

November 16, 2017

(Translation)

Dear Sir/Madam,

Company: JP-HOLDINGS, INC  
Representative: Kazuhiro Ogita,  
President and Representative Director  
(Stock Code: 2749, First Section of TSE)  
Contact: Mika Matsumiya,  
General Manager, Administration Division  
(Tel: +81 52 933 5419)

### **Comments on Reports Issued by Proxy Advisory Firms Glass Lewis and ISS**

As already informed in the convocation notice, JP-Holdings, Inc. (hereinafter referred to as the “Company”) will hold an extraordinary shareholders meeting (hereinafter referred to as the “Extraordinary Shareholders Meeting”) at 10 AM, November 22nd, 2017 (Wednesday). (Please refer press releases such as “notice of the extraordinary shareholders meeting” dated October 17th.)

We recognized major proxy advisory firms Glass Lewis & Co., LLC (hereinafter referred to as “Glass Lewis”) and Institutional Shareholder Services, Inc. (hereinafter referred to as “ISS”) which have issued their reports on this Extraordinary Shareholders Meeting respectively.

Regarding the reports of Glass Lewis and ISS, it was proved that while Glass Lewis supports the opinions of our board, ISS does not properly understand them and opposes Proposal 1 but agrees to Proposal 2 to 4.

However we find that the ISS report (herein after referred to as “ISS report”) seems to include analyses which do not fully understand the facts. Therefore we write a supplementary explanation as below.

We would like shareholders, including institutional investors to refer to the following statements and decide exercise of voting rights prudently.

#### **1. Details of Investigation in 2015**

The ISS report states that serious sexual harassment committed by Mr. Hiromi Yamaguchi is “If the allegation made by the company holds true, that would be a serious concern for shareholders, and would constitute grounds to oppose Yamaguchi’s proposals.” At the same time they stated the investigation immediately after Mr. Yamaguchi’s departure on February 17, 2015 (hereinafter

referred to as “special investigation in 2015”) was not conducted by a third party committee with an independent chairperson, so the findings by the investigation cannot be regarded as objective.

However, we think this analysis is due to insufficient understanding of the facts and would like to make this supplementary explanation.

The special investigation in 2015 includes our statutory auditor as a member and was not conducted by a so-called third party committee. However this investigation was conducted in a considerably independent (i.e. fair and neutral) manner away from the Company. We introduce the details of investigation members and method of investigation as below.

In addition, we notice the outline of identified parts related to facts (facts regarding serious sexual harassment conducted by Mr. Yamaguchi before his departure in the special investigation in 2015.) However, as mentioned below, as for the report of special investigation in 2015 itself, the Company and the special investigation committee (herein after referred to as the “Special Investigation Committee” or the “Committee”) agrees that the report is not assumed to be announced externally taking into consideration the need to care for a victim’s privacy and feelings. Therefore, we never write the details of the concrete facts and only refer to conclusion parts.

### **(1) Details of special investigation in 2015**

#### **① Sequence of establishment of the investigation committee**

Our board meeting held on April 21, 2015 decided to establish an investigation committee in order to investigate and analyze the cause of facts of why Mr. Hiromi Yamaguchi resigned, and to prevent recurrence.

#### **② Members of the Committee**

Members of the Committee are as follows.

Chair Akira Takeuchi (Attorney, Proact Law Office)

Yuko Gomi (Attorney, T.Kunihiro & Co. Attorneys-at-Law)

Takashi Watanabe (Attorney, Proact Law Office)

Hideaki Sashiwa (External corporate auditor)

Manabu Uchiyama (Statutory corporate auditor)

Both before and after the special investigation in 2015, attorney Akira Takeuchi, Attorney Yuko Gomi, Attorney Takashi Watanabe and the Company have no business relationship other

than the special investigation in 2015, therefore these attorneys are independent third party members who have no conflicts of interest with the Company.

Attorney Akira Takeuchi, as Chair, used to be the chair of a third party committee which the Japan Academic Association For Copyright Clearance established and a member of “a third party committee on crisis response operations” established by Shoko Chukin Bank as one of the leading persons regarding investigation of scandals in companies etc.. Furthermore, he is a member of the Committee for Rating Third Party Committee Reports (private entity which was established by volunteers of attorneys aiming to heighten social credit of third party committees and their reports by announcing ratings of investigation reports of third party committees etc. <http://www.rating-tpcr.net/>), who has expertise to determine the fairness of investigation committees that attorneys join.

### ③ Period of the investigation

The investigation was operated from April 21, 2015 to June 11, 2015.

### ④ Method of the investigation

The Special Investigation Committee verified objective materials provided by the Company, and operated hearings from staff of the Company and other interested persons. Hearings totalled 47 hours and 40 minutes against a total of 22 persons. The Special Investigation Committee was held 7 times and discussion totalled 14 hours.

As for Mr. Yamaguchi, the Special Investigation Committee made an interview and hearing with the attendance of an attorney of Mr. Yamaguchi, which totalled 3 hours.

### ⑤ The investigation report

The investigation report of this Committee consists of “Part 1 Special investigation committee”, “Part 2 Facts acknowledged by investigation”, “Part 3 Factor Analysis”, “Part 4 Proposals to prevent recurrence” and total pages number 62.

### ⑥ Character of the investigation

The Special Investigation Committee was conducted on the basis of “Guideline of third party committee concerning scandals of companies etc.” announced on July 15 2010 and revised on December 17 2010.

Therefore, the investigation excluded the participation of our directors completely. Our directors had never engaged in the investigation other than receiving interviews abiding by requests of the investigation committee. As mentioned before, the Special Investigation Committee including a member of our statutory auditor, could not be specifically called a “third party committee” but has the essence of a third party committee in actuality considering the above-mentioned character of the investigation.

⑦ Contents acknowledged by the investigation report

Regarding the facts of issue, the following acknowledgement was done.

- Presence or absence of facts regarding the configuration elements of the crime is not identified, but given the statement of the victim this does not deny possibility of constitution of crime.
- The act of Mr. Hiromi Yamaguchi was evaluated as a serious sexual harassment.
- The behavior and act of Mr. Yamaguchi were evaluated as extremely malicious.
- If facts of this issue were known to internal staff, many would be severely shocked and it may cause mass resignations because of the distrust and disgust against Mr. Hiromi Yamaguchi.
- Situation like this erode the social standing of not only Mr. Hiromi Yamaguchi but also the child rearing business the Company in which the group operates. In particular the loss of faith from mothers of young children, who are important stakeholders for the Company, shall have a negative side effect.
- If (i) the facts of this issue were to become apparent and (ii) Mr. Yamaguchi stayed at the top of the Company, municipality government which control nurseries' administration would not neglect it. Heightening of this negative social consequence could cause jeopardize receiving future subsidies. In addition, recruitment could be impacted by new staff not wishing to be involved in such a delicate situation.
- In conclusion, Mr. Yamaguchi who is deemed to have acted inappropriately is apparently unqualified to be a Representative Director and Director.

Furthermore, in the investigation report, Mr. Yamaguchi acknowledged the act which the Special Investigation Committee evaluated as serious sexual harassment was on February 17, 2015.

Considering this investigation which was operated as independently as possible from the Company was fairly and neutrally determined as serious sexual harassment, even if in the premise of the ISS report, we believe shareholders should ignore proposals put forward by Mr. Hiromi Yamaguchi.

## **(2) Reason JP-Holdings, Inc. did not announce special investigation in 2015**

The timing of special investigation in 2015 conducted soon after the occurrence of becoming aware of the incident we needed to care for the privacy and well-being of the victim as the utmost consideration. Therefore as mentioned before, the Company and the Special Investigation Committee agreed that the investigation report itself was to be kept internally.

In addition, at the timing of special investigation held in 2015, Mr. Yamaguchi who committed these acts already resigned as President and Representative Director of our Company, and it was decided he would not participate in the management of our company going forward taking into account of sequence of this issue. To that end we believed it unnecessary to disclose the results on the investigation of facts to minimize the impacts to the victim.

Even now, we still need to care of the privacy and feelings of the victim in the utmost, which is why we avoid disclosing the details of the facts therefore only refer to the conclusion.

## **(3) Reason we established a third party committee**

As mentioned before, this investigation committee is almost identical to a third party committee in actuality, but since statutory auditor of the Company was included, nominally it was not considered a pure third party committee in and of itself.

Therefore in order to give context for shareholders to properly determine their individual voting rights, we deemed it necessary to offer a fair and objective verification by a third party committee to give that independent perspective.

As mentioned before, JP-Holdings, Inc. and the Special Investigation Committee agreed that the investigation report itself was not intended to be announced externally. In the context to provide materials for shareholders to appropriately exercise their voting rights, we think that we needed to ask a third party committee to investigate and provide an objective standpoint for the sake of impartiality.

Mr. Hiromi Yamaguchi stated in his proxy solicitation that the Company's problem in the presentation is switching operational concerns for his sexual harassment issues. However in order to cope with shareholder proposals it is only natural to present the problems associated with the act of Mr. Yamaguchi conducted while he was president and representative director. His recognition of trying to switch the focus makes apparent that Mr. Hiromi Yamaguchi himself does not understand the gravity of this issue.

## **2. Issue of Possible Resignations of Employee**

While the ISS report recognizes that the resignations of employees could certainly cause raise serious impact for the Company's daily business operations, it says from the viewpoint of Mr. Yamaguchi himself not being nominated as a director, and the passage of shareholder proposals does not mean he will come back, ISS still think that *“Even under the employee exodus, Mr. Hiromi Yamaguchi should be able to cope with the situation by building the business in a way he originally established it.”*

However, there is currently a shortage of nursery staff nationwide, and the ratio of job offers to job seekers over the most recent five years is increasing year by year from 1.36x on January 2012 to 2.76x in January 2017, which stays high. Therefore, it is an extremely difficult task to secure sufficient nursery staff and in some cases the openings of nurseries are delayed and the numbers of children accepted into nurseries are restricted due to the shortage of nursery staff.

Acutely the ratio of job offers to job seekers in Tokyo increased from 3.27x in January 2012 to 5.66x in January 2017, which results in further difficulties for our Company because our nurseries in operation are concentrated in the Tokyo metropolitan area.

Therefore when we compare Mr. Yamaguchi's time as president and our current situation, there has been a huge change in the demand and supply in the market for talented people related to child nursing. Should a certain proportion of people become disaffected and leave the industry it will be difficult to replace them. Even if the ISS report suggests that Mr. Yamaguchi can deal with such a situation, we believe that he is not adequately aware to deal with the current demand and supply situation affecting nurseries.

In addition, where certain childcare professionals become withdraw from our group, there is a possibility, in the worst case scenario, that the inability to maintain the appropriate ratio of child to childcare workers could lead to the cancellation of our authorization to manage such facilities. Based on the above, we believe that if Mr. Yamaguchi is involved in the management of the Company in some way, it might become difficult to continue to operate the management of facilities, which could have a significant influence on the Company's operating results.

### **3. Regarding Mr. Satake's Career**

With regards to Mr. Yasumine Satake (herein after referred to as “Mr. Satake”) who is regarded as a candidate for director in the shareholder proposal, Mr. Yamaguchi stated his reasons for the appointment as appropriate for the Company's corporate governance. The ISS report also analyzes that Mr. Satake would contribute to the board of directors.

However, we have recognized the facts (hereinafter referred to as “facts”) about Mr. Satake as follows:

- ① Mr. Satake was a director of DIO Japan from June 27th, 2013 to June 30th, 2014.
- ② During the term of office served by Mr. Satake from June 2011 to March 2012, DIO Japan held a number of related subsidiaries (which means the companies (i) the representatives of these affiliates were DIO Japan's interested persons, and (ii) DIO Japan owned more than 50% of the stake. Hereinafter referred to as "business entrustment") which were related to human resource development projects (hereinafter referred to as "consignment projects") which utilized the emergency employment creation project stemming from the Great East Japan Disaster commissioned to local governments.
  - (i) It failed to report an asset it acquired which was not approved in the emergency employment creation project.
  - (ii) The consumption tax equivalent amount not covered by the related subsidiary of DIO Japan was transferred to the consigned business as a business expense.
  - (iii) Employees hired for the consignment project engaged in work unrelated to the outsourced project.
  - (iv) A failure to report and/or underclaim the income generated by the consignment project, and did not refund the balance as required.

The Ministry of Health, Labor and Welfare (MHLW) indicated it received a contract cost of 405,540,311 Japanese yen in total by not reporting an amount exceeding expenses due to underreporting (details attached). DIO Japan filed for an application under the civil rehabilitation law in November 2014 post Mr. Satake retiring from the company. The petition was dismissed on December 27<sup>th</sup>, 2014 and the company went bankrupt.

These facts show a glaring lack of corporate governance at DIO Japan and its subsidiaries, in particular the outsourcing of expenses of the consigned project to be covered by subsidies from prefectural and local governments. To that end we cannot ignore such oversights where subsidies are an important component of our business management. Had DIO Japan received payment for improper expenses as above during Mr. Satake's term of office we feel great concern to his qualifications as an outside director.

Regarding these facts, the Company asked Mr. Yamaguchi the following points on November 13<sup>th</sup>, 2017. We view these questions as easily answered by Mr. Yamaguchi so we have requested the reply by November 15<sup>th</sup>, 2017 but as of November 15th have yet to receive any reply.

- ① Whether Mr. Yamaguchi recognized these facts,

- ② In the event Mr. Yamaguchi has recognized these facts, why Mr. Yamaguchi did not address them despite their importance for enabling shareholders to exercise their voting rights.
- ③ If Mr. Yamaguchi did not recognize these facts:
  - (i) Regarding Mr. Satake, whether there was an examination of the presence or absence of facts that may fall under Article 74, paragraph 4, item 4 of the Enforcement Regulations of the Companies Act,
  - (ii) In the case Mr. Yamaguchi had the investigation, how it was conducted,
  - (iii) In case of not investigating, even it is an extremely important factor in judging the eligibility of Mr. Satake as an outside director, what was the reason for not to be investigated,
  - (iv) Whether to maintain Mr. Satake as a candidate for director or not after recognizing this fact.

#### **4. Concerning the evaluation of our performance compared with Mr. Yamaguchi when he was in office**

The ISS report made reference to the fact that the operating profit of the Company decreased since current representative director Kazuhiro Ogita (“Ogita”) took the helm. With this, the report surmises that the performance of management now is worse than the 13 years served under Mr. Yamaguchi as representative director.

However the current management believes that in response to a variety of problems that were not given due priority at the time of expansion under Mr. Yamaguchi are being addressed during the last two years to ensure sustainable growth over the medium to long term.

With regards to the issues that occurred at the time of Mr. Yamaguchi’s appointment we provide the following explanations with respect to the relationship with the concrete steps taken to improve these problems and the decrease in operating profit in fiscal year ended March 2017.

##### **(1) Increased burden of personnel expenses etc.**

Since Ogita took over as representative director, the operating profit margin compacted due to an increase in employment related expenses due to the following reasons.

Among all professions, low salary levels for nursery staff is regarded as an issue in Japan and as a result national and local government subsidy programs are being conducted in order to improve

their conditions. Our Company raised the salaries for nursery staff by 10% in the fiscal year ended March 2016 and a further 4% in the following year. This level exceeds the improvement guidelines encouraged by the national and local governments by 2-8% which in turn increases the burden on personnel expenses and statutory welfare which is one reason why labor costs have risen.

In addition, in order to create a work environment where employees can have peace of mind, it is imperative to manage working hours. In order to do this, it has been important to develop systems to accurately monitor working hours. After assuming the representative director role, Ogita reviewed whether there existed any improper treatment in the overtime application procedure. He confirmed there were insufficient mechanisms in place to make proper overtime applications. To address this we regularly conduct awareness raising activities for employees and made a decision to introduce personnel and attendance systems. By introducing such a system we believe that effective labor management is possible through the prevention of unpaid overtime through more vigilant compliance. We are aiming to put the system in place from January 2018 and expect a cost of around 84 million Japanese yen annually after its introduction.

In addition we realized that one of the higher ranking reasons for nursery staff turnover was salary related. Many complaints were raised about low salaries by the nursery staffs themselves during the process of unclear personnel evaluation. As a result we have introduced fundamental reforms to provide an open and transparent evaluation system. We note in a survey conducted at the end of March 2017 that staff turnover as a result of salary has declined significantly.

## **(2) Increase of burden from system installation costs**

Since Ogita took over as representative director, we have introduced improved systems in each field in order to reduce the workload and increase management department efficiency

To begin with, at nurseries the burden of administrative work has increased. Nursery staffs prepare daily written reports summarizing the state of children who report this to parents. In order to alleviate such burdens, we introduced a child management system in the fiscal year ended March 2017. In doing so we are able to focus more on child care and safety aspects making services easier to provide for parents.

In the management division we are strengthening the accumulation, processing and management of data such as personnel salaries, attendance and expenses via the introduction of a company-wide core system and establishing and maintaining networks between nurseries including the safe and speedy sharing of data, facilitation of communication between organizations, strengthening in management departments, improving work efficiency and bolstering information security. We understand that in order to run a nursery school smoothly and continuously it is just as important to strengthen indirect divisions and recognize that this upfront investment in order to

achieve sustainable growth over the medium to long term is vital.

Given the importance of these systems to our business and as a key tenet of our medium term management plan we recorded expenses of 47 million Japanese yen in the fiscal year ended March 31, 2017 and expect to record a further 92 million Japanese yen in the following fiscal year, March 31, 2018.

### **(3) Increase in burden of recruitment activity expenses**

In contrast to the 176 million Japanese yen of recruitment activity under Mr. Yamaguchi who resigned in the fiscal year ended March 31, 2015 we were forced to spend 275 million Japanese yen in the fiscal year ended March 31 2017. In addition it is estimated the annual amount to be spent on recruitment activity for the fiscal year ending in March 31<sup>st</sup> 2018 will be around 386 million Japanese yen and is increasing year by year.

Recruitment of nursery staff becomes more and more difficult year by year, and the current supply-demand dynamics differ substantially to the period when Mr. Yamaguchi was in office. To put that in perspective in the last 5 years the effective recruitment rate of nursery staff has risen year by year from 1.36x in January 2012 to 2.76x in January 2017. Especially the effective job offering ratio for Tokyo based nursery teachers has risen from 3.27x to 5.66x respectively. For our Company which is focused on nurseries in the Tokyo metropolitan area, this situation is particularly severe.

Under Mr. Yamaguchi recruitment focused on direct application to the Company through job recruitment including new graduates and mid-career hires, but now we are forced to utilize recruitment companies so that maintaining hiring plans. Among them, 90% of recruitment through introduction agencies accounted for 90% of mid-career entry and introduction fees have risen accordingly. Along with the changes in the recruitment methods for nursery staff the fees paid to recruitment agencies in fiscal year ended March 2015 was 40 million Japanese yen compared to 115 million Japanese yen in the fiscal year ended March 2017.

Even though securing nursery staffs has been challenging we hired 410 people in the fiscal year ended March 2016 comprising of 197 new graduates and 213 mid-career hires. We hired 532 people in the fiscal year ended March 2017 comprising of 244 new graduates and 288 mid-career hires and we are targeting 665 in the fiscal year to end in March 2018 comprising of 300 new graduates and 365 mid-career hires.

### **(4) Impairment treatment for improving profitability**

Since the entry into the child care support business, the Company has continued to open

facilities with maximum capacity based on the ability to secure sufficient nursery staffs based on initial business plans. However as securing nursery staff becomes harder each year, it is becoming more challenging to hit our business plans.

Based on these circumstances, since Ogita took the role as representative director, the Company has focused on verifying the profitability of facilities that we believe have insufficient profitability from the past by revising plans and taking appropriate impairment treatment where recovery looks challenged. As a result in the fiscal year ended March 2016 we had 9 facilities with total impairments of 118 million Japanese yen and 20 facilities in the fiscal year ended March 2017 with impairments of 323 million Japanese yen which were all a result of openings made under Mr. Yamaguchi's management.

#### **(5) Recording expenses for ensuring the safety of facilities**

In the fiscal year ended March 2016 the Company recorded repair expenses to ensure safe facilities of 48 million Japanese yen (an increase of 12 million Japanese yen over the previous year). This is mainly due to contracts with maintenance specialists. Since Ogita took over as representative director he has pushed strengthening the safety aspects of the group's facilities. As a specialist, maintenance companies acting as contact points and quickly respond to any necessary equipment repair further enhancing safety.

To further enhance our Company management philosophy of "safety and security first" we have installed automatic external defibrillator (AED) units in all our facilities since November 2015

#### **5. Concerning for borrowing from financial institutions**

The ISS report is a summary of the issues raised by Mr. Yamaguchi's shareholder proposal financial institutions have raised only slight concern from financial institutions with respect to borrowings. We believe that questions about our borrowing from financial institutions are extremely important factors for shareholders to determine the exercising of their voting rights and we provide the following supplemental explanation.

For our Company, the funds to open new nurseries are facilitated by borrowing from financial institutions. In the event it becomes difficult to procure funds as planned, opening new nurseries will become more problematic and this could impact group earnings and our financial position as described in our securities report.

Before receiving the request for the convocation of the Extraordinary Shareholders Meeting there have been no particular issues with the current management in continuing existing borrowing or future borrowing from financial institutions. However, on the convocation of the Extraordinary

Shareholders Meeting where the outcome is not yet clear, there is a risk that existing or new borrowing from multiple financial institutions gets impeded. We are receiving information that it may become more difficult to borrow over the long term depending on the outcome of the Extraordinary Shareholders Meeting.

Therefore even if the shareholder proposal is passed or rejected if the financial institutions determine that the same situation as shareholders proposals from Mr. Yamaguchi occurs again we may not be able to procure funds according to our plans which could have serious ramifications for our group results and financial condition.