3 June 2020

NICHIIGAKKAN CO.,LTD.
2-9 Kanda-Surugadai
Chiyoda-ku
Tokyo, Japan

To: The Board of Directors of NichiiGakkan Co. Ltd (the "Board") and the Special Committee advising the Board established on 10 March 2020 (the "Special Committee")

Dear Sirs,

We write to you on behalf of the funds that we advise or manage (together, "LIM Advisors" or "we"), which are shareholders of NichiiGakkan Co., Ltd. ("NichiiGakkan" or the "Company"). We are an investment firm based in Hong Kong that has been investing in Japan for over 20 years. Unless otherwise defined in this letter, terms have the meanings assigned in the Notice Regarding Implementation of Management Buyout and Recommendation to Tender Shares release by the Company on 8 May 2020[1] (the "Notice").

We note the tender offer bid for all the common stock of NichiiGakkan by K.K. BCJ-44 ("Tender Offeror") announced on 8 May 2020 at ¥1,500 per share (the "Tender Offer") as part of a management buyout of the Company.

We are positive about NichiiGakkan's business. It has the leading market position in medical-related services and strong positions in nursing and child-care services. The Company provides important social infrastructure meeting the needs of the Japanese population. We believe the long-term outlook for the business is very attractive and agree with the Company's assessment that "*further increases in demand in the nursing business and medical-related business markets as the birthrate declines and the population ages*[2]" are expected.

We are also very positive on Japan and Japanese stocks, especially after Prime Minister Abe introduced "Abenomics" including a stronger focus on corporate governance and shareholder returns. One of the pillars of corporate governance is METI's Fair M&A Guidelines[3] (the "Guidelines") which specially cover management buyouts ("MBO") in their scope. According to the Guidelines, "*the fair conduct of MBOs and acquisitions of a controlled company by the controlling shareholder is crucial for raising confidence in Japanese capital markets, both in Japan and abroad*." We are of the view that respect for the Guidelines by the board of directors of Japanese companies is a matter of national interest for Japan as well as good for the individual company and its shareholders.

Sadly, as a shareholder in the Company, we are concerned about the weak governance process surrounding the Board's approval and recommendation of the Tender Offer. We note the following:

- The Tender Offer price, recommended by the Board, is substantially below fair value which we estimate to be ¥2,400 per share, a 60% premium to the Tender Offer Price.
- The timing for the offer is opportunistic, coming so soon after the recent correction in the stock price during the ongoing Covid-19 crisis (despite limited impact on the Company's operations).
- Members of the founder's family, management and Bain Capital, all of whom are represented on the Board, are affiliated with the Tender Offeror thus creating significant potential or perceived conflicts of interest.

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[1] https://www nichiigakkan.co.jp/en/topics/assets/Notice%20Regarding%20Implementation%20of%20Management%20Buyout%20and%20Recommendation%20to%20Tender%20Shares.pdf

[2] Page 8 of the Notice

[3] Fair M&A Guidelines – Enhancing Corporate Value and Securing Shareholders' Interests issued on 28 June 2019 by Japan's Ministry of Economy, Trade and Industry ("METI")

- There are concerns on whether the review process conducted by the Board and Special Committee was fair to all shareholders. Some of the Board and Special Committee actions have fallen well short of what we believe was required to protect minority investors and certainly well below what we also believe to be best practice recommendations as per the Guidelines.
- The financing package includes ¥99bn of debt, which is more than the offer equity value and slightly below the offer enterprise value. If the founder's relatives roll part of their equity interests into the Tender Offeror, the Transaction may require little to no cash contribution by the buyer group illustrating the undervaluation of the offer.

Inherent Conflicts of Interest & Concerns over the Board Decision-Making Process

There are inherent conflicts of interest in the proposed management buyout given that **the buyer group includes the founder's relatives, the CEO and Bain Capital, all of whom are represented on the Board**. Additionally, there are four senior members of management who are directors on the Board that may have loyalty to the buyer group as well as an expectation or hope of a continued role in the business after its privatization. While conflicts of interest are inherent in many MBO's, it is particularly unusual that the financial sponsor should already have a board seat. The buyer group and senior management control eight out of ten board seats, with only two independent directors. While the buyer group, representing four board seats recused themselves from negotiations and deliberations regarding the Tender Offer by the Board, the four senior management members, who have all worked at the Company for over twenty years, continued in their roles on the Board. Given the foregoing, it was incumbent upon the Board and Special Committee to take very robust actions to ensure the fairness of the transaction and dispel doubts that the buyer group controls the board. Unfortunately, we have seen several areas of concern around the Board's decision-making process.

No "majority of minority" condition. The Guidelines indicate that it is preferable to have a "majority of minority" condition that would enable minority shareholders to confirm directly whether they are satisfied with the deal terms. We see no reason why the Board did not try to meet this condition. We have reviewed other MBO's announced since the Guidelines were published, and 8 out of 9 had "majority of minority" conditions thus it is clearly market practice and we see no reason for the lack of such a condition in your case. We wonder whether minority investors are receiving equal treatment as required under General Principle 1 of the Corporate Governance Code.

No "market check". The Guidelines indicate that it is preferable for the Board to undertake a "market check" as a price discovery mechanism to secure fairness. In this case, the Board has not sought an alternative bid primarily as Bain was considered to be a preferred partner for the MBO having been well known to the Company. Instead the Company has stated that the Tender Offer period is 31 days rather than the minimum 20 days which should act as an indirect market check as it secures an opportunity for a Counterbidder to emerge. However, in these unprecedented times with social distancing norms and a state of emergency which only ended on 25 May, it has been almost impossible for any Counterbidder to consider the transaction let alone conduct due diligence and negotiations with the Company.

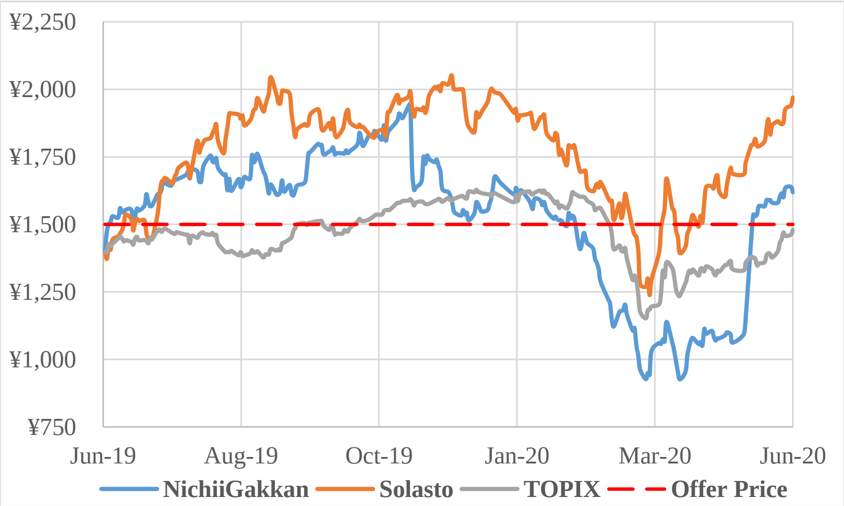
No separate advisors for the Special Committee. The Guidelines indicate that the Special Committee should have separate financial and legal advisors to the main Board. This was not the case in this situation. Nor is it clear whether the Special Committee had independent access to the Company's advisors nor if they had an option to retain their own advisors. This has left us concerned about whether the Special Committee was sufficiently empowered to fulfill its functions in the review of the Transaction. What we do know is that **Deloitte Tohmatsu Financial Advisory Godo Kaisha ("Deloitte") was retained by the Company as financial advisor and third-party valuation agent and that their fee includes a success fee component contingent upon consummation of the Transaction**. We think that this success fee arrangement compromises the financial advisor's neutrality as an independent advisor to a target company, and we have observed that it is common in recent MBO cases that third-party valuation agents advising target companies were retained on a fixed or a time-charge basis (not on a success fee basis) to secure neutrality or independence. As described further below, we believe that Deloitte's valuation work was weak and grossly undervalued the Company.

No fairness opinion. The Guidelines advise that it is preferable to have a fairness opinion on the reasonableness of a transaction from an independent advisor. Given the significant conflicts of interest in the transaction, the lack of market check and the lack of majority of minority condition, **the Board should have sought a more robust independent opinion on the valuation on a fixed-fee basis**.

Opportunistic Timing

The **Tender Offeror appears to be taking advantage of Covid-19 related weakness in the share price at the expense of minority investors**. Covid-19 is an extraordinary but temporary shock that should not impact the long term value of the Company. As noted by the Company "*even though the Japanese market is currently impacted by the outbreak of the novel coronavirus, at this point the impact is not thought to be serious to the extent of significantly harming the business value of the Company*[4]". Given the strong long-term outlook for the business, we do not believe that the recent correction is reflective of a change in corporate value of the business and it certainly is not a suitable base upon which to price an offer to privatize the Company. The share price graph below illustrates that the significant correction in share price since February also clearly coincided with the correction in the wider market and the Company's main listed peer – Solasto Corp.

One-Year Share Price Chart[5]- offer is well below recent trading levels



We are unclear why there was an urgency to push forward the deal in the current environment with a depressed share price. While financial performance in recent quarters was a little lower than expected, the business is profitable, growing and produces strong cash flow. Press reports[6] have suggested that management of inheritance tax may be a factor in the timing of the MBO. We note that the visionary founder, Former Chairman Terada, passed away on 28 September 2019[7] and understand that typically inheritance tax in Japan is due within 10 months of the ancestors' death which will be around July this year. We are concerned that the proposed MBO has been pushed forward at an opportunistically low price due to the founder's relatives' desire to monetize shares for payment of tax while retaining control over the business through reinvestment of part of the Tender Offer proceeds into the Tender Offeror.
The sequence of events as provided in the background[8] to the offer in the Notice raise some suspicions of an agenda to privatize the company at a low valuation. In November 2019 at the first quarterly results after the passing of Former Chairman Terada, full year guidance was unexpectedly revised down primarily due to rise in costs from facility expansion in the nursing segment. Discussions on an MBO

[4] Page 8 of the Notice
[5] Source Bloomberg. Solasto and TOPIX rebased to NichiiGakkan share price as of 2 June 2019
[6] Financial Times – Bain Capital makes $1bn bet on Japan's nursing homes, 9 May 2020 (https://www.ft.com/content/63b35e8b-b0c4-4652-9f1d-21dd7ca8a2e0)
[7] https://www.nichiigakkan.co.jp/topics/assets/48f3f5b76418449bb972e8ca29a3537d59604b21.pdf
[8] Background, Objectives and Decision-Making Process behind the Tender Offeror's Decision to Implement the Tender Offer - Notice

commenced soon after in December 2019 and Bain was approached shortly after in January this year. A formal proposal from Bain to the Company came on the same day as the state of emergency was announced in Japan. We are concerned that the Tender Offeror has timed the Tender Offer to pay a discounted price and taken advantage of its unique knowledge and influence in the Company.

Valuation Concerns

We believe that **the Tender Offer price is substantially below fair value which we estimate to be approximately ¥2,400 per share** (i.e. a 60% premium to the Tender Offer Price) based on a thorough analysis using a variety of commonly used valuation methodologies.

We believe that the third-party valuation agent, Deloitte, has grossly undervalued the business in their share valuation report. As stated earlier, we have concerns about the independence of Deloitte given that their fee includes a success fee contingent upon consummation of the MBO transaction. It is also unclear whether Deloitte's share valuation report considered the valuation of the company under the basis of full control.

Valuation – Market Analysis

We think that the high headline premium to the average closing share price for the one and three month periods prior to the offer announcement is referenced to a period highly affected by Covid-19, which drove down the stock price, and therefore masks the low valuation relative to recent trading history. We make the following observations:

- Offer price is below the ~¥1,600/share level when conversations regarding an MBO first began with Bain in early January 2020.
- The offer is also -22.5% below the one-year high of ¥1,911 on 12 November 2019.
- The offer price is below the share price level for the whole of the second half of 2019.
- The offer price is -0.8% below the simple average of the closing prices for the one year period prior to announcement of ¥1,512.
- Market analysis does not include any assumption for control premium

The Special Committee acknowledged the low premium (8.93%) of the Tender Offer price over the simple average closing price for the six-month period up to 7 May 2020 relative to premiums in recent MBO cases in Japan of approximately 39%[9]. This was explained as being due to the low share price in the three month period post the publication of the third quarter results on 7 February 2020 (the "Q3 Results"). It was added that the (low) "*market price of the Shares following the release of the Third Quarter Preliminary Financial Statements is believed to reflect the Company's current circumstances*[10]" and by implication the (higher) share price prior to 7 February 2020 was not a true reflection of the current value of the Company. In our view, this analysis was disingenuous and that the low share price post the Q3 Results was not due to a diminution of corporate value but rather a reflection of i) the market crash due to concerns around Covid-19 which began shortly after the Q3 Results; ii) temporary flows towards companies with stronger near-term earnings outlook during the market crash; iii) poor execution of business reforms and nursing growth plans; and iv) the lack of a clearly explained business strategy in the period since the revision of full year guidance in following the second quarter results announced on 12 November 2019.

We note that the simple average share price for the three month period post the Q3 Results up to the date prior to the Tender Offer announcement was -26% lower than the closing share price prior to the Q3 results. TOPIX was -15% lower on a like-for-like basis illustrating that Covid-19 effect was likely a much larger impact on the share price post Q3 results than a reflection of the "*current circumstances*" of the

[9] Premiums for MBO announced since July 2019. Transactions included are: Sogo Medical HD (5 February 2020), Odelic (4 February 2020), Miyako (4 February 2020), Jeguia (31 January 2020), Mamezou HD (30 January 2020), Fujikoh (1 November 2019), Mystar Engineering (8 November 2019)
[10] Page 18

business. We find it shocking that the Special Committee did not acknowledge the negative market impact of Covid-19 on the share price in recent months and take account of it by considering the average share price in the pre-Covid-19 period. Covid-19 is a large but temporary shock which has little expected impact upon the long term prospects of the Company. For most of 2019, the market was beginning to value the longer term corporate value of the Company following the commencement of long overdue reforms in January 2019 starting with the closure of part of the education business and China JV business and therefore is representative of the corporate value of the Company.

The one-year simple average of the daily closing price prior to the MBO announcement on 8 May would have been a better reference point upon which to consider appropriate pricing using a market analysis method. Based upon our review of recent MBO's since the publication of the Guidelines, the average premium to one-year average closing price was 42.2%. If we apply such a premium to NichiiGakkan, this implies a price of ¥2,151 per share.

Valuation – Comparable Company Analysis

The comparable company analysis valuation by Deloitte resulted in a very low valuation range. The valuation was based on multiples which are currently suppressed below their long term averages due to Covid-19 market impact. Additionally, Deloitte's selection of comparable companies does not, in our view, appropriately capture the true value of the Company as it is based on a sample of companies primarily in the nursing sector regardless of size, liquidity or market position. Three[11] out of the six comparables are nursing companies which are substantially smaller and are illiquid with little analyst coverage. Another comparable used is an education business[12] which has a very different model to NichiiGakkan's small education business. Therefore, four out of six of the comparables selected by Deloitte seems to be irrelevant and have artificially suppressed the comparable company valuation result. Deloitte's comparable valuation company implies EV / LTM EBITDA[13] of 6.1x - 7.2x, which is significantly below the multiple of its two closest peers – Solasto and Tsukui which were trading on 15.4x and 7.8x respectively on the calculation reference date[14] of the share valuation report prepared by Deloitte.

We believe a sum-of-the-parts ("SOTP") approach is a more appropriate method to value the Company as each of NichiiGakkan's business segments appears to be independent with no synergies created between them and most comparables are focused on a single segment. **We conducted a SOTP valuation with the key assumptions shown below, resulting in a valuation of ¥1,949/share**[15]:

- Valuation on a one-year forward EV/EBITDA basis[16] (EBITDA based upon management projection in the Notice)
- Solasto's multiple is used to value the medical segment. Solasto is the only listed peer focused on medical support (#2 player after NichiiGakkan) which also has a nursing business. While the nursing business is growing quickly, the medical services business still provides the bulk of earnings. Despite having a substantially smaller market share in both medical services and nursing segments than NichiiGakkan, Solasto trades at a substantial premium on account of better productivity and a clearly defined strategy. We applied a 15% discount to reflect the lower margins enjoyed by NichiiGakkan's medical business. (Arguably one could apply no discount or even a premium over Solasto's multiple given your larger market share and potential for margin expansion if you introduce obvious efficiencies.)
- Tsukui's multiple used to value the nursing segment. Tsukui has a nursing business which is comparable in size to NichiiGakkan's.

[11] St-Care Holding, Longlife Holding and Unimat Retirement Community
[12] Gakken Holdings
[13] We reference an LTM (last twelve months) multiple as we assume Deloitte's comparable company valuation was on an LTM basis as many of the comparable companies chose by Deloitte do not have consensus forecasts
[14] As of 7 May 2020 (calculation reference date in share valuation report from Deloitte)
[15] EBITDA and one-year forward EBITDA multiple for each segment are: Nursing: ¥12,900m and 8.4x, Medical: ¥6,946m and 13.8x, Child Care: ¥568m and 11.0x, and Other: -¥2,461m and 7.6x
[16] Multiple of comparable companies as of 2 June 2020

- JP-Holdings Inc. was used to value the child-care segment. JP-Holdings is the only pure listed child care business with comparable size. A 15% discount was applied on account of the lower margin of NichiiGakkan's child-care business.
- Other non-core businesses valued at NichiiGakkan's consensus multiple.
- The overall implied multiple is 10.7x one-year forward EV/EBITDA, still a substantial discount to closest listed peer Solasto which currently trades at 16.3x, leaving substantial room for the Tender Offeror to make reforms to close the valuation gap. **<u>We emphasize that the SOTP valuation does not include any control premium.</u>**

We also note that the Tender Offer Price values the Company at an EV/LTM EBITDA of 8.0x. This compares to 15.4x for Solasto, the closest listed peer to NichiiGakkan. We find it slightly perverse that the Tender Offer Price values the Company at a very large discount to Solasto, to such a degree that Solasto has a higher market capitalization and enterprise value despite Solasto having one third of the revenue, only ~25% market share in medical support compared to over 50% for the Company and a much smaller nursing business than the Company. There is obviously a lot of hidden value in the Company that can be unlocked by some easy-win strategies such as i) focusing on core segments of medical service, nursing and child-care; ii) ICT-led strategy to improve productivity and service quality; iii) M&A driven approach to increase market share in the fragmented nursing and child-care sectors; and iv) review of the staff-management practices to increase staff retention rate and quality. We believe that the Carlyle-led MBO and re-listing of Solasto provides a clear template for possible actions that the Company could undertake either as a private or public company to unlock value.

<u>*Valuation – Discounted Cash Flow Analysis ("DCF")*</u>

The DCF valuation prepared by Deloitte is based on very conservative three-year projections by senior management. Given the significant conflicts of interest already highlighted, we believe this is problematic. The projections appear too conservative as they seem to assume increased capital expenditure and operating expenditure but no obvious revenue benefit. The projections also took no account of the improvements in earnings that could be expected from post-privatisation reforms. Given that the purpose of the transaction is to facilitate restructuring of the business, we believe that management should have included this in the projections. In fact, one could argue that the Board has not properly disclosed adequate information to its shareholders if they have not included information about the value that will be generated by the improvements after privatization. Of course, if no value is being generated by the privatization, then there is no point in the privatization.

The Guidelines explicitly state that general shareholders should be able to enjoy i) all the value that can be realized by without executing the M&A transaction; and ii) a portion of the value that can only be realized by executing the M&A transaction. Therefore, it is clear that the Board and Deloitte should have considered the value that can be realized by executing the MBO.

Deloitte's DCF valuation was very low at ¥1,316 - ¥1,779 and in spite of that, the offer price of ¥1,500 is below the mid-way point of ¥1,548. We conducted our own base case DCF based on consensus forecasts, with no acceleration of long-term growth but assuming two key reforms; i) closure (or sale) of persistently loss-making non-core businesses at a one-time cost equivalent to half a year of revenue at the start of FYE 03/22; and ii) EBITDA margin expansion of 1.7% towards Solasto's level assuming productivity improvements following the MBO (the "Base Case"). Our DCF[17] result was ¥2,341 to ¥3,084 per share which is substantially in excess of Deloitte's figures. We believe that the Base Case projection is the minimum that any private equity firm should expect to achieve following a privatization. There would be material upside to this valuation if the business was able to accelerate growth, for example through market share gains driven by M&A. Given the success that Carlyle had with the MBO of Solasto (2012-2016), we believe that Bain should also be well placed to effectuate similar change at NichiiGakkan.

[17] WACC of 5.16% - 6.16% (estimated cost of capital post lease payments), lowering of corporate income tax rate to national level of 30.9% tax rate in three years, and perpetual growth rate of 0.25% - 0.75%

Valuation – Leveraged Buyout ("LBO")

We calculated the estimated LBO returns to the Tender Offeror implied by the offer price using the conservative management projections (which assume no improvement in margins or growth), a sale of the business at an exit multiple equal to historical three year average of 9.3x EV/LTM EBITDA multiple and the disclosed financing structure. The result was an IRR of 46% - 57%[18] over a 4-5 year period. We believe that this level of return is too high (frankly outrageous) for a scenario of no improvements to the business. The implied returns, should there be any business reforms resulting in higher margins and/or growth, would result in even more extraordinary returns for the Tender Offeror. We have no objections to private equity investors making a healthy return, but that should be a reward for making a meaningful contribution to a business, taking large risks and not at the expense of minority shareholders. We do not believe the MBO is very risky since the business is quite stable and strong (but can be improved) and the Carlyle privatization and re-listing of Solasto has created a template that can be easily followed.

While we do not think that the conservative management projections are an appropriate basis for valuation, if we were to assume a more reasonable return for Bain of ~20% IRR under this no turnaround scenario, it would imply an offer price of ¥1,850 per share, still a meaningful premium to the Tender Offer Price. A 20% IRR would be, in our view, very acceptable in the private equity world, but especially in Japan where the cost of capital is extremely low. We see no reason why Bain should earn an IRR of over 50% on this transaction. The offer price implied by our Base Case assuming an IRR of 22% implies an offer price ¥2,850 per share.

Financing Structure

The financing banks are so confident in the business that they have agreed to lend ¥99bn of debt, which is more than the offer equity value and slightly below the enterprise value[19]. **If the founders' relatives roll over only ~15% of their equity, the Tender Offeror could complete a buyout, including refinancing existing debt, with no cash investment.** This should be an embarrassing outcome for the Board and further highlights the undervaluation of the Company as reflected in the Offer Price. We believe that the Board should seek further clarity on the intentions of the founder's relatives and make the information public.

Recent Developments

The share price of the Company since the Tender Offer announcement has been above the Tender Offer Price with significant volume traded (~ 18% of the shares outstanding) indicating that the Tender Offer Price is undervaluing the Company. We also note that TOPIX has rallied by +9.7% since the announcement as Covid-19 concerns have begun to ease.

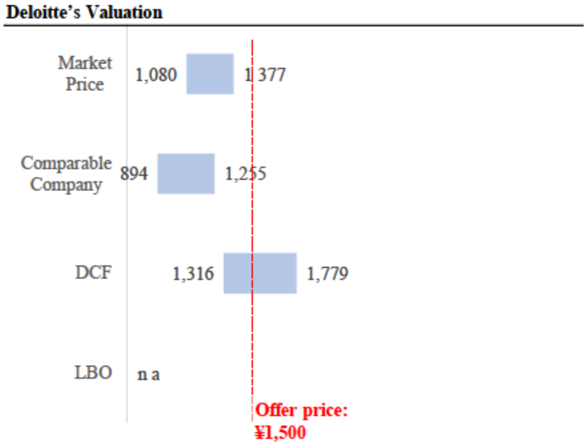
Valuation Summary

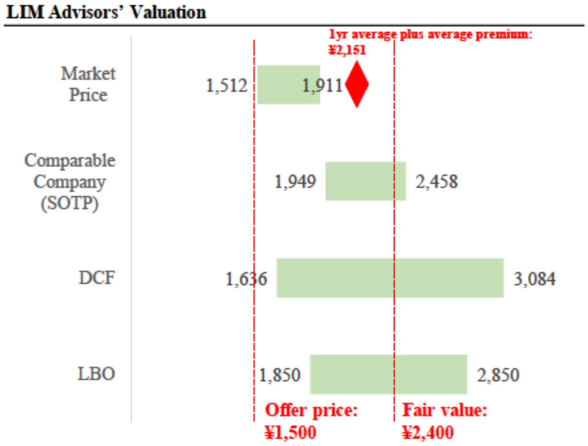
We present below a chart comparing the valuation by Deloitte[20] and our valuation based upon the methodologies described above. This chart clearly demonstrates that fair value is approximately ¥2,400 per share.

[18] Assuming no roll over from management, interest rate margin of 1.5% over TIBOR for term loans, ¥6,000m minimum cash,and ¥10,500m sponsor equity (¥27,000m sponsor equity from Bain is reduced by capital in excess of amount required to finance the transaction)

[19] Lease liabilities relating to property leases not included

[20] Source: the Notice





- DCF valuation, using our WACC estimate and based upon two projection cases:
    - Upper threshold: Base Case projections and 0.75% terminal growth rate;
    - Lower threshold: management case based projections as provided to Deloitte and 0.25% terminal growth rate.
- LBO valuation based on offer price sufficient to achieve target IRR for financial sponsor:
    - Upper threshold: Base Case projections, exit at blended exit EV/LTM EBITDA multiple of 11.3x[22] and 22% IRR for financial sponsor
    - Lower threshold: management projection case, exit at historical three years average EV/LTM EBITDA multiple of 9.3x and 20% IRR for financial sponsor.

Given the significant difference between our and Deloitte's valuation, we request that their share valuation report be published in full for public scrutiny.

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Conclusion

We believe that the Board recommendation of the Tender Offer is unsatisfactory and significant further explanation is required why further measures to ensure fairness were not taken or were deemed sufficient. We are concerned that the interests of the founders' relatives have been prioritized ahead of those of minority investors. We do not object to a management buyout of the Company, but believe minority investors should be paid fair compensation for the loss of opportunity to remain invested in a business with strong prospects. We believe a fair valuation for the business to be ¥2,400, or a 60% premium to the Tender Offer Price.

In order to secure a fair outcome for minority shareholders, we respectfully ask the Board to seek an extension to the Tender Offer and:

- Demand a change in the takeover condition to majority of the minority;

[21] Implied SOTP blended multiple of 10.7x one-year forward EV/EBITDA
[22] Blended multiple using Solasto, Tsukui and JP Holdings multiples weighted by segmental mix on EBITDA basis (assumes non-core business closed/sold)

- Allow the Special Committee to hire their own financial and legal advisors to provide advice and commission a fairness opinion;
- Review assumptions behind Deloitte's valuation, especially seek a review of management projections to take into account reasonable restructuring assumptions; and
- Negotiate a fairer offer price by Bain-led offer group.

We request a meeting with the Company within a week of the date of this letter to further discuss our views.

Yours sincerely,

LIM Advisors