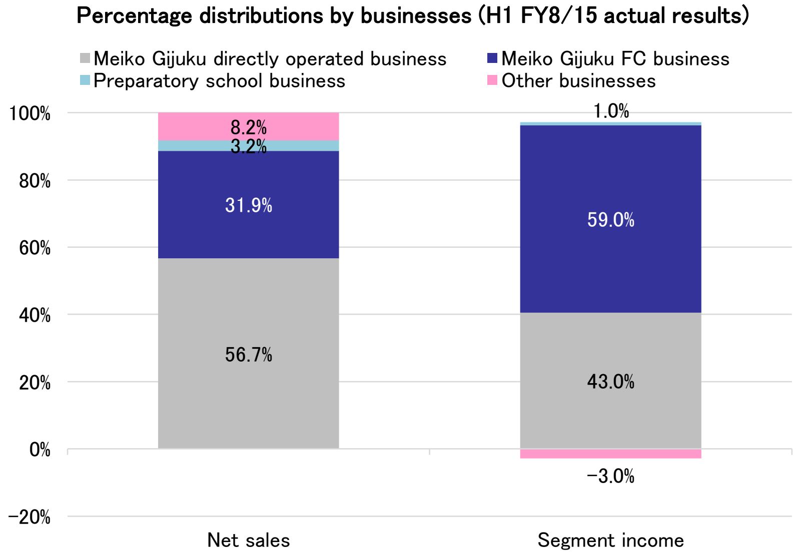

Business Trends

Meiko Network Japan posted record semiannual results and increased operating income for the first time in two years.

(1) Overview of 1H FY8/15

On April 10, 2015, the company announced its consolidated operating results for H1 FY8/15 (September 2014 to February 2015). Consolidated net sales rose 19.5% YOY to ¥9,368mn, and operating income increased by 6.5% to ¥2,117mn. The company posted record semiannual results and increased operating income for the first time in two years.

New subsidiaries added ¥1,706mn to net sales and ¥196mn to operating income, the consolidation of MAXIS being a key addition.

The cost of sales per sales was 60.5%, up 2.2 percentage points YOY, the principal cause being a higher personnel expense ratio from the acquisition of MAXIS. The SGA expenses ratio was up 0.5 of a percentage point, but this was due mainly to an increase in amortization of goodwill. With that factor excluded, the ratio would have been negative 0.3 of a percentage point. The share of profit of entities accounted for using the equity method was up ¥63mn, while the gain on reversal of loss on valuation of investment securities rose ¥36mn, helping to boost non-operating income ¥125mn YOY.

Although net sales were slightly less than planned at the start of the term, earnings gained more than 20%. The net sales result reflected the Meiko Gijuku FC business segment's lagging forecasts, while earnings benefited from personnel expense constraints progressing more than anticipated in the Meiko Gijuku directly operated business segment and from the increased profitability of MAXIS.

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H1 FY8/15 results (consolidated)

(unit: ¥mn)

	H1 FY8/14		H1 FY8/15				
	Actual	vs. Sales	Company forecast	Actual	vs. Sales	YOY	vs plan
Net sales	7,837	–	9,580	9,368	–	19.5%	-2.2%
Cost of sales	4,572	58.3%	–	5,672	60.5%	24.0%	–
SGA expenses	1,276	16.3%	–	1,578	16.8%	23.6%	–
Operating income	1,987	25.4%	1,730	2,117	22.6%	6.5%	22.4%
Ordinary income	2,043	26.1%	1,800	2,298	24.5%	12.5%	27.7%
Net extraordinary income	93	1.2%	–	90	1.0%	–	–
Net income	1,321	16.9%	1,160	1,504	16.1%	13.8%	29.7%

Higher sales and profit from Meiko Gijuku directly operated business

(2) Business segment trends

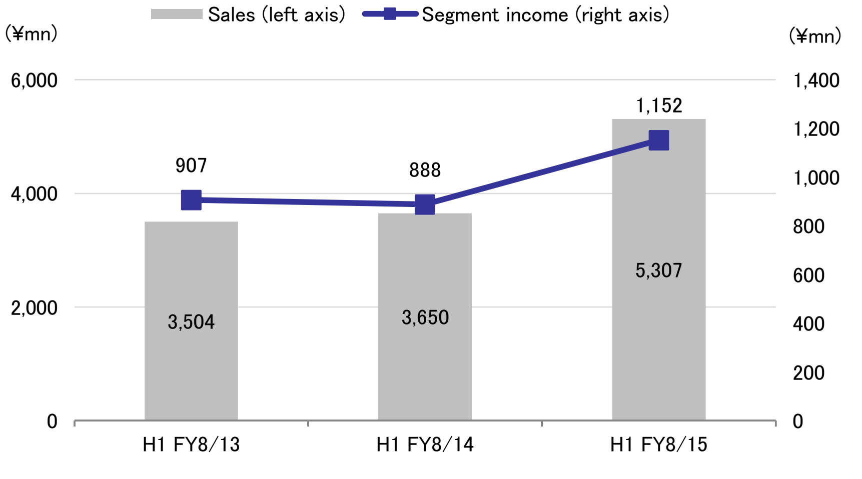
○Meiko Gijuku directly operated business

Sales in the Meiko Gijuku directly operated business segment increased by 45.4% YOY to ¥5,307mn, and segment income increased by 29.7% YOY to ¥1,152mn. The acquisition of MAXIS added ¥1,587mn to net sales, ¥262mn to segment operating income, and ¥71mn to goodwill amortization (amortized over 10 years). Even with the contributions of MAXIS excluded, net sales would have risen 1.9% YOY to ¥3,719mn, with segment income gaining 8.3% to ¥962mn.

After excluding MAXIS, the number of directly operated schools increased by 7 YOY, to 220 by the end of H1, reflecting transfers from franchisees. The number of students rose 1.1% to 17,842. The average number of students per school was down 2.4, to 81.2, but sales per student increased from ¥207,000, to ¥209,000. The segment income margin was 25.9%, up 1.6 percentage points YOY, reflecting progress with cost reductions.

MAXIS maintained 89 schools serving 7,143 students. The average number of students per school was 80.9, and sales per student were ¥222,000. The segment income margin before goodwill amortization was 16.5%, which was considerably lower than the average for Meiko Gijuku directly operated schools. This reflected the impact of royalties (for the Meiko Gijuku FC business) on the operations of MAXIS. With this factor excluded, the margin was still slightly below the average for Meiko Gijuku directly operated schools.

Meiko Gijuku directly operated business



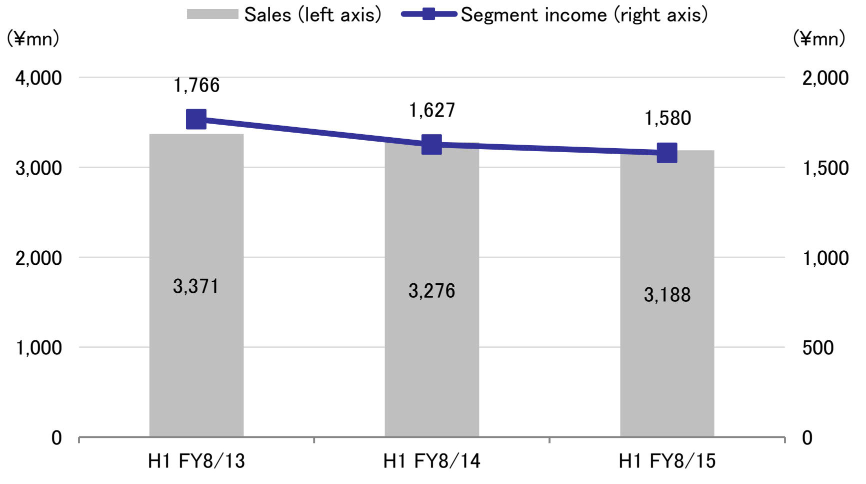
○Meiko Gijuku FC business

Sales in the Meiko Gijuku FC business segment decreased 2.7% YOY to ¥3,188mn. Segment income declined 2.8% to ¥1,580mn (sales included the franchise royalties of ¥196mn from MAXIS).

The number of franchised schools declined 7 YOY to 1,917. This included the 89 schools of MAXIS. Although 41 schools opened, an equal number closed. The Kyushu area accounted for 12 closures, or around 30% of the above total reflecting intensifying price competition.

The number of students declined 0.7% YOY to 121,882. The average number of students per school was 63.6, down 0.2%. Sales per school were down 1.9% to ¥1,118,000. Sales and profits were down as the number of students per school continued to decline and the number of schools decreased.

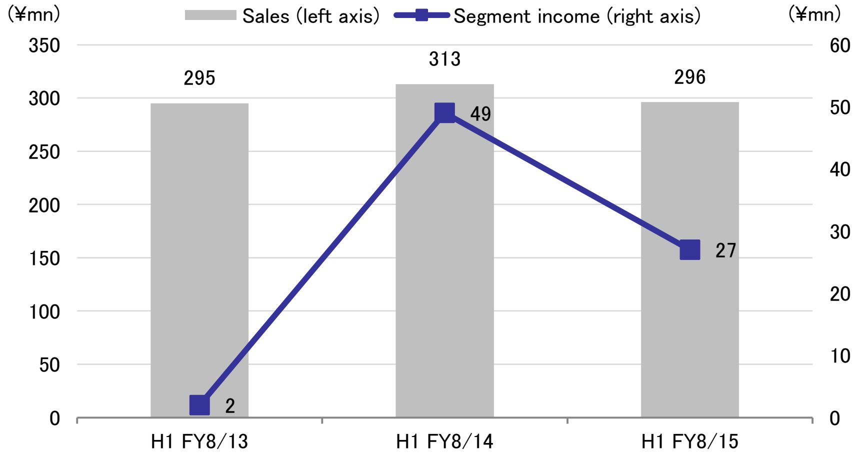
Meiko Gijuku FC business



○Preparatory school business

Sales in the preparatory school business that Tokyo Ishin Gakuin (Tokyo Medical School Preparatory Institute) operates declined by 5.3% YOY to ¥296mn. Segment income dropped 45.2% to ¥27mn. One factor was that the number of students decreased by 3 YOY to 136. Another was an increased expenditure in line with company efforts to acquire new students in spring 2015, such as conducting consultation sessions for entry into medical universities with the cooperation of private medical universities and proprietary general model examinations. It also paid for advertising on websites for medical professionals and in specialist magazines.

Preparatory school business



○Other businesses

Sales for other businesses increased 29.1% YOY to ¥823mn. The segment loss was ¥80mn, up from ¥41mn a year earlier.

By operation, Meiko Soccer Schools posted sales of ¥67mn (¥65mn in H1 FY8/14) and an operating loss of ¥7mn (¥10mn in H1 FY8/14). The number of directly operated schools increased by 2 YOY to 15 schools, and a total of 17 schools including two franchised schools. The total number of students at directly operated and franchised schools increased steadily to 1,011, up 86 YOY.

Sales from Waseda Academy Kobetsu Schools were ¥181mn (¥138mn in H1 FY8/14) and operating loss was ¥8mn (operating profit of ¥18mn in H1 FY8/14). The slight loss despite an increase in sales was due to operating system expenses that had been included in corporate expenses until FY8/14 being attributed to business segment expenses from FY8/15. Excluding this factor, the segment saw a slight increase in income. The number of directly operated schools was 6 (from 2 a year earlier). The number of franchised schools was 12 (from 16 a year earlier), and the number of Waseda Academy directly managed schools was 9 (from 4 a year earlier). The number of students was 1,562 (from 1,161 a year earlier). A key factor in the student number growth was the track record the schools have built as many students have passed entrance exams for highly selective junior high and high schools.

Meiko Kids Schools opened two schools in spring of 2014, bringing the number of schools to 3. The number of students (regular students only) expanded from 77 students in H1 FY8/14 to 221 in H1 FY8/15. Sales doubled to ¥43mn (from ¥23mn a year earlier). Losses increased, however, reflecting increased initial outlays on school openings. The first Meiko Kids Schools school has already become profitable.

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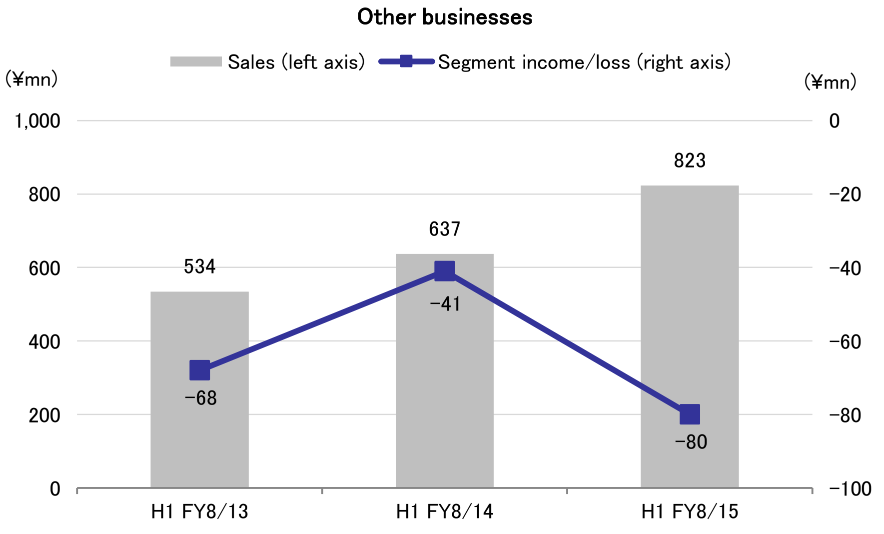
In other operations, consolidated subsidiary YouDEC Co. increased sales to ¥335mn (from ¥301mn in H1 FY8/14) and operating income to ¥18mn (from ¥7mn in H1 FY8/14) owing to solid sales of the key offering of model entrance examination questions. The company included the results of Waseda EDU from Q2. That new subsidiary generated sales of ¥67mn and segment income of ¥12mn. Amortization of goodwill was ¥11mn (amortized on a straight-line basis over 13 years). The operating income ratio before goodwill amortization was 17.9%, illustrating that this is the company's most profitable new business.

Waseda EDU had 405 students at the end of February 2015, mostly from Asia. The largest group was from China, at 62.2%, followed by Vietnam, at 13.1%, and Nepal, at 7.4%. Admissions are in January, April, July, and October. Graduations are in March. The curriculum includes courses as long as two years. March 2015 saw 136 students graduate. The intake in April was 101 individuals, with the total number of students standing at 397. With demand strong, the school has applied to raise capacity from the current 420 students, to 520. Admissions are currently brisk, so the school looks to have almost 520 students within a year.



The company has maintained a robust financial position

(3) Financial status and management indicators

In the Company's financial status as of the end of February 2015, total assets were ¥18,188mn, up ¥1,619mn from the end of FY8/14. The main increases and decreases were due to a ¥443mn decrease in cash and deposits and a ¥1,941mn rise in goodwill owing to the acquisitions of subsidiaries MAXIS and Waseda EDU.

Liabilities stood at ¥3,930mn, up ¥552mn from the end of FY8/14, reflecting the above two acquisitions. Net assets increased ¥1,066mn, to ¥14,258mn, owing to a rise in retained earnings.

Turning to management indicators, although the current ratio declined following a decrease in cash deposits, the equity ratio stayed above 70% and since the company is managed virtually without debt, we consider that it has continued to maintain a good financial status.

Consolidated balance sheet and management indicators

(¥mn)

	FY8/14	Q2 FY8/15	Changes	Factors for change
Current assets	9,707	9,300	-407	
(cash and deposits)	7,363	6,919	-443	Acquisition of shares of MAXIS, Waseda EDU (¥1,513mn)
Fixed assets	6,860	8,888	2,027	Goodwill increased by ¥1,941mn
Total assets	16,568	18,188	1,619	
Current liabilities	2,774	3,218	443	Increases in Accounts payable-trade, Accounts payable-other, and Advances received
Fixed liabilities	602	711	109	
Total liabilities	3,377	3,930	552	
Net assets	13,191	14,258	1,066	
Measures of financial stability				
Shareholders' equity ratio	79.4%	78.2%		
Current ratio	349.8%	289.0%		
Interest-bearing debt ratio	0.4%	0.6%		

Financial Outlook and Future Actions

Retaining initial outlook as earnings trending ahead of projections

(1) Financial outlook for FY8/15

Meiko Network Japan has left its outlook for consolidated financial results for FY8/15 unchanged, planning net sales of ¥19,420mn, up 24.8% YOY, operating income of ¥3,500mn, up 2.5% YOY, ordinary income of ¥3,620mn, up 2.5% YOY, and income of ¥2,260mn, up 2.7% YOY.

Through Q2 FY8/15, revenues slightly lagged forecasts while earnings grew faster than anticipated. As long as student and school numbers do not drop significantly, we think that the company is highly likely to reach its targets. Goodwill is slated to increase from ¥20mn in the previous term to around ¥197mn owing to the consolidation of two subsidiaries.

In sales forecasts for each business, the Meiko Gijuku directly operated business should boost its revenues 48.7%, owing partly to the contribution of MAXIS, but franchised school sales should rise only 0.3%. Increases were initially predicated on an increase of 60 schools YOY, but there will also be an overhaul of franchised schools.

For the preparatory school business, revenues and earnings continued to decline through Q2 FY8/15, but the outlook is for gains for the full term. New student numbers increased in spring 2015. The number of registered students was 136 as of April 8, representing an increase of more than 20% from the 113 registered as of April 30, 2014.

With regard to other businesses, the company's policy is to increase school numbers in Meiko Soccer School, Waseda Academy Kobetsu Schools, and Meiko Kids, respectively, and is forecasting an increase in sales due to the attendant increase in student numbers. That said, Meiko Kids opened three new schools in April 2015, so the company expects to incur a slightly higher operating loss in the current term owing to increased investment spending.

Sales by Segment

(¥mn)

	FY8/12	FY8/13	FY8/14	FY8/15E	Growth
Meiko Gijuku directly operated business	6,864	6,814	7,062	10,503	48.7%
Meiko Gijuku FC business	6,736	6,613	6,565	6,582	0.3%
Preparatory school business	559	597	593	600	1.2%
Other business	324	1,319	1,434	1,733	20.8%
Eliminations	–	-66	-88	–	–
Total	14,484	15,279	15,565	19,420	24.8%

Income by segment

(¥mn)

	FY8/12	FY8/13	FY8/14
Meiko Gijuku directly operated business	1,443	1,461	1,455
Meiko Gijuku FC business	3,313	3,276	3,072
Preparatory school business	-7	37	58
Other	-120	-126	-44
Corporate expenses, amortization of goodwill, etc.	-1,086	-1,068	-1,126
Total	3,543	3,580	3,416

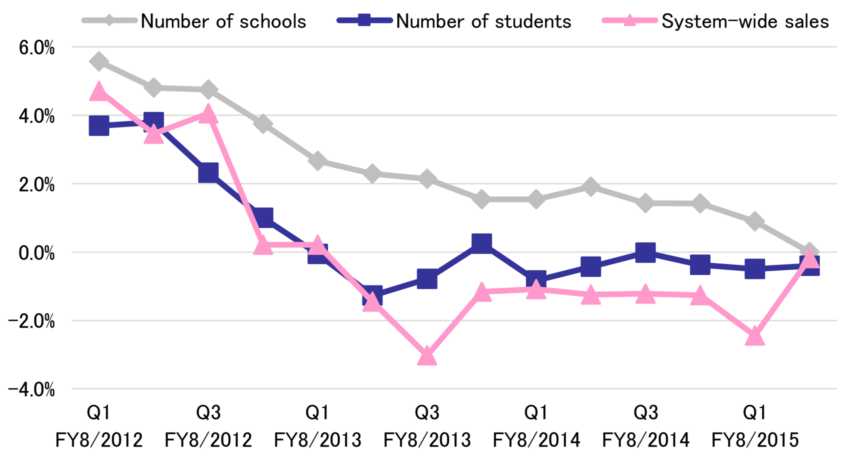
The key is whether the company can again expand student numbers

(2) Measures towards promoting the renewed growth of the Meiko Gijuku business

Whether the company can continue the H1 FY8/15 pace of increasing profits for the first time in two years will depend greatly on whether the core Meiko Gijuku business can again expand student numbers, which are currently lackluster.

Quarterly growth rates for Meiko Gijuku school and student numbers and system-wide sales suggest declines for student numbers and system-wide sales since FY8/13, with the growth pace starting to slow for school numbers. Recently, falls have been comparable to the levels of the previous term.

Meiko Gijuku business school and student numbers and system-wide sales(YOY growth rates)



Note: Including franchise schools. School and student numbers are as of term-ends. System-wide sales are aggregates for all of the sales of directly managed schools and administration fees, instruction charges and other sales (excluding educational materials charges and examination fees) for franchise schools.

To date, the company has pursued a growth strategy that encompasses expanding the number of schools, increasing student numbers, and increasing sales per student. This is likely an outcome of intensifying competition among private tutorial schools amid a declining birth rate. The company thus rolled out five policies to overcome this situation in FY8/15.

The first was to undertake far-reaching organizational reforms. Specifically, it integrated the Meiko Gijuku Directly Operated Business Division and Meiko Gijuku Franchised Business Division and divided the new setup into seven units. This reorganization has enabled directly operated schools and franchise owners to jointly conduct seminars, school visits, and other events and share information more than they have done before. On top of that, franchise owners can now conduct area gatherings instead of the separate ones put on to date and coordinate information. Such an approach has helped to increase organizational vitality and enable schools to mutually incorporate positive facets of what they have learned.

The second policy was to enhance customer satisfaction by setting up a special support center to enhance communications with students and their guardians and reduce the rates of recess/withdrawal.

Third, the company decided to systematize instructor training to reinforce hiring and education and extend this program for the first time to franchised schools. To overcome difficulties in hiring instructors, the company launched a contest in which instructors recounted memorable events, selecting two stories for short movies that it put on YouTube. The videos apparently attracted more than 200,000 views in the first two weeks after distribution, and the company hope that it will motivate more viewers to apply for work as instructors.

Fourth, the company started deploying a new information systems (called the GIS Geographic Information System and the METIS Portal). The company customized the GIS Geographic Information System, which started operating in February this year. The system makes it possible to analyze operating areas accurately, making it possible to solicit schools and open schools with a greater level of precision. The METIS information portal links the head office and schools, and also began operating in February. It is designed to enhance information dissemination from the head office (distributing both text and images), providing schools with the information (including for recruiting students, notifying of events, and gathering competitive information) and tools that they need. This setup also makes it possible to share operational target management information among managers of school, franchise owners, supervisors, and other entities, and should therefore help enhance school operations.

Fifth, the company sought to encourage school openings by reviewing owner recruiting and areas and thereby bolster satellite school establishments and enhance support when new schools open.

While such efforts will not bear significant fruit soon, they should contribute to a recovery in student numbers for franchise schools.

Looking to post record earnings gains by as early as FY8/15

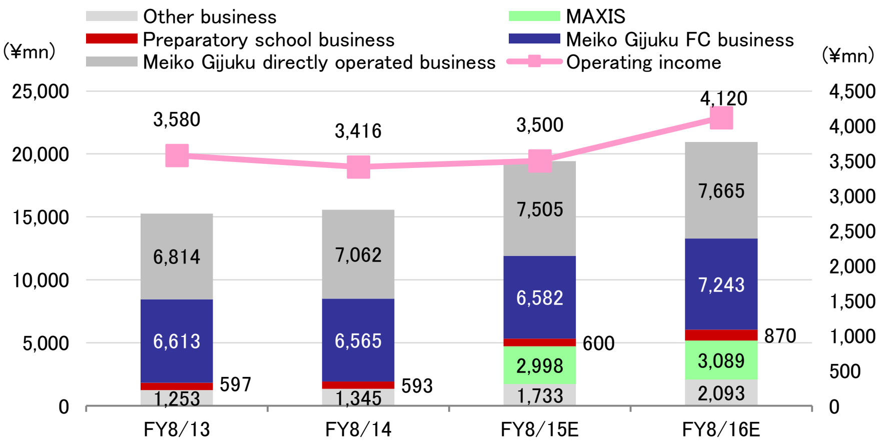
(3) Three-year medium-term business plan

For FY8/16, when its three-year medium-term business plan ends, the company targets net sales of ¥20,960mn and ¥4,120mn in operating income. Management seeks to post record operating income in this term for the first time in three years.

Looking at the sales plan by business, the company looks for stable growth in the Meiko Gijuku directly operated and franchised school businesses, with the preparatory school business and other businesses also delivering gains. Management aims to retain the Meiko Gijuku business as central to earnings while pushing ahead strategically to expand school and student numbers in other educational service businesses, thereby bolstering revenue and earnings underpinnings.

The company will continue to pursue M&As, candidate areas being in the educational services market. This would include areas that the company does not currently engage in, notably lifelong learning, nursing care, and behavioral support for the elderly.

Medium-term business plan



Note: The most recent company forecasts used for FY8/15 segment sales

Shareholder Return Policy

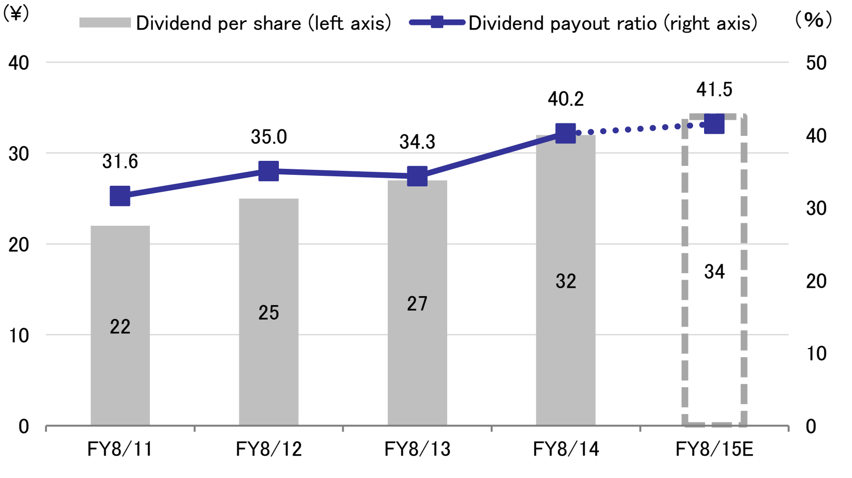
Expectations for steady earnings increase and growth in dividends

The company has been recording continued dividend increases since it was listed on the stock market, and for FY8/15 it plans an increase of ¥2.00 YOY to ¥34.00. Thus, the company is highly regarded as having a proactive stance on shareholder returns. The company has established a policy of raising its dividend payout ratio in steps to 50% with continuous increases in dividends as its basic policy from now on.

Also, the Company has a shareholder special benefit plan of giving shareholders on August 31 a QUO card worth ¥3,000 per share unit (100 shares). On the basis of the closing share price of ¥1,434 on April 17, 2015, the gross investment yield per share unit is in the 4% level, which far exceeds the average gross investment yield for listed companies of about 1.5%.

The company has established stable high profitability and a sound financial standing through its unique franchise system in the fiercely competitive educational service industry. Thus, the company is estimated to expand steady earnings and, at the same time, to increase its dividends. Also, with regard to ROE (Return On Equity), which is gaining importance as an investment indicator, the company's actual figure was 17.6% for the previous fiscal year, which far exceeds the average 8.5% for the companies listed on the first section of the Tokyo Stock Exchange, and thus will gain continued attention as an attractive company to invest in.

Dividend per share and dividend payout ratio



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