COMPANY RESEARCH AND ANALYSIS REPORT

MEIKO NETWORK JAPAN CO., LTD.

4668

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Index

Summary

Preparatory school with multiple brands and focusing on English education service and foreigner work and learning assistance services

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

1. Overview of FY8/19 results

The Company reported FY8/19 consolidated results with net sales rising 4.5% year-on-year (YoY) to ¥19,967mn and operating income growing 23.1% to ¥1,775mn. While it slightly missed guidance (¥20,320mn in net sales and ¥1,860mn in operating income) due to ongoing declines in the number of classrooms and students in mainstay Meiko Gijuku business (including franchises) and weakness at some consolidated subsidiaries, both sales and profits rose YoY for the first time in two years. Key factors contributing to the gains were conversion of the Meiko Gijuku franchise operating company to a consolidated subsidiary (adding ¥1,126mn YoY) and decline in sales promotion costs for the Meiko Gijuku business (providing a savings of ¥459mn) in profits. Although period-end levels dropped to 1,937 classrooms (down 4.5% YoY) and 113,081 students (down 2.8%) in the Meiko Gijuku business, progress in classroom scrap & build activities lifted the average number of students per classroom by 1.8% to 58.4 people, the first increase in four years.

2. Priority strategies in FY8/20

The Company has presented four priority strategies in FY8/20 of 1) strategic promotion of franchise business, 2) restructuring of the Meiko Gijuku business, 3) expansion and reinforcement of existing businesses, and 4) creation of new businesses. In strategic promotion of franchise business, it plans to pursue franchise business for Jiritsu Gakushu RED, a personalized preparatory school operated by peer SPRIX <7030>, and tyotto Juku, a private tutoring school that specializes in university exams operated by tyotto Inc., through business alliances. This strategy aims to accommodate a wide range of customer needs by promoting multiple preparatory school brands with different characteristics using the Company's franchise operational knowhow as a base. In Meiko Gijuku business, meanwhile, the Company has outlined a policy of continuing classroom scrap & build efforts again in FY8/20 and also raising class quality and service levels through use of ICT and other techniques and strengthening local marketing strategies with a goal of improving profitability by halting decline in student volume and increasing sales per student. In existing businesses, it plans to strengthen kids business and English learning business. In new businesses, it is launching online learning services for the Japanese language, business manners, and other areas geared toward companies hiring foreign workers.

3. FY8/20 outlook

The forecasts for the FY8/20 consolidated earnings calls for higher sales but lower profits, anticipating net sales to increase 5.2% to ¥21,000mn, and operating income to decrease 11.6% to ¥1,570mn. Breakdown of the planned sales increase includes ¥540mn from a full-year contribution by KMG Corporation (below, KMG), which the Company acquired as a subsidiary in 3Q FY8/19, ¥450mn in parent sales (Meiko Gijuku business at ¥200mn, kids business at ¥120mn, Waseda Academy Kobetsu schools at ¥60mn, etc.), and other subsidiaries at ¥40mn. In operating income, meanwhile, the Company expects a ¥200mn profit boost from higher sale, but setbacks of ¥400mn in strategic investment costs (information and ICT content development costs in Meiko Gijuku business at ¥150mn, investments in English business at ¥150mn, and business development costs in new preparatory schools at ¥100mn). Management wants to solidify the Company's growth foundation through strategic investments and then steadily deliver growth from FY8/21.

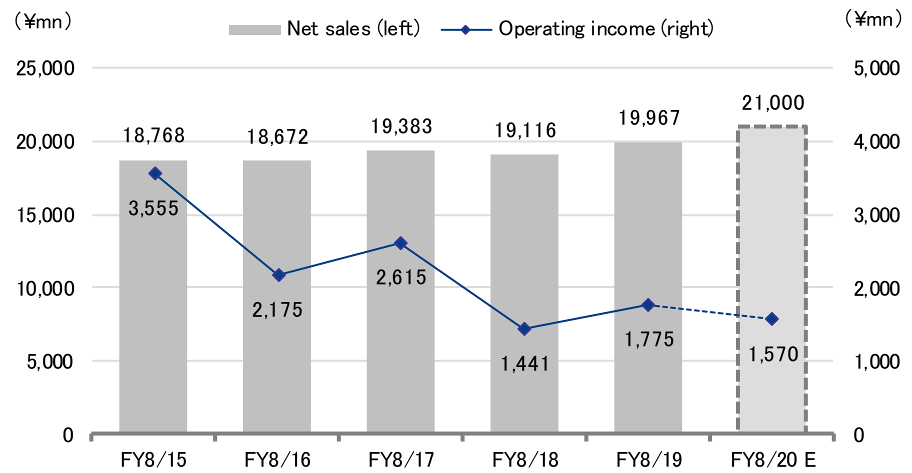
4. Shareholder return policy

There has been no change to the Company's policy of actively returning profits to shareholders. The FY8/20 dividend per share will be ¥30 (dividend payout ratio, 94.8%), maintained the same level YoY. Going forward, the Company sets 80% as the target standard for the dividend payout ratio. 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 4-6% level at the current share price (¥947 as of October 25, 2019).

Key Points

- Sales and profits rose in FY8/19 for the first time in 2 fiscal years from the effects of M&A and the reduction in sales promotion cost
- Expanding the line-up of educational services through aggressive business alliances and building a growth foundation
- Plans to continue robust implementation of shareholder return

Results trends



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

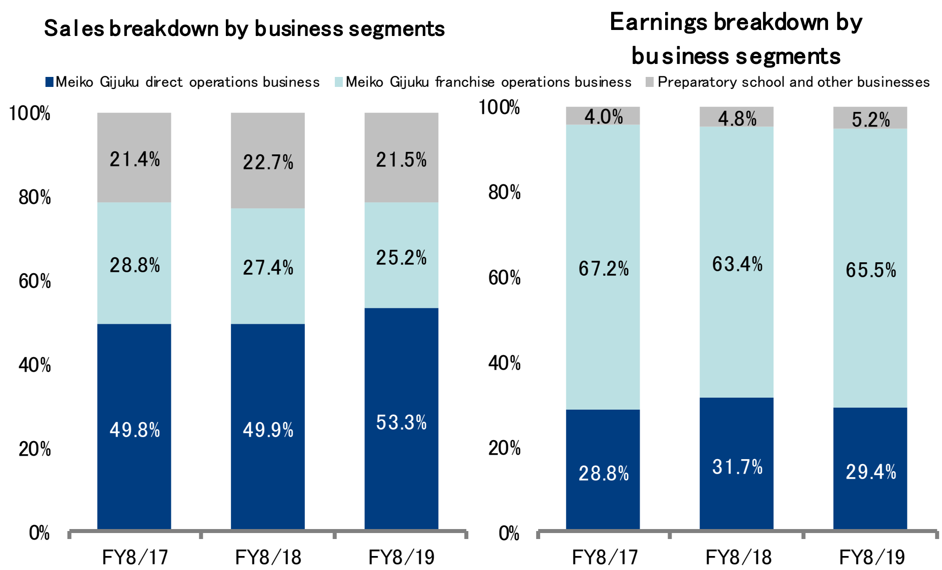
Business overview

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 (direct and franchise 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, preparatory schools that specialize in the medical university field, and Waseda EDU Japanese language schools and JCLI Japanese language schools as schools that cater to overseas students learning Japanese. Other businesses include subsidiary Kotoh Jimusho Co., Ltd., which operates support businesses for university entrance exam and pre-university education; 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.

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; 25.0% stake), which operates the Meiko Gijuku business in Taiwan.

The Company's breakdown by business segments shows Meiko Gijuku business (including direct-operation schools and franchise schools) as the main business at roughly 80% of sales and just over 90% of profits, including Meiko Gijuku franchise business at just over 60% of overall profits.



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

Business performance

Sales and profits rose in FY8/19 for the first time in 2 fiscal years from the effects of M&A and the reduction in sales promotion cost

1. Overview of FY8/19 results

The Company posted FY8/19 consolidated results with ¥19,967mn in net sales (up 4.5% YoY), ¥1,775mn in operating income (up 23.1%), ¥1,907mn in ordinary income (up 22.4%), and ¥958mn in net income attributable to owners of the parent (up 45.8%). The results are slightly below the Company's forecasts but both sales and profits increased for the first time in two fiscal years.

Consolidated FY8/19 results

(¥mn)

	FY8/18		FY8/19				
	Results	% of sales	Forecast	Results	% of sales	YoY	vs. forecast
Net sales	19,116	-	20,320	19,967	-	4.5%	-1.7%
Cost of sales	13,020	68.1%	14,080	13,744	68.8%	5.6%	-2.4%
SG&A expenses	4,654	24.3%	4,380	4,447	22.3%	-4.4%	1.5%
Operating income	1,441	7.5%	1,860	1,775	8.9%	23.1%	-4.6%
Ordinary income	1,558	8.2%	1,940	1,907	9.6%	22.4%	-1.7%
Net income attributable to owners of the parent	657	3.4%	1,020	958	4.8%	45.8%	-6.1%
Number of students enrolled at Meiko Gijuku schools, number of schools, total system-wide sales (direct and franchise operations)							
Number of schools (end of August)	2,029			1,937		-4.5%	
Number of students (end of August)	116,374			113,081		-2.8%	
Number of students per school (end of August)	57.4			58.4		1.8%	
Total system-wide sales	41,637			40,410		-2.9%	

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

The Company received sales boosts from its consolidation of K.Line Co., Ltd., the Meiko Gijuku franchise operating company, in 4Q FY8/18 and KMG in 3Q FY8/19 of ¥844mn and ¥414mn respectively, offsetting sales declines in parent business and at other consolidated subsidiaries. The unit cost ratio climbed by 0.7ppt YoY to 68.8% mainly due to increases in personnel costs and rents related to acquisitions of K.Line and KMG as subsidiaries. The SG&A expenses ratio, meanwhile, dropped 2.1ppt to 22.3%. Main changes were increases of ¥160mn (¥63mn in advertising and promotional costs, ¥57mn in goodwill amortization costs, and ¥40mn in rents) accompanying acquisition of K.Line and KMG as subsidiaries and ¥52mn in paid fees and a decline of ¥459mn in sales promotion costs from ¥1,597mn in the previous year to ¥1,138mn. The Company spent more than usual on sales promotion costs related to a branding renewal in FY8/18 and return to the level in a typical year in FY8/19 contributed to higher operating income.

Shortfalls versus guidance were lower numbers of classrooms and students in the Meiko Gijuku business and weaker results at some subsidiaries, such as Youdec and Tokyo Ishin Gakuin. In Meiko Gijuku business, the number of classrooms (direct-operation and franchise) dropped by 4.5% YoY to 1,937 schools and the number of students was down 2.8% to 113,081 students at period-end, the fourth straight year of declines. System-wide sales fell 2.9% to ¥40,410mn, the seventh straight annual decline. New openings, additions, and re-openings only totaled 10 classrooms (a decline of four classrooms YoY), while closures, suspensions, and terminations reached 102 classrooms (an increase of 43 classrooms). Progress in closures and other revisions of unprofitable classrooms supported the first rise in average student volume per classroom at period-end in four years with an increase of 1.0 students. Even though middle school and high school student volumes continued to move lower, the number of elementary school students increased in a second straight year.

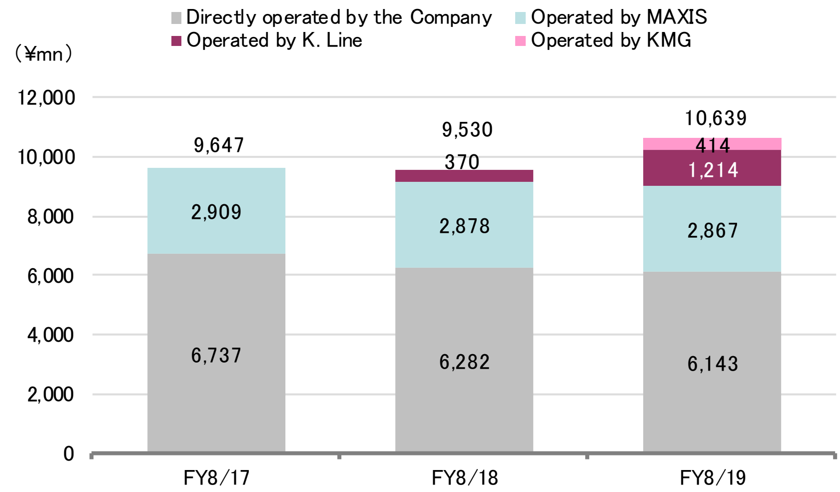
Ongoing classroom and student decline in Meiko Gijuku business, but average number of students per classroom switched to an increase at period-end

2. Segment trends

(1) Meiko Gijuku direct operations business

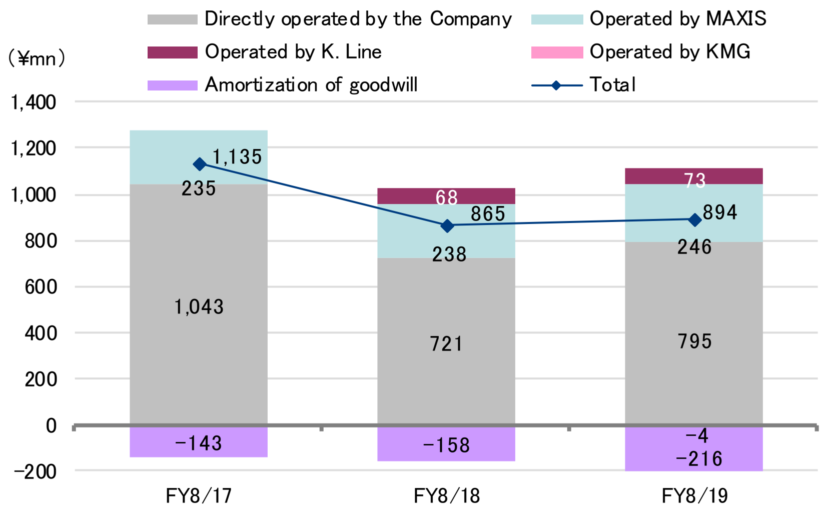
Meiko Gijuku direct-operation business posted sales and profit gains for the first time in four years with an 11.6% YoY rise in sales to ¥10,639mn and a 3.4% increase in segment profit to ¥894mn. By company, the Company's direct-operation sales fell 2.2% to ¥6,143mn while operating income climbed 10.3% to ¥795mn, and subsidiary MAXIS Education Co. Ltd. (below, MAXIS) reported a slight decline in sales of 0.4% to ¥2,867mn and a 3.4% increase in operating income to ¥246mn. K.Line, which was added as a consolidated subsidiary in 4Q FY8/18, booked ¥1,214mn in sales and ¥73mn in operating profit, and KMG, which was added in 3Q FY8/19, provided ¥414mn in sales and a ¥4mn operating loss. K.Line and KMG consolidation lifted sales. In profits, while goodwill amortization costs rose by ¥58mn YoY, the Company benefited from a ¥62mn decline in sales promotion costs and rise in sales per student in direct-operation business.

Net sales in the Meiko Gijuku direct operations business



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

Segment income in Meiko Gijuku direct operations business



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

Number of directly operated schools and enrolled students

	Directly operated by the Company			Operated by MAXIS			Operated by K. Line			Operated by KMG
	FY8/18	FY8/19	Change	FY8/18	FY8/19	Change	FY8/18	FY8/19	Change	FY8/19 3Q-4Q FY8/18 4Q
Number of schools (end of August)	233	221	-5.2%	93	92	-1.1%	42	41	-2.4%	43
Number of enrolled students (students)	15,974	15,281	-4.3%	6,438	6,482	0.7%	2,680	2,689	-	2,143
Average number of students per school (students)	68.6	67.4	-1.7%	68.3	69.8	2.2%	63.8	64.5	-	49.8
Sales per student (¥1,000)	393.3	402.0	2.2%	447.2	442.4	-1.1%	138.0	451.6	-	193.4

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

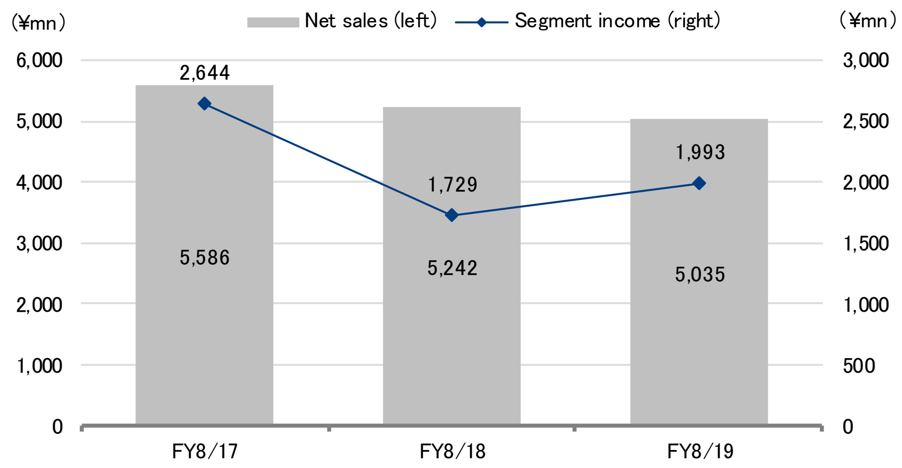
As a result of scrap & build activities, the Company's direct-operation schools fell by 12 classrooms YoY to 221 classrooms at period-end and average student volume declined 4.3% to 15,281 students and the average number of students per classroom was down 1.7% to 67.4 students during the period. In contrast to continuing declines in these levels, average revenue per student rose 2.2% to ¥402,000, the first increase in eight years. Main sources of the higher average price were tuition revisions in spring 2019, increase in the number of students taking summer courses due to a change in the program, and a rise in students in the English program utilizing ICT, such as Meiko Mirai English for elementary students and Meiko Middle School Listening for middle school students. Additionally, the number of students at period-end fell at a slower pace than previously of 2.3% YoY and the average number of students per classroom climbed 3.0%, the first increase in four years. In quarterly results, 4Q FY8/19 (Jun-Aug) posted gains of 2.0% in sales and 16.1% in operating income.

MAXIS had 92 classrooms at period-end, a decline of one classroom YoY, and an average of 6,482 students (up 0.7%), 69.8 students as the average number of students per classroom (up 2.2%), and ¥442,400 in average revenue per student (down 1.1%) during the period. It also reported a 4.1% YoY increase in the number of students and a 5.2% rise in the average number of students per classroom at period-end. Business indicators are generally improving. MAXIS booked higher sales and profits in 4Q FY8/19 with gains of 3.1% YoY in sales and 9.7% in operating income.

(2) Meiko Gijuku franchise operations business

Meiko Gijuku franchise business reported ¥5,035mn in sales (down3.9% YoY) and ¥1,993mn in segment profit (up15.3%). Due to conversion of KMG to a subsidiary (transfer to direct-operation business) and existing classroom closures and suspensions, this business had declines at period-end of 121 classrooms to 1,540 classrooms, down 9.4% in the average number of students during the period to 87,387 students, and down 3.4% in the average number of students per classroom to 54.4 students. Even though sales dropped in an eighth straight year, segment profit restored an increase for the first time in two years thanks to a ¥339mn decline in sales promotion costs.

Meiko Gijuku franchise operations business



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

Numbers of franchise schools and enrolled students

	FY8/18	FY8/19	Change
Number of schools (end of August)	1,661	1,540	-7.3%
Average number of enrolled students (students)	96,456	87,387	-9.4%
Average number of students per school (students)	56.3	54.4	-3.4%
Royalty sales (¥mn)	3,317	3,069	-7.5%
Royalty sales per school (¥1,000)	1,935.6	1,911.5	-1.2%

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

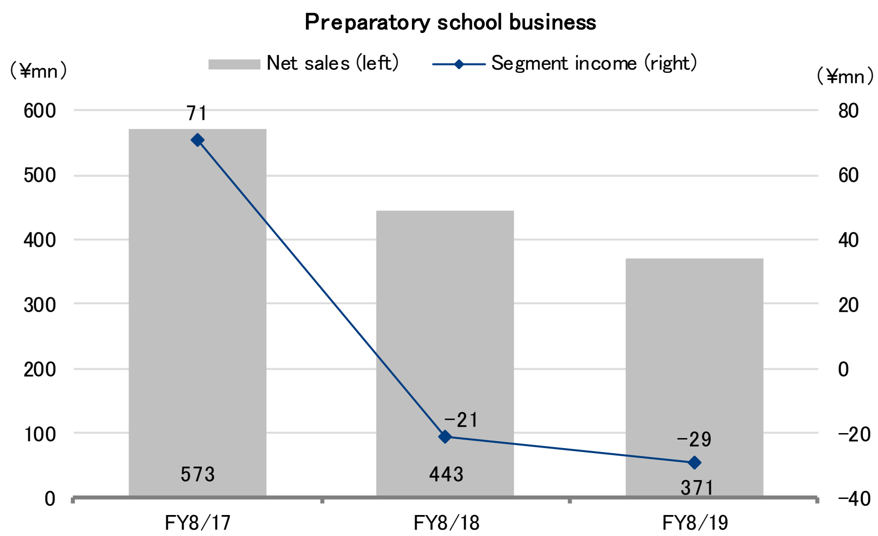
In the sales change breakdown, royalty revenue was down by ¥247mn due to decline in student volume, franchise advertising sales fell by ¥136mn, franchise educational material sales (mainly the English program and other ICT-based learning services) climbed by ¥103mn, and contract value improved by ¥67mn on increase in franchise member volume. Franchise member volume change largely reflected a shift to younger owners, including cases of classroom managers going independent and business succession from an existing franchise owner due to aging.

While Meiko franchise business had been trapped in an adverse spiral as tougher competition in the private tutoring school market led to steady decline in the average number of students per classroom and this trend undercut the investment appetite of FC owners and thereby contributed to downturn in the numbers of classrooms and students, it recovered to an increase in the average number of students per classroom at end-FY8/19 for the first time in nine years with a gain of 0.7 students. We think the main improvement was progress in closing unprofitable schools, though it also reflects positive effect from reinforcement of initiatives in various training and seminars for franchise owners, classroom managers, and teachers aimed at raising service quality. Additionally, the Company rolled out MEIKO-Style Coaching, a tutoring method implemented at direct-operation classrooms for the purpose of providing differentiation from rivals, at franchise classrooms in spring 2019. While the effect of this rollout still needs time to materialize, the Company hopes to leverage concrete results in the form of improved student academic performance through continued use of MEIKO-Style Coaching to increase new student volume and curtail service suspension and departure rates.

* 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.

(3) Preparatory school business

In the preparatory school business, which is conducted by the consolidated subsidiary Tokyo Ishin Gakuin Co., Ltd., net sales decreased 16.2% YoY to ¥371mn and operating loss was ¥29mn (compared to operating loss of ¥21mn in the same period in the previous fiscal year). Competition to acquire students has been steadily intensifying for medical preparatory schools, and decline in the number of new entrants to the boarding course (graduates) again in spring 2019 continued to weaken earnings. The number of students at period-end dropped by 11.5% YoY to 69 students, or about half of the 153 students at the recent peak at end-FY8/15.

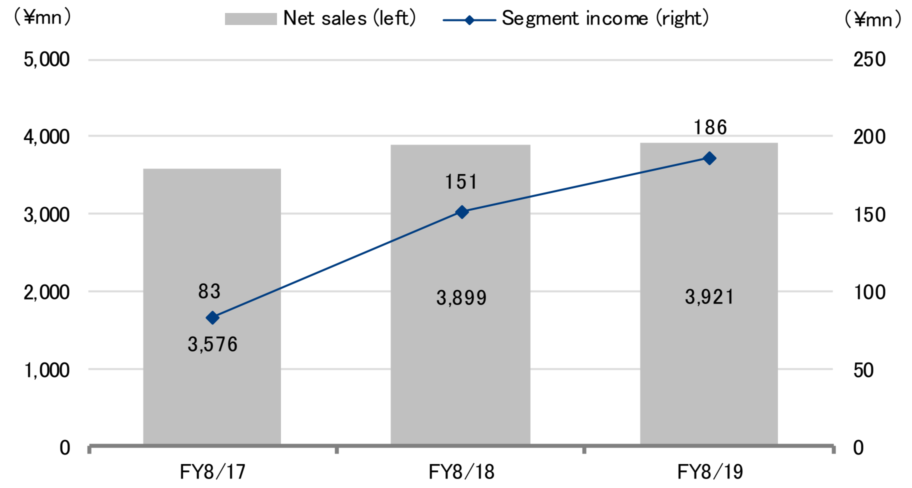


Source: Prepared by FISCO from the Company's financial results

(4) Other businesses

Other businesses reported ¥3,921mn in sales (up 0.5% YoY) and ¥186mn in segment profit (up 22.8%), continuing expansion trends. With goodwill amortization costs for the Japanese school and Kotoh Jimusho at ¥243mn, profits prior to deduction of goodwill amortization costs climbed 8.6% to ¥430mn.

Other businesses



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

FY8/19 results breakdown in the other businesses segment

(¥mn)

	Net sales	YoY	Operating income	YoY	Note: Period-end figures, figures in parentheses are YoY increases/decreases
Japanese language schools	1,361	3.3%	82	57.7%	No. of students 1,782, (-35)
School-support and academic publishing businesses	1,387	-7.7%	61	-67.6%	Sales and profits rose for Kotoh Jimusho as planned, while declining at Youdec and Koyo Shobo Corporation
Waseda Academy Kobetsu schools	532	5.9%	17	Restored profitability	No. of schools 35 (±0), No. of students 3,120 (+281)
Kids schools	390	30.9%	23	666.7%	No. of schools and consignment operations 25 (+6), No. of students 1,144 (+142)
Soccer schools	141	-0.2%	9	28.6%	No. of schools 14 (+1), No. of students 870 (+27)
Other	108	-20.4%	-7	Narrowed losses	ESL club (English schools), overseas businesses, study clubs, etc.
Total	3,921	0.5%	186	22.8%	

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

Looking at trends in the main business, Waseda Academy Kobetsu schols booked ¥532mn in sales (up 5.9% YoY) and ¥17mn in operating income (vs. an ¥11mn operating loss in the previous fiscal year). While the number of schools at period-end was flat YoY at 35 schools (eight direct operation, five MAXIS direct operation, nine franchise, and 13 Waseda Academy direct operation), the number of students expanded at a healthy 9.9% YoY pace to 3,120 students and both sales and profits increased.

Kids business performed well, thanks to increase in after-school childcare demand, with gains to ¥390mn in sales (up 30.9% YoY) and ¥23mn in operating income (up 666.7%). Main drivers of robust growth were higher student volume at direct-operation schools and promotion of operating formats that facilitate quicker income, such as franchise members, private operation of public sites, and consigned operation. This business had 25 schools at period-end (seven direct operation, three children's clubs, and 15 franchise and consigned operation), an increase of six schools YoY (two children's clubs and four franchise and consigned operation), and the number of students rose by 14.2% to 1,144 students.

Soccer business posted ¥141mn in sales (down 0.2% YoY) and ¥9mn in operating income (up 28.6%). The number of period-end schools rose by one school to 14 schools, and the number of students increased 3.2% to 870 students, the first gain in four years. We think main factors driving student volume upward were revision of the school format from FY8/18 to two types with Meiko Soccer Academy (provides full-fledged training with the aim of becoming a professional athlete in the future) and Meiko Soccer School (provides practical skills that boost soccer capabilities and enjoyment of the game) and introduction of an overseas camp (Spain) as a summer event to promote a rise in student membership.

The Company operates two brands for the foreigner Japanese language school business run by consolidated subsidiaries – Waseda EDU Co., Ltd.'s Waseda EDU Japanese Language School and Kokusai Jinzai Kaihatsu Co., Ltd.'s JCLI Japanese Language School. These two brands reported total sales of ¥1,361mn (up 3.3% YoY) and ¥82mn in operating income (up 57.7%). Operating income prior to goodwill amortization costs (¥169mn) rose 13.5% YoY to ¥252mn. This is a high-margin business with profitability at about 18%. The number of students at period-end fell slightly by 1.9% to 1,782 students. While Waseda EDU Japanese Language School achieved healthy growth with a 1.6% increase to 697 students, JCLI Japanese Language School's 4.1% dip to 1,085 students weighed on overall student volume. Stricter immigration reviews for people coming from Myanmar and Sri Lanka undercut the number of students joining the school in the July semester. JCLI Japanese Language School hopes to revive student volume by broadening student recruitment efforts to China and other countries. Capacity levels are 710 students at Waseda EDU Japanese Language School and 1,380 students at JCLI Japanese Language School.

The school assistance and publishing business consists of consolidated subsidiaries Kotoh Jimusho, Youdec, and Koyo Shobo and booked ¥1,387mn in sales (down 7.7%) and ¥61mn in operating income (down 67.6%). While Kotoh Jimusho fared well in its mainstay university entrance exam problem solutions business and sales rose 2.6% YoY to ¥531mn, as planned, weakness at Youdec with sales down 14.6% to ¥540mn due to decline in university sample test services and Koyo Shobo with sales off 10.5% to ¥315mn because of a drop in new publication issuance volume resulted in both sales and profit declines in this business.

Other businesses include ESL club (one school), a private-lesson English school, and Study Club (three schools), a private tutoring preparatory school that utilizes ICT, and overseas business.

* ESL club is a private-lesson English school (up to two students per bilingual teacher) and provides high-level education service to elementary students seeking to pass the Eiken Level 2 test. MAXIS transferred the operating company to Meiko Network Japan.

While the financial condition continues to be strong, recovering profitability is an issue

3. Financial position and management indicators

Looking at financial conditions at end-FY8/19, gross assets expanded by ¥1,081mn YoY to ¥19,765mn. Main changes were a ¥987mn increase in cash and deposits under current assets and a ¥204mn decline in goodwill versus increases of ¥350mn in investment securities, ¥80mn in software and the software provisional account, ¥86mn in tangible fixed assets, and ¥40mn in deposits and guarantees. Goodwill outstanding value totaled ¥3,046mn (MAXIS at ¥719mn, K.Line at ¥520mn, KMG at ¥242mn, Waseda EDU at ¥378mn, Kokusai Jinzai Kaihatsu at ¥834mn, and KOTO & Company at ¥351mn).

Total liabilities increased by ¥1,003mn YoY to ¥5,350mn. This included increases of ¥408mn in unpaid corporate taxes, ¥110mn in unpaid consumption tax, ¥191mn in unpaid costs, and ¥100mn in advance payments under current liabilities and ¥64mn in long-term loans under fixed liabilities. Net assets climbed by ¥77mn YoY to ¥14,414mn, mainly due to a ¥92mn increase in other securities valuation income.

In business indicators, although the capital ratio dropped from 76.6% to 72.9% at period-end due to a rise in liabilities, it remains at a high level. The Company also operates at effectively no debt with a 1.4% interest-bearing debt ratio and has a robust just over ¥7bn in net cash. We think it is sustaining healthy financial standing. Revitalizing the Meiko Gijuku business, which has been steadily contracting, is an issue. Nevertheless, restoration of YoY increase in the number of students per classroom at period-end and other bright signs have started emerging, thanks to cutbacks in unprofitable classrooms through scrap & build activities, rollout of MEIKO-Style Coaching at all classrooms, and expanded use of ICT learning content describe above, and are raising expectations of a recovery.

Consolidated balance sheet and management indicators

(¥mn)

	FY8/15	FY8/16	FY8/17	FY8/18	FY8/19	Change
Current assets	9,828	6,865	10,431	8,959	9,734	774
(Cash and deposits)	7,345	4,633	7,822	6,508	7,495	987
Non-current assets	8,852	10,105	8,883	9,723	10,030	306
Total assets	18,680	16,970	19,314	18,683	19,765	1,081
Current liabilities	3,357	3,059	4,168	3,563	4,506	943
Non-current liabilities	694	701	729	782	843	60
Total liabilities	4,052	3,760	4,897	4,346	5,350	1,003
(Interest-bearing debt)	96	82	70	70	197	127
Net assets	14,628	13,209	14,416	14,336	14,414	77
Management indicators						
(Stability)						
Equity ratio	78.0%	77.4%	74.5%	76.6%	72.9%	-3.7pt
Interest-bearing debt ratio	0.7%	0.6%	0.5%	0.5%	1.4%	0.9pt
(Profitability)						
ROE	17.1%	6.8%	14.8%	4.6%	6.7%	2.1pt
Operating income margin	18.9%	11.7%	13.5%	7.5%	8.9%	1.4pt

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

Business outlook

Expanding the educational service line-up through aggressive arrangement of business alliances and building a growth foundation

1. Priority strategies in FY8/20

The Company has presented four priority strategies as its business policy in FY8/20 of 1) strategic promotion of franchise business, 2) restructuring of Meiko Gijuku business, 3) expansion and reinforcement of existing businesses, and 4) creation of new businesses. Management sees this as a period to solidify its base for building a growth foundation.

(1) Strategic promotion of franchise business

This strategy aims to accommodate a wide range of customer needs by concluding business alliances with peers offering educational services with different characteristics and promoting franchise businesses in multiple preparatory school brands by utilizing the Company's strength of franchise operational knowhow as a base amid continued intensification of competition in the preparatory school industry. In franchise business through alliances with other firms, the Company already formed a capital and business alliance with Waseda Academy <4718> in 2010 and rolled out Waseda Academy Kobetsu as a private tutoring preparatory school for elite schools and announced, and this time it announced business alliances with SPRIX and tyotto (press release issued on October 10, 2019). Management intends to steadily promote franchise business.

a) Business alliance with SPRIX

SPRIX operates Mori Juku, a private tutoring school, and Jiritsu Gakushu RED, a personalized preparatory school that utilizes IT. The new business alliance calls for mutual promotion of Jiritsu Gakushu RED and development and provision of educational materials and IT content. Jiritsu Gakushu RED is a preparatory school that utilizes IT content and does not rely on teachers. It has developed a network of 83 classrooms nationwide through October 2019 since it launched franchise operations in 2014. This school's main characteristic is low-cost provision of services that meet needs for periodic test preparation by fourth year elementary to third year middle school students.

Provision of self-learning classes that utilize IT allows for schools in areas that could not support schools up to now due to teacher shortages by keeping the number of teachers as low as possible.

b) Business alliance with tyotto

tyotto is a start-up company established in 2016 that operates the "tyotto Juku," a private tutoring school that provides specialized coaching for university exams (one classroom in Kawasaki). This school aims to elicit appetite to learn independently and boost academic capabilities through direct guidance with coaching and utilization of the self-developed "tyotto folio" learning management app. It also periodically implements active-learning original educational content, ProgressTime and fosters a stance of tackling problems without answers and thinking and communication capabilities.

The business alliance calls for integration of the Company's private tutoring school operational knowhow and franchise development knowhow and tyotto's coaching knowhow, ICT content, and active learning content and direct and franchise rollout of "tyotto Juku" by the Company and joint development and provision of ICT content.

(2) Rebuilding the Meiko Gijuku business

As initiatives to revitalize the Meiko Gijuku business, the Company aims to improve student results through continued improvement of class quality and service level, just as in FY8/19, and pursue unique value and boost customer satisfaction with a consistent marketing strategy.

Key measures to enhance class quality and service level are promoting wider adoption of MEIKO-Style Coaching and development of ICT educational materials, pursuing improved and more efficient classroom operation by strengthening and bolstering the unique learning and management assistance system, and developing high value-added services that utilize accumulated customer data, such as “Meiko epo.” The Company needs to look more closely at support of franchise owners amid an overall trend of further advances in ICT usage.

As marketing strategy, meanwhile, the Company promotes Web advertising strategy that addresses local features and intends to strengthen contact center functions. The contact center seeks to increase new entrant students by quickly responding to inquiries submitted via the official web page and comparison sites and counseling set-up. The Company has newly started a contact center for franchise classrooms too. This initiative aims to improve service quality by lightening the work burden on classrooms and collecting inquiry content data and feeding it back to front-line classrooms.

(3) Expansion and reinforcement of existing businesses

In other existing businesses besides Meiko Gijuku, the Company hopes to expand kids business, which has already been growing at a strong pace of at least 20% a year, even more. It reached a total of 25 schools under operation through direct operation, franchise, consigned operation, and other formats as of October 2019. It is also scheduled to begin consignment operation of after-class schools at a number of new schools as soon as spring 2020 amid vibrant demand for after-school childcare and other after-class schools.

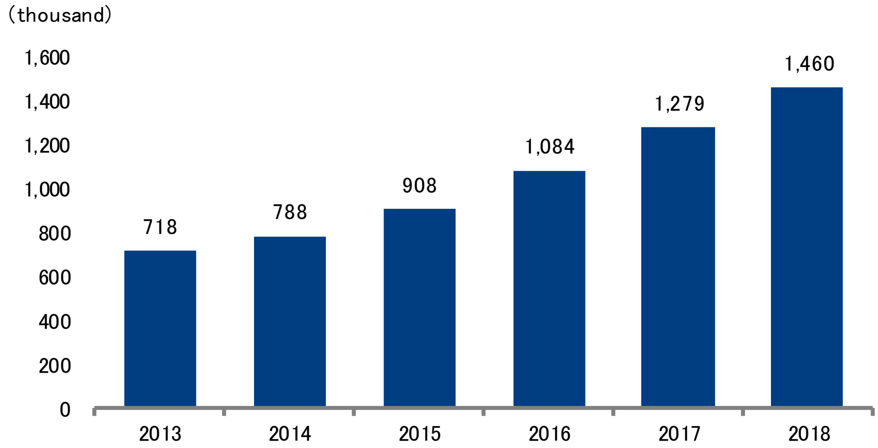
The Company also plans to roll out a new English education business with native and bilingual teachers for small children (three-year olds to kindergarteners) and elementary students under a new brand. It intends to open two direct-operation schools in Tokyo in April 2020 and subsequently develop franchise business after establishing the income model. It is looking to develop franchise operations for ESL club, a private tutoring school for elementary school students seeking to pass Eiken Level Two, in the English education business.

(4) Creation of new businesses

The Company is beginning a job and learning assistance business for foreigners as a new business. This initiative targets the anticipated further rise in foreign workers following the government’s introduction of “Specified Skilled Worker” as a new visa status covering 14 specialized industries, including care and construction, expected to confront severe manpower shortages in April 2019. The government envisions acceptance of about 350,000 foreign workers under “Specified Skilled Worker” status over the next five years.

* The new visa status for expanding acceptance of foreign workers has two types – Type 1 and Type 2. The stay period for a Type 1 visa is a total of five years. Type 2, which requires a higher level of skill, allows for unlimited renewal of the stay period and also permits joint entry with family members accepted for Type 1 and future application for permanent residence status. The 14 industries are care, building cleaning, forged parts manufacturing, industrial machinery manufacturing, electric and electronic information, construction, shipbuilding and marine business, automotive repairs, airlines, accommodations, farming, fishing, food and beverage manufacturing, and restaurants. The only Type 2 industries out of this group are construction and shipbuilding and marine business. Visa acquisition requires passing a Japanese language test and industry skill test. A person who completes a three-year skill-training course can transition to Type 1 without a test. The government plans to define Type 2 tests in FY3/22.

Number of foreigner workers in Japan



Source: Prepared by FISCO from the Ministry of Health, Labour and Welfare's "Past Trends in the Number of Business Sites Employing Foreigners and the Number of Foreign Workers"

Limited understanding of the Japanese language and Japanese culture has led to numerous cases of trouble amid increase in the number of foreigner workers in Japan. The Company started Japany service, an online learning service for Japanese and business manners aimed at addressing these issues in October 2019. It jointly developed this service with bond, Inc., which supplies online Japanese learning materials, and soeasy Co., Ltd., which provides training videos, and delivers it mainly to companies that employ foreigners and domestic and overseas Japanese language schools and educational institutions.

Key features of the Japany service are online provision of learning aids for not only Japanese language required in daily life and business but also a wide range of contents, including Japanese certification test strategies and specified skill test strategies, availability of learning management support, such as daily confirmation by a Japanese teacher of learning progress and online one-on-one services, and the ability for individual companies to add original training videos along with learning videos for basic business manners, Japanese culture, and other topics. Monthly charges begin at ¥1,500 per person. This is a low-cost way of efficiently educating employees compared to school-style services. We think this business deserves attention as a growth area because of significant latent demand.

By implementing these priority strategies, the Company aims to realize growth from FY8/21 as a group that provides a wide range of services from educating young children to job assistance for foreigners.

Positioning FY8/20 as an investment phase, expects profit decline on higher sales

2. FY8/20 outlook

The forecasts for the FY8/20 consolidated earnings calls for higher sales but lower profits, anticipating net sales to increase 5.2% to ¥21,000mn, operating income to decrease 11.6% to ¥1,570mn, ordinary income to fall 11.4% to ¥1,690mn, and net income attributable to owners of the parent to decline 12.3% to ¥840mn.

FY8/20 outlook (consolidated)

(¥mn)

	FY8/19		FY8/20		
	Results	% of sales	Forecast	% of sales	YoY
Net sales	19,967	-	21,000	-	5.2%
Cost of sales	13,744	68.8%	14,850	70.7%	8.0%
SG&A expenses	4,447	22.3%	4,580	21.8%	3.0%
Operating income	1,775	8.9%	1,570	7.5%	-11.6%
Ordinary income	1,907	9.6%	1,690	8.0%	-11.4%
Net income attributable to owners of the parent	958	4.8%	840	4.0%	-12.3%
EPS (¥)	36.08		31.63		

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

The breakdown of the ¥1.03bn YoY rise in sales includes ¥540mn from a full-year contribution by subsidiary KMG, ¥450mn in parent sales (Meiko Gijuku business at ¥200mn, kids business at ¥120mn, Waseda Academy Kobetsu schools at ¥60mn, etc.), and other subsidiaries at ¥40mn. In Meiko Gijuku business, the Company has outlined a policy of continuing classroom scrap & build efforts to improve profitability, despite ongoing declines in classroom and student volumes, by increasing sales per student and raising the average number of students per classroom. In kids business, the Company projects a 31% YoY rise in sales through increase in student volume at existing schools and acquisition of new consignment deals. In Waseda Academy Kobetsu schools, it expects an 11% rise in sales mainly on higher student volume at existing schools. Management thinks double-digit growth is possible in both areas. In other subsidiaries, Japanese language school business and Kotoh Jimusho are slated to deliver healthy growth. Despite the prospect of continued difficult conditions for the preparatory school business, which has been steadily slumping, in 1H FY8/20 due to decline in student volume, the Company aims to revitalize business activity by updating service content from spring 2020.

In operating income, meanwhile, the Company expects a ¥200mn profit boost from higher sale, but setbacks of ¥400mn in strategic investment costs for priority areas described above. Investments consists of information and ICT content development costs in Meiko Gijuku business at ¥150mn, investments in English-related business (English schools for preschool and younger children, ESL club) at ¥150mn, and business development costs in new preparatory schools at ¥100mn.

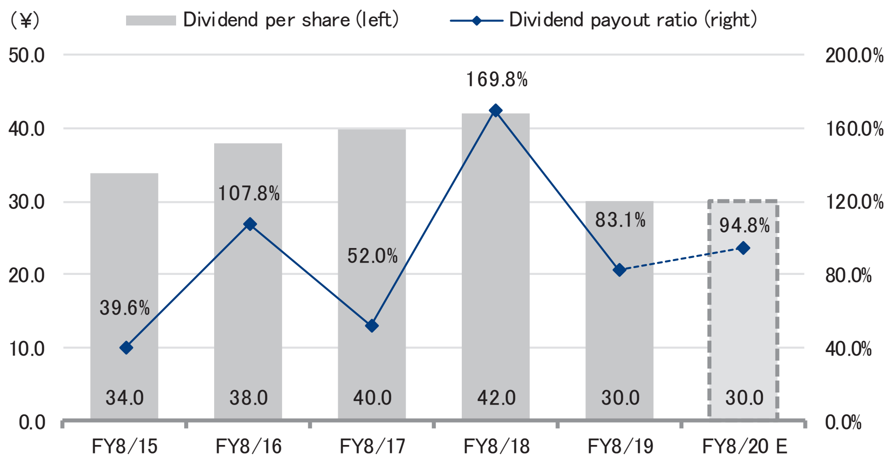
Shareholder return policy

Intends to continue robust shareholder return

The Company presented a policy of continuing robust shareholder return. In FY8/19, it lowered the dividend for the first time since listing its shares in 1997 due to a determination that continuing to pay a dividend exceeding period profit was not a good choice for shareholders due to importance of investing in future growth. In FY8/20, however, it intends to pay a flat dividend (YoY) of ¥30.0 (putting the dividend payout ratio at 94.8%). Management has set a target of 80% as the payout ratio and we see potential for a dividend hike if it seems that the payout ratio might drop below this level.

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 4-6% level at the current share price (¥947 as of October 25, 2019). 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.

Dividend per share and payout ratio



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.

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