COMPANY RESEARCH AND ANALYSIS REPORT

MEIKO NETWORK JAPAN CO., LTD.

4668

Tokyo Stock Exchange First section

30-May-2019

FISCO Ltd. Analyst
Yuzuru Sato

FISCO Ltd.
http://www.fisco.co.jp

Index

Summary

Progressing measures toward rebuilding the Meiko Gijuku business

MEIKO NETWORK JAPAN CO., LTD. <4668> (hereafter, also "the Company") offers a variety of educational services centered on the directly operated and franchised operations for the Meiko Gijuku private tutorial schools, but that also include medical-related preparatory schools, soccer schools, after-school care, and Japanese language schools for overseas students. Its strengths include its expertise in franchised operations and the Company is aiming to become a top company in human development while expanding business domains with M&A activities.

1. FY8/19 1H results

In the FY8/19 1H (September 2018 to February 2019) consolidated results, both sales and profits increased, with net sales rising 3.3% YoY to ¥10,092mn and operating income growing 30.4% to ¥1,547mn. Sales increased due to the effects of K. Line Co., Ltd., a franchise operations management company, being made a subsidiary in the previous Q4 (¥609mn). Operating income increased because of the measures to keep down expenses as a whole, particularly sales promotion expenses. In the mainstay Meiko Gijuku business (including franchise operations), although the number of students continued to decline, some bright signs have started to appear, including the rise in the sales unit price per student from the positive evaluations of courses, such as the English learning and programming learning courses utilizing ICT. Also, compared to the initial Company forecasts (net sales of ¥10,240mn and operating income of ¥1,240mn), net sales were slightly below forecast, but operating income was above forecast. This was because expenses, mainly personnel expenses, were less than expected, and also because some sales promotion expenses were shifted to the 2H.

2. FY8/19 outlook

For the FY8/19 consolidated results, the initial forecasts have been left unchanged, of net sales to increase 6.3% YoY to ¥20,320mn and operating income to rise 29.0% to ¥1,860mn. Sales will increase by around ¥800mn to ¥900mn from K. Line being made a subsidiary, while from this Q3 onwards, K.M.G. Corporation Co., Ltd., a Meiko Gijuku franchise operations management company, will be added to the scope of consolidation, and this will increase sales by approximately ¥400mn to ¥500mn. The outlook is for operating income to increase mainly due to the reduction of sales promotion expenses. Up to Q2, operating income had exceeded the forecast by ¥300mn. But in the 2H, ¥200mn will be recorded as strategic investment expenses in the Meiko Gijuku business, while the decline in the number of Meiko Gijuku schools and the below-forecast results of subsidiaries will be negative factors of ¥100mn, which will cancel out the above-forecast part in the 1H.

3. Measures aimed at rebuilding the Meiko Gijuku business

In order to recover the Meiko Gijuku business, in which the numbers of students and schools have continued to decline since FY8/16, the Company has been introducing MEIKO Style Coaching* as a new learning guidance method. It started to introduce it into directly operated schools from the fall of 2017, and it then introduced it into all schools, including franchise operations schools, from April 2019. Further, it is not only enhancing learning programs that utilize ICT, it is also working to strengthen services, including increasing the frequency it holds training seminars in each region in order to improve educational abilities. In marketing, the Company is implementing measures to recruit students through Internet advertisements that are tailored to the characteristics of each region. The effects of these measures are starting to appear, including that the number of students newly enrolling in directly operated schools in January to March 2019 increased 13% YoY. On the other hand, the Company plans to also progress scrap & build, including of unprofitable schools, and it intends to build a foundation toward the re-growth of the Meiko Gijuku business by FY8/20.

* MEIKO Style Coaching is a learning system that effectively improves students' academic performance through combining "review lessons" and an e-portfolio system (Meiko e-Po). "Review lessons" are a learning guidance method that raises students' understanding capabilities during learning through the tutor giving them hints, and the students then solving problems using their own capabilities and explaining what they have understood in their own words to the tutor, and recording this in review notes. Meiko e-Po is a dedicated app in which students record information, such as learning records and plans, and the parents and guardians can use their smartphones to check on their children's learning status and academic performance at any time.

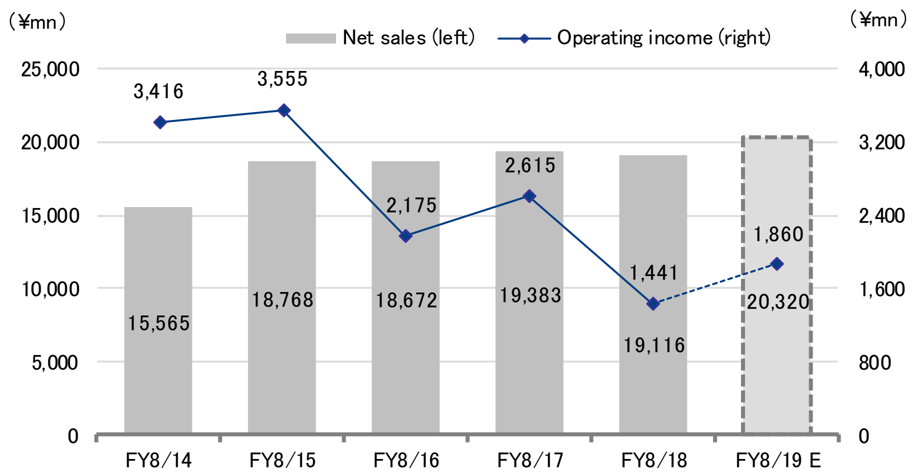
4. Shareholder return policy

There has been no change to the Company's policy of actively returning profits to shareholders. The FY8/19 dividend per share will be ¥30 (dividend payout ratio, 78.1%), down ¥12 YoY, which will be the first decrease since the Company was listed. However, its policy is to set an upper limit for the dividend payout ratio of 80%. There have also been no changes to the shareholder benefit program, in which the Company gives QUO cards worth ¥1,000 to ¥5,000 to shareholders as of the end of August, according to the number of shares they hold and the length of time that they have held them. The gross investment yield per share unit, including the shareholder benefit program, is at the 3-5% level at the current share price (¥1,094 as of April 19).

Key Points

- In FY8/19, the Company is working to rebuild the Meiko Gijuku business as the top priority and has left the initial results forecasts unchanged
- Sales are increasing in the Meiko Gijuku business through franchise operations companies being made into subsidiaries, while the Kids Schools and Japanese language schools businesses are expected to grow in the future
- Although its record of increasing dividends will end for the time being, going forward it will continue the policy of actively returning profits to shareholders

Results trends



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

Business overview

Aiming to become a top company in human development through the mainstay Meiko Gijuku business and expanding into other educational services

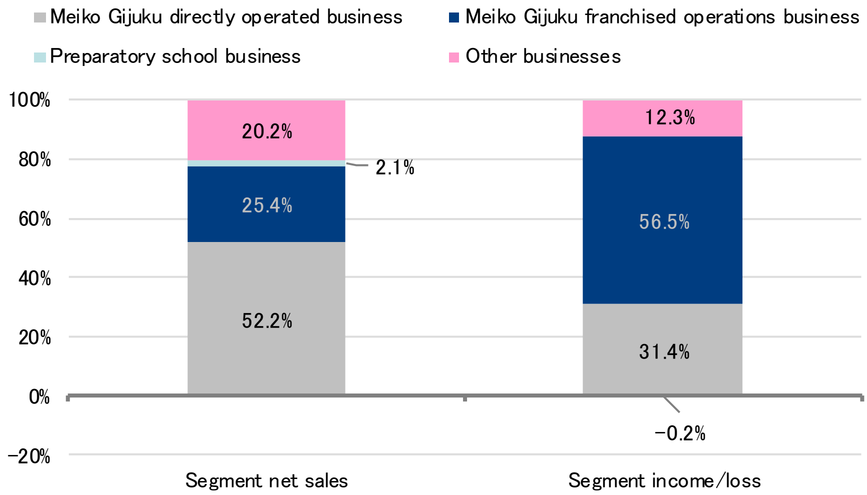
Based on its educational philosophy of human development through independent learning, the industry leader* in private tutorial schools primarily operates the Meiko Gijuku business (directly operated and franchised operations). The Company is also actively expanding into other businesses related to educational services, aiming to become a top company in human development. Specifically, it operates the Meiko Soccer Schools, soccer schools for children; Waseda Academy Kobetsu Schools, which provide tutorial instruction to junior high school and high school students seeking entry into prestigious high schools and universities; and Meiko Kids Schools, which provide nursery care for preschool children and after-school care for elementary school children. Additionally, its subsidiaries operate Tokyo Ishin Gakuin, a preparatory school that specializes in the medical university field, and Waseda EDU Japanese language school and JCLI Japanese language schools as schools that cater to overseas students learning Japanese. Other businesses include subsidiary Kotoh Jimusho Co., Ltd., which operates businesses related to university education and exams; subsidiary Youdec Co., Ltd., which publishes an exam information magazine, produces mock exam questions, sells educational materials, and offers private instruction to students at their schools; and Youdec's subsidiary Koyo Shobo Co., Ltd., which is involved in the academic publishing business.

* Meiko Gijuku's share of the private tutorial schools market in FY2018 was approximately 9.4%. In reference to the market-scale values in the 2018 Education Industry White Paper by Yano Research Institute Ltd., the Company assumed Meiko Gijuku total system-wide sales as ¥41,637mn in FY2018, from the period of September 2017 to August 2018.

In overseas businesses, the mainstay Company operates a nursery school for Japanese residents in Singapore (non-consolidated subsidiary COCO-RO PTE LTD) and has invested in NEXCUBE Corporation, Inc. (equity-method affiliate; 23.7% stake), which operates private tutorial schools in South Korea, and Taiwan-based Meiko Bunkyo (affiliated company not accounted for by the equity method; 25% stake), which operates the Meiko Gijuku business in Taiwan.

Looking at the percentages of results by business segment in FY8/19 1H, the Meiko Gijuku business (including directly-operated and franchise operations) served as the main business, providing 77.7% of net sales and 87.9% of segment income. The other businesses contributed 20.2% of net sales and 12.3% of segment income due to growth in the Japanese language schools, the Kids Schools businesses, and others.

Composition by business segment (1H FY8/19)



* Segment income/loss is before the deduction of corporate expenses.
Source: Prepared by FISCO from the Company's financial results

Business performance

In the FY8/19 1H results, achieved higher sales and profits for the first time in two years from the reduction in sales expenses, mainly sales promotion expenses

1. Overview of FY8/19 1H results

In FY8/19 1H consolidated results announced on April 12, net sales increased 3.3% YoY to ¥10,092mn, operating income rose 30.4% to ¥1,547mn, ordinary income rose 27.5% to ¥1,608mn, and net income attributable to owners of the parent was up 42.1% to ¥971mn. This was the first increase in both sales and profit on a half-year basis in two years.

Sales declined in the Meiko Gijuku franchise business, the preparatory schools business, and other businesses. But the main reason for the higher sales overall was the increase in sales in the Meiko Gijuku directly operated schools business from the effects of making K. Line, which was a Meiko Gijuku franchise operations management company, a subsidiary in the previous Q4 (¥609mn). Conversely, in profits, although cost of sales increased 4.7% YoY, mainly due to the rise in personnel expenses (including an increase from making K. Line a subsidiary) and gross profit rose by only 0.7%, operating income still increased by double digits, This was because sales, general, and administrative (SG&A) expenses declined 14.7%, which was mainly due to the reduction in sales promotion expenses (¥390mn). In the same period in the previous fiscal year, the Company recorded higher sales promotion expenses than in a typical year, including for renewing the brands, but they returned to the same level as in a typical year in this fiscal quarter. However, due to K. Line being made a subsidiary, amortization of goodwill increased (¥29mn). Also, compared to the Company forecasts, net sales were slightly below forecast, but operating income was 24.8% above forecast. The main reasons for the increase in operating income were that the Company worked to control expenses as a whole, including personnel expenses, and that it shifted some sales promotion expenses relating to student recruitment to the 2H.

At the end of Q2, the number of schools in the mainstay Meiko Gijuku business, including directly operated and franchise operations schools, had declined 2.2% YoY to 2,020 schools, while the number of students also fell 6.2% to 117,304 students, so the downward trends continued. In a situation of intensifying competition to acquire students in the private tutorial schools industry, it is considered that the main reasons for the decline in student numbers are that customers are not fully understanding aspects such as the features and superiority of MEIKO Style Coaching, which the Company created as a differentiation strategy, and also that it has been slow to respond with measures for student recruitment that utilize the Internet. However, there are some bright signs to focus on, including that average sales per student rose 3% and that the extent of the fall in total system-wide sales contracted to a decline of 3.5% YoY. Courses utilizing ICT, including Meiko Mirai Eigo for elementary school students, Meiko Chugaku Listening for junior high school students, and English learning programs, such as the course to prepare students for the English proficiency test, have been favorably received, which would seem to have led to the rise in the sales unit price per student.

Consolidated FY8/19 1H results

(¥mn)

	FY8/18 1H		FY8/19 1H				
		% of sales	Forecast	Results	% of sales	YoY	vs. forecast
Net sales	9,769	-	10,240	10,092	-	3.3%	-1.4%
Cost of sales	6,291	64.4%	6,920	6,590	65.3%	4.8%	-4.8%
SG&A expenses	2,291	23.5%	2,080	1,954	19.4%	-14.7%	-6.1%
Operating income	1,186	12.1%	1,240	1,547	15.3%	30.4%	24.8%
Ordinary income	1,261	12.9%	1,280	1,608	15.9%	27.5%	25.6%
Net income attributable to owners of parent	683	7.0%	690	971	9.6%	42.1%	40.8%

Number of Meiko Gijuku schools, number of students enrolled, and total system-wide sales (directly operated and franchised operations)

	FY8/18 1H	FY8/19 1H	YoY
Number of schools (end of 1H)	2,066	2,020	-2.2%
Number of students (end of 1H)	125,045	117,304	-6.2%
Total system-wide sales	22,107	21,323	-3.5%

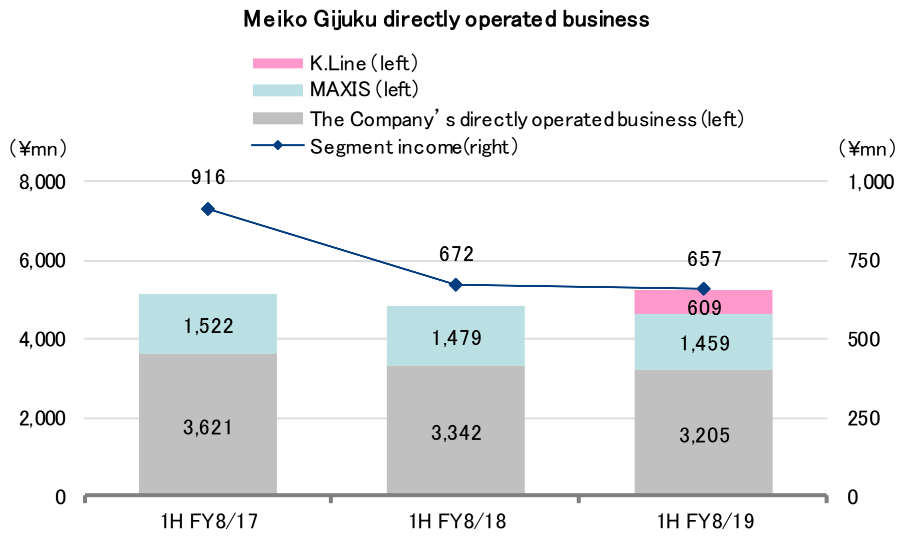
Note: Total system-wide sales = the sum of 1) total sales of directly operated schools, including lesson fees, fees for educational materials, and test fees, and 2) total sales of franchised operations including lesson fees. Fees for educational materials, tests, etc., at franchised operations are not included.
Source: Prepared by FISCO from the Company's financial results

Profits increased in the Meiko Gijuku franchise business due to the decline in sales promotion expenses, while earnings also continue to grow in the Japanese language schools and the Kids Schools businesses

2. Segment trends

(1) Meiko Gijuku directly operated business

In the Meiko Gijuku directly operated schools business, net sales increased 9.3% YoY to ¥5,273mn and segment income decreased 2.2% to ¥657mn. On looking on an existing-business basis after excluding the effects of K. Line being made a subsidiary, net sales decreased 3.3% and segment income fell 4.4%. In the Company's directly operated schools business, net sales decreased 4.1% to ¥3,205mn and operating income declined 1.6% to ¥554mn. In the subsidiary MAXIS Education Co., Ltd. (hereafter, MAXIS), net sales fell 1.4% to ¥1,459mn and operating income declined 11.6% to ¥160mn, while in K. Line, net sales were ¥609mn and operating income was ¥44mn. Total amortization of goodwill relating to MAXIS and K. Line was ¥101mn (¥71mn in the same period in the previous fiscal year). Segment income before the amortization of goodwill increased, if only slightly, up 2.0% YoY, which was due to the reduction in sales promotion expenses and the addition of the results of K. Line. But profitability declined slightly, mainly due to the addition of K. Line, which has a relatively low profit margin.



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

Number of directly operated schools and number of students

	Directly operated by the Company			Operated by MAXIS			Operated by K. Line		
	FY8/18 1H	FY8/19 1H	Change	FY8/18 1H	FY8/19 1H	Change	FY8/18 1H	FY8/19 1H	Change
Number of schools (end of 1H)	233	231	-0.9%	95	94	-1.1%	-	42	-
Average number of enrolled students	16,967	15,933	-6.1%	6,748	6,672	-1.1%	-	2,791	-
Average number of students per school (end of 1H)	72.9	68.9	-5.5%	71.0	71.6	0.8%	-	66.5	-
Sales per student (¥1,000)	197.0	201.2	2.1%	219.3	218.7	-0.3%	-	218.2	-

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

On looking at the various indicators, at the end of the current Q2 in the Company's directly operated schools business, the number of schools had decreased 0.9% YoY to 231 schools, the average number of students during the period had fallen 6.1% to 15,933 students, and the average number of students per school had declined 5.5% to 68.9 students, so each indicator continued to trend downward. However, sales per student increased 2.1%. In MAXIS, the number of schools and the average number of students during the period also declined slightly, decreasing 1.1% to 94 schools and falling 1.1% to 6,672 students, respectively. But the average number of students per school improved marginally, rising 0.8% to 71.6 students. However, sales per student fell 0.3% because of the slump in the number of students enrolling on learning courses in the winter period.

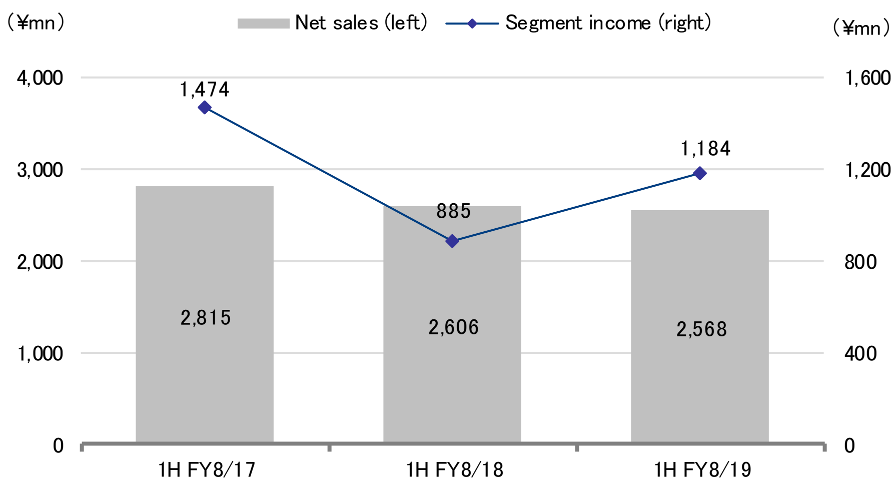
The Company started introducing MEIKO Style Coaching into directly operated schools from the fall of 2017 as a differentiation strategy toward recovering student numbers. In terms of its effects, if looking only at the number of students up to the current Q2, its effects would appear to be limited. So the issues going forward will be strengthening policies and educational abilities in order to spread awareness of it among customers.

(2) Meiko Gijuku franchised operations business

In the Meiko Gijuku franchise operations business, sales decreased but profits increased, with net sales declining 1.5% YoY to ¥2,568mn and segment income rising 33.7% to ¥1,184mn. The main reason for the lower sales was the decline in royalty sales (¥132mn) following the decreases in the numbers of franchise operations schools and students. But profits increased from the reduction in sales promotion expenses (¥285mn).

At the end of the current Q2, the number of schools had declined 4.9% YoY to 1,653 schools (down 2.5% when including K. Line), the average number of students during the period had decreased 10.1% to 95,115 students (down 7.5%), and the average number of students per school had fallen 5.4% to 57.5 students (down 5.0% to 57.8 students). So the same as in the directly operated schools business, the number of schools, the number of students, and the average number of students per school continued to trend downward. Also, royalty sales per school decreased 2.6% YoY, which is a smaller extent of decrease than the decrease rate of the number of students, and in franchise operations schools also, it can be seen that sales per student are increasing. That said, the number of students per school continues to trend downward in franchise operations schools as well, so the most important issues in the franchise operations business are also first increasing the number of students per school and improving the profitability of each school.

Meiko Gijuku franchised operations business



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

Numbers of franchise operations schools and students

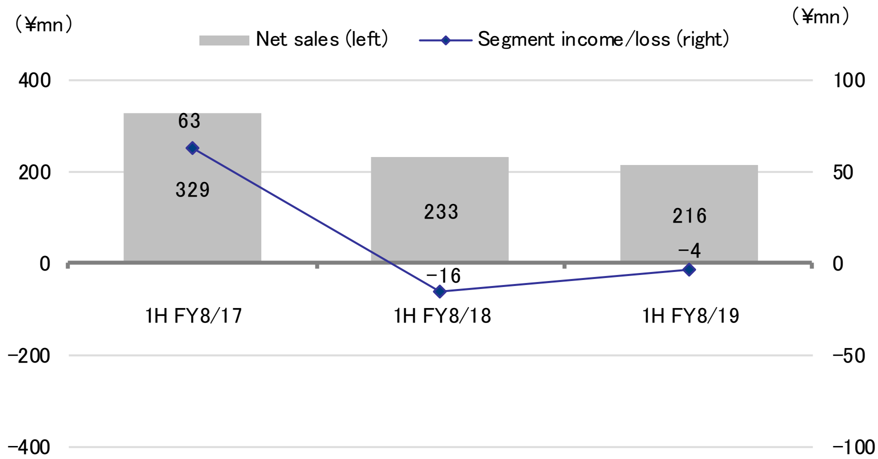
	FY8/18 1H	FY8/19 1H	Change
Number of schools (end of 1H)	1,738	1,653	-4.9%
Average number of enrolled students	105,797	95,115	-10.1%
Average number of students per school	60.8	57.5	-5.4%
Royalty sales (¥mn)	1,783	1,651	-7.4%
Royalty sales per school (¥1,000)	1,024.8	997.7	-2.6%

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

(3) Preparatory school business

In the preparatory school business, which is conducted by the consolidated subsidiary Tokyo Ishin Gakuin Co., Ltd., net sales decreased 7.5% YoY to ¥216mn and the segment loss was ¥4mn (compared to a loss of ¥16mn in the same period in the previous fiscal year). In the medical-related preparatory schools also, competition is intensifying each year and the slump in the number of new students in the spring of 2018 resulted in the worsening of earnings, although the extent of the loss contracted slightly due to the reduction in costs. At the end of the 1H, the number of students had decreased 18.6% to 79 students. As the fall in the number of currently enrolled students who have a low sales unit price was comparatively large, the rate of the decrease in net sales was small relative to the decline in the number of students.

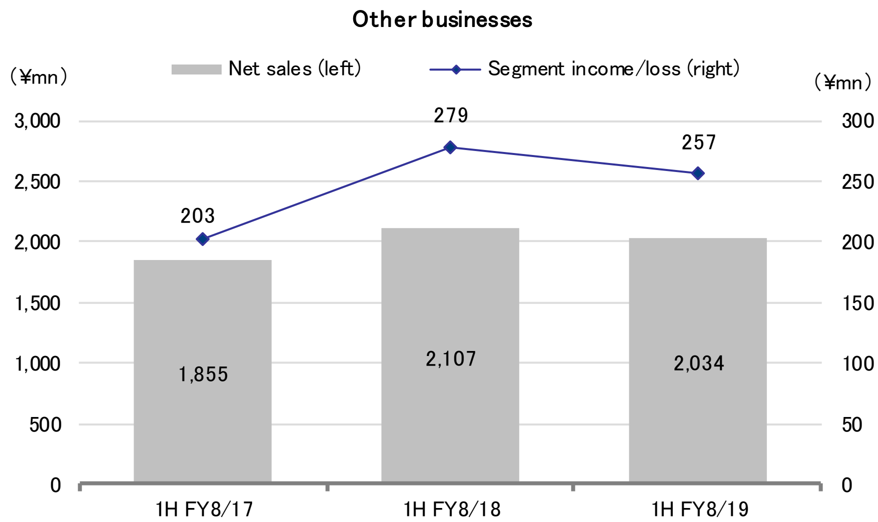
Preparatory school business



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

(4) Other businesses

In other businesses, net sales decreased 3.5% YoY to ¥2,034mn and segment income declined 8.0% to ¥257mn. This was because although results grew steadily in some businesses, including the Kids Schools and the Japanese language schools businesses, the worsening of results in Youdec and Koyo Shobo dragged down results as a whole.



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

Other businesses' net sales

(¥mn)

	FY8/18 1H	FY8/19 1H	Change rate	Change amount	Special notes Figures within parentheses are YoY increases/decreases
Waseda Academy Kobetsu Schools	269	265	-1.3%	-4	No. of schools 35 (±0), No. of students 2,577 (+155)
Kids	126	167	32.7%	41	No. of schools and consignment operations 19 (+4), No. of students 1,009 (+67)
Soccer	68	65	-4.1%	-3	No. of schools 13 (-2), No. of students 906 (-38)
Waseda EDU Japanese language school	218	226	3.5%	8	No. of students 643 (-13)
JCLI Japanese language schools (Kokusai Jinzai Kaihatsu)	434	448	3.3%	14	No. of students 1,231 (+48)
Kotoh Jimusho	403	416	3.3%	13	University education-related business Making progress as planned for both sales and profits
Youdec	354	276	-22.1%	-78	Private instruction to students at their schools, mock exam questions, etc. Entrance exam-related sales declined
Koyo Shobo	157	116	-26.2%	-41	Academic publishing Sales declined, as the number of new publications was less than planned
MAXIS (ESL business)	17	20	19.5%	3	Private tutorial English schools
Other	56	29	-47.4%	-27	Study Clubs, etc.
Total	2,107	2,034	-3.5%	-73	

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

Looking at the trends in the main businesses, in Waseda Academy Kobetsu Schools, net sales decreased 1.3% to ¥265mn, but operating income doubled to ¥18mn. At the end of the current Q2, the number of schools was unchanged YoY at 35 schools (7 Company directly operated schools, 5 MAXIS directly operated schools, 11 franchise operations schools, and 12 Waseda Academy directly operated schools). The number of students enrolled in all schools had increased 6.4% to 2,577 students and the average the number of students per school had risen 6.4% to 73.6 students, so both steadily increased. Sales declined slightly, as no new franchise operations schools were established in this fiscal period (compared to 2 new schools in the same period in the previous fiscal year). But the Company strengthened collaborations, including conducting joint tutor training with Waseda Academy <4718>, and it worked to improve the quality of entrance exam guidance. In addition, its track record of having its students pass the entrance exams for prestigious, difficult-to-enter schools has started to grow, and therefore the number of students steadily increased. Profits also grew, mainly from the decline in expenses.

The Kids Schools business is benefiting from the increase in demand for nursery care and after school care, with net sales increasing 32.7% YoY to ¥167mn and operating income of ¥4mn (compared to a loss of ¥5mn in the same period in the previous fiscal year). At the end of the current Q2, the number of schools had increased by 4 YoY (including consignment operations and related facilities) to 19 schools (7 directly operated schools, 1 nursery care club facility, and 11 consignment operations and related facilities), and the number of students enrolled in the schools had risen 7.1% to 1,009 students. The strengthening of consignment operations services, which can quickly generate earnings, contributed to the increase in profits.

In the Soccer Schools business, net sales decreased 4.1% YoY to ¥65mn and operating income was ¥5mn (compared to ¥1mn in the same period in the previous fiscal year). At the end of 1H, the number of schools had decreased by 2 to 13 schools (down 2 to 12 directly operated schools and 1 franchise operation due to consolidation), and the number of students had also fallen 4.0% to 906 students, so sales declined. However, profits increased, if only slightly, due to the efforts to improve management efficiency. Specifically, since the second half of the previous fiscal year, it has been conducting management through dividing schools into two types; Meiko Soccer School Academies, (which aim for students to acquire the fully fledged techniques to become professional players in the future) and Meiko Soccer Schools (which provide enjoyable coaching for students to acquire practical skills to become better at soccer).

The business of Japanese language schools for overseas students consists of two schools, the Waseda EDU Japanese language school managed by consolidated subsidiary Waseda EDU, and the JCLI Japanese language school managed by Kokusai Jinzai Kaihatsu Co., Ltd. At the end of the current Q2, the total number of students in both schools had increased 1.9% YoY to 1,874 students (643 students in the Waseda EDU Japanese language school and 1,231 students in the JCLI Japanese language school), and the upward trend continued. Net sales also continued to trend upward alongside the increase in the number of students, rising 3.5% YoY to ¥674mn, while operating income grew 20.7% to ¥105mn. As the Company recorded ¥84mn as the amortization of goodwill, the operating income margin before the amortization of goodwill, which shows actual profitability, was 28.0%, from which we understand that it is a highly profitable business.

In the school-support businesses, which is conducted by consolidated subsidiaries Kotoh Jimusho, Youdec and Koyo Shobo, total net sales decreased 11.6% YoY to ¥809m and operating income fell 32.3% to ¥126mn, for lower sales and profits. This was because, although Kotoh Jimusho made progress in line with the Company's forecasts, with net sales rising 3.3% to ¥416mn and operating income also increasing, in Youdec, sales declined 22.1% to ¥276mn due to the decline in orders for mock entrance exams and other services. In Koyo Shobo also, the number of new publications was below the number in the same period in the previous fiscal year, and its sales also fell 26.2% to ¥116mn, so sales declined by double digits in both companies.

Continues to have an abundance of cash on hand and to maintain essentially debt-free management, and its financial condition is highly stable

3. Financial position and management indicators

Looking at the Company's financial condition at the end of FY8/19 Q2, total assets were up ¥1,145mn on the end of the previous fiscal year to ¥19,829mn. The main change factors were that in current assets, accounts receivable decreased ¥214mn but cash and deposits increased ¥1,136mn. In non-current assets, investment securities increased ¥267mn due to the rise in the prices of shares held, while tangible non-current assets grew ¥121mn. The assets and the goodwill of K.M.G. Corporation Co., Ltd. (hereafter, KMG)*, which was newly made a subsidiary at the end of Q2, were recorded. Its main assets are rental deposits and security deposits of ¥57mn, while goodwill of ¥255mn was recorded.

* It was a franchise operations management company that managed 43 Meiko Gijuku schools in Kyoto, Shiga, and Nara. In December 2018, the Company acquired all of its shares for ¥300mn and made it a subsidiary. The amortization period has not been decided, but it is highly likely that it will be 10 years, the same as for MAXIS and K. Line.

Total liabilities were up ¥553mn on the end of the previous fiscal year to ¥4,900mn. In non-current liabilities, advanced payments decreased ¥298mn, including due to seasonal factors, although there were increases of ¥499mn for unpaid corporation tax and ¥135mn for unpaid consumption tax. In non-current liabilities, long-term debt of ¥71mn was recorded, while deferred tax liabilities increased ¥78mn. Net assets were up ¥591mn on the end of the previous fiscal year to ¥14,928mn. This was because retained earnings increased ¥413mn and as the valuation difference on other available-for-sales securities rose ¥186mn.

Looking at the management indicators, the equity ratio decreased slightly, down from 76.6% at the end of the previous fiscal period to 75.2%, but as before it remains at a high level. The interest-bearing debt balance is also only ¥174mn and the Company is essentially maintaining debt-free management, so it can be judged that its financial condition remains excellent.

Consolidated balance sheet and management indicators

(¥mn)

	FY8/16	FY8/17	FY8/18	FY8/19 1H	Change
Current assets	6,865	10,431	8,959	9,637	677
(Cash and deposits)	4,633	7,822	6,508	7,645	1,136
Non-current assets	10,105	8,883	9,723	10,191	468
Total assets	16,970	19,314	18,683	19,829	1,145
Current liabilities	3,059	4,168	3,563	3,986	422
Non-current liabilities	701	729	782	914	131
Total liabilities	3,760	4,897	4,346	4,900	553
(Interest-bearing debt)	82	70	70	174	104
Net assets	13,209	14,416	14,336	14,928	591
Management indicators					
(Stability)					
Equity ratio	77.4%	74.5%	76.6%	75.2%	-1.4pt
Interest-bearing debt ratio	0.6%	0.5%	0.5%	1.2%	0.7pt

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

Business outlook

In FY8/19, the Company is rebuilding the Meiko Gijuku business as its top priority and it has left the initial forecasts unchanged

1. FY8/19 outlook

For the FY8/19 consolidated results, the Company has left the initial forecasts unchanged, of net sales to increase 6.3% YoY to ¥20,320mn, operating income to rise 29.0% to ¥1,860mn, ordinary income to grow 24.5% to ¥1,940mn, and net income attributable to the owners of the parent to increase 55.2% to ¥1,020mn. In the 1H, operating income was ¥307mn above the forecast. But in the 2H, the Company will record ¥200mn as additional expenses for strategic investment toward rebuilding the Meiko Gijuku business (¥150mn in expenses for student-recruitment activities, ¥30mn as expenses to maintain school environments, and ¥20mn to invest in ICT contents). In addition, the results of subsidiaries, including Tokyo Ishin Gakuin, Youdec, and Koyo Shobo, are set to be ¥70mn below forecast, while the decline in profits from Meiko Gijuku schools is expected to reduce profits by ¥30mn. Therefore, for the full fiscal year, results are expected to be around the same level as the initial forecasts.

The main reason for the increase in sales compared to in the previous fiscal year will be the contributions of K. Line, which was made a subsidiary, and of KMG, which was added to the scope of consolidation from the current Q3. K. Line will increase sales by around ¥800mn to ¥900mn and KMG by approximately ¥400mn to ¥500mn. Also, at FISCO we think that at the operating income stage, both K. Line and KMG will have a slightly negative effect due to the recording of the amortization of goodwill. Therefore, the main factors behind the higher profits compared to in the previous fiscal year will be the reduction in sales promotion expenses, and also that other expenses will be kept down.

FY8/19 outlook (consolidated)

(¥mn)

	FY8/18			FY8/19		
	Results	% of sales	YoY	Forecast	% of sales	YoY
Net sales	19,116	-	-1.4%	20,320	-	6.3%
Cost of sales	13,020	68.1%	2.5%	14,080	69.3%	8.1%
SG&A expenses	4,654	24.3%	14.3%	4,380	21.6%	-5.9%
Operating income	1,441	7.5%	-44.9%	1,860	9.2%	29.0%
Ordinary income	1,558	8.2%	-44.5%	1,940	9.5%	24.5%
Net income attributable to owners of the parent	657	3.4%	-67.8%	1,020	5.0%	55.2%
EPS (¥)	24.74			38.41		

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

K.M.G. Corporation's business results and financial condition

(¥mn)

	FY6/16	FY6/17	FY6/18
Net sales	1,251	1,178	1,041
Operating income	64	42	12
Ordinary income	61	41	11
Net income	43	28	-292
Total assets	516	527	200
Net assets	308	332	40

Source: Prepared by FISCO from the Company's materials

In the last few years, the Company has successively made subsidiaries of several leading Meiko Gijuku franchise operations companies, of MAXIS, K. Line, and then KMG. The aim of this was to further improve the competitiveness of the Meiko Gijuku chain as a whole by strengthening the collaborations with these companies. As a part of this series of efforts, from FY8/19, the President and Representative Director of MAXIS was newly made an executive officer of the Company, and he will supervise the Educational Affairs Headquarters. In a situation in which Meiko Gijuku as a whole is being forced to struggle, MAXIS has been highly evaluated for its management capabilities, including a track record of exceeding the Group averages for the number of students per school and sales per student. It also has an excellent reputation for its educational affairs and guidance capabilities, and the aim is to share its expertise with the Group as a whole. The Company is also working to quickly improving educational abilities, including by increasing the number of training sessions for the owners and heads of franchise operations schools in each region. Furthermore, the effects of introducing MEIKO Style Coaching, which was launched in all franchise operations schools from April 2019, can be expected to appear in the future.

Sales in the Meiko Gijuku business increased from franchise operations companies being made subsidiaries, while the Kids Schools and Japanese language schools businesses are expected to grow in the future

2. Outlook by business segment

In the outlook for sales by segment in FY8/19, in the Meiko Gijuku directly operated schools business, net sales are forecast to increase 10.6% YoY to ¥10,544mn; in the Meiko Gijuku franchised operations business, to decrease 0.7% to ¥5,205mn; and in the preparatory schools business and other businesses, to rise 5.2% to ¥4,570mn.

In the Meiko Gijuku business, since April 2019 a system has been in place to deploy MEIKO Style Coaching in all schools, including franchise operations schools. Going forward, the aim by the end of the current Q4 is to have caught-up the number of students to the same level as at the end of the same period in the previous fiscal year, while also strengthening student-recruitment activities. For the number of schools, the Company's policy is to continue with scrap & build, including closing unprofitable schools. So for the time being it plans to improve profitability per school by increasing the number of students per school and the sales unit price per student.

In the Meiko Gijuku directly operated schools business, as previously stated, sales will increase mainly because K. Line and KMG have been made subsidiaries. On the other hand, in the Meiko Gijuku franchise operations business, sales will decrease primarily due to the fall in royalty income from K. Line and KMG. But on excluding this factor, sales are expected to increase slightly in this business also. The point to pay attention to toward achieving the forecasts will be whether or not the Company can halt the downward trend in the number of students from Q3 onwards by introducing MEIKO Style Coaching into all schools. Therefore, it plans to invest in sales promotion expenses in the 2H for student recruitment, including for television commercials and Internet advertising.

In the other businesses, the Kids Schools and the Japanese language schools businesses are expected to grow. In particular, in April 2019, the Kids Schools business started managing 5 facilities as the total of subsidy- and consignment-type facilities, including from local governments and schools. It also opened Keikyu Kids Fun (Ota Ward, Tokyo), which is the first such franchise operations school for the Company. This franchise operations school was realized through a collaboration with Keikyu Kaihatsu Co., Ltd., which is a member of the Keikyu Corporation <9006> Group. The demand for nursery care and after school care is strong, so going forward also, it is forecast that growth will accelerate through the acquisition of these subsidy- and consignment-type projects and the development of franchise operations.

The outlook for the Japanese language schools business is also that the increases in sales and profits will continue against the backdrop of the rise in the number of overseas students in Japan. Up until recently, the 2 schools were able to accommodate 2,090 students, but the number of enrolled students reached approximately 90% of this number, so the schools relocated to new buildings (Waseda EDU in December 2017 and JCLI in October 2018), which increased the number of students they can accommodate to 2,360 students. In April 2019, the revised Immigration Control Act was enforced with the aim of expanding the scope of foreign workers that can be accepted in Japan. It is forecast that this will lead to a further increase in demand for Japanese language schools, and at FISCO, we think it is a significant opportunity for growth for the Company, which is a major provider of Japanese language schools in Japan.

In addition to the above, for the Waseda Academy Kobetsu Schools, at the current time there are no specific plans to increase facilities, but it is thought that the number of schools will increase by around 1 to 2 schools during FY8/19 through the development of franchise operations. There are also no plans to increase school facilities in the Soccer Schools business, and the outlook for the time being is that it will maintain its current condition.

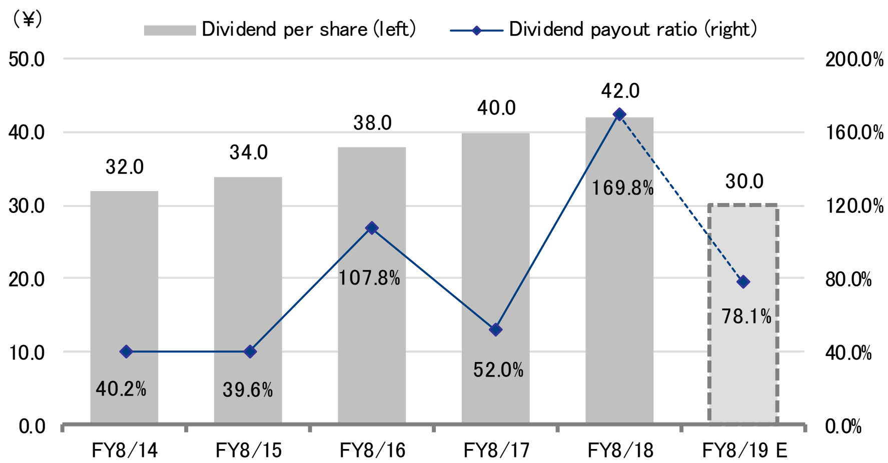
Moreover, as a new style of private tutorial school, the Company started Study Clubs from the spring of 2018, and it was managing 3 of these schools at the end of the current Q2. Their potential students range from elementary to high school students and one of the features of these clubs is that a single tutor can handle many students by utilizing EdTech. Students learn using tablet devices and digital teaching materials. It seems that their service content is being well received as a whole, and the Company is also considering developing franchise operations in the future.

Shareholder return policy

Although its record of increasing dividends will end for the time being, going forward it will continue the policy of actively returning profits to shareholders

Since it was listed on the JASDAQ market in April 1997, the Company has continuously increased its dividend. But for FY8/19, it has announced it will decrease the dividend for the first time, down ¥12 YoY to ¥30.0 (dividend payout ratio, 78.1%). Amidst the continuing severe earnings environment for its mainstay Meiko Gijuku business, the Company decided that temporarily diverting funds for the purpose of investment into rebuilding its growth base would better serve shareholder interests. However, as it has set a standard of 80% for the dividend payout ratio level, from FY8/20, if profits continue to trend upward, we can expect it to increase the dividend again.

Under the shareholder benefit program, the Company continues to give QUO cards worth ¥1,000-5,000 to shareholders as of the end of August, according to the number of shares they hold and the length of time that they have held them. Those holding 100 shares for less than three years will receive a ¥1,000 QUO card, while those holding the same number of shares continuously for three years will receive cards with a value of ¥3,000. The gross investment yield per share unit, including the shareholder benefit program, is at the 3-5% level at the current share price (¥1,094 as of April 19). The Company's capital policy is unchanged to strengthen its equity and to flexibly consider acquiring treasury stock when possible, taking into account the share price and financial position.



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

Shareholder benefit program

QUO card distribution (once annually, for shareholders as of August 31)		
Number of shares held	Value of gift cards for holding stock for less than three years	Value of gift cards for holding stock for three years or more
100–499 shares	Equivalent to ¥1,000	Equivalent to ¥3,000
500–999 shares	Equivalent to ¥2,000	Equivalent to ¥4,000
1,000 or more shares	Equivalent to ¥3,000	Equivalent to ¥5,000

Note: Shareholders became eligible for the program from August 31, 2016.
Source: Prepared by FISCO from Company materials

Information security policy

The Company manages tutorial schools and also concludes contracts with member companies based on its own franchise system, and it provides continuous school management guidance. In the school management process, it obtains personal information on students, parents and guardians, and tutors. It manages this personal information in accordance with its Regulations on the Protection of Personal Information. It also examines measures to prevent the leakage of information through the Risk Management Committee and verifies the operational status of measures to protect personal information.

Disclaimer