

October 29, 2012

Dear clients and colleagues,

One of the investment themes in our portfolio is the aging global population. It is becoming a growing concern in many countries, and particularly obvious in Japan. About 30 million Japanese, 20% of the population, is over 65 years old. By 2020 the share will be 30%. The waiting list for special-care homes for the elderly is now reaching 420,000 people.

What could be an investment opportunity in such environment? This week we shall profile Message, a new addition in the portfolio this year.

Message (2400 JP - ¥276,000)

www.amille.jp

Business Overview

Message is Japan's largest operator of fee-paying senior homes, with 223 facilities and over 10,000 units. It offers two types of facilities: nursing homes and senior rental homes with optional care services. The nursing home segment is the main business pillar representing 81% of revenue, but the rental home business is the growth driver. The company is also expanding related businesses such as food services and day care.

History

The company was founded in 1997 and went public in 2004. In 2006 the government slowed down the opening of nursing homes due to budget constraints. A year later, Message started a new business - senior rental homes with onsite nursing care.

Management

Management is very experienced and stable. The founder/chairman Toshiaki Hashimoto holds 26.5% ownership.

Market Data

Market Cap \$691M, net debt/ebitda 1.9x, div yield 2.0%, p/e (2014/03) 12.8x, ev/sales (2014/03) 0.9x, ev/ebitda (2014/03) 6.6x, gross margin 29.4%, operating margin 15.2%, profit margin 8.7%, roe 16.7%.

Target Market

In Japan there are about 3,900 nursing homes, growing at +9% annually from 2008 to 2011. The number of senior rental homes is relatively smaller at 2,400 because it is a new concept, but grew 6x since 2008. The penetration of nursing homes in Japan is close to other developed countries. For example, 3.5% in Japan, vs. 2.5% Denmark, 3.7% UK, and 4.0% US. However, the penetration of senior rental homes is very low, only 0.9%, vs. 8.1% in Denmark, 8.0% in UK, and 2.2% in US.

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Competition

Message competes in both nursing home and senior rental home markets. The top nursing care providers are Nichii Gakkan and Benesse Style Care. Big care-service providers are Nippon Care Supply, Tsukui and Watami.

Competitive advantages

- #1 in the low-cost senior homes business: no upfront fee while competitors charge between 3 and 10 million yen.
- Industry-leading occupancy: 97% vs. industry average of 85%.
- Pioneer in senior rental homes: by far the #1 in terms of units, with the highest margin.
- Experienced care managers: Message's care managers have the highest average pay in the nursing care industry.

Growth strategy

- Distribution: to open 45 new rental homes per year.
- M&As: In 2012 it acquired Japan Care Service Group, the second largest player in home nursing services.

Risks

- Regulations: Reimbursement fees for senior care may decrease, although unlikely in the near term.
- Reputation: subject to accidents of care services.

Valuation

Target price = ¥495,600, using DCF model at growth rate of 10% for the next 5 years, 3% at maturity, and WACC of 9%.

Have a nice week.

The Global Alpha Team

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