GENDA (9166 JP)

Analyzing Impact of Free Cash Flow Generation through Stricter Investment Discipline

Executive Summary

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GENDA Inc. (9166 JP)

Share Price (6 January, 2026)	JPY 702
Market Cap.	US$ 850 mn

FY (Jan.-end)	F25E	F26E	F27E	F28E
Cash EPS	42	67	94	121
Cash P/E	17x	10x	7x	6x
EV/EBITDA	8.8x	6.1x	4.4x	3.5x
P/B	2.0x	1.7x	1.4x	1.1x
Dividend Yield	0%	0%	0%	0%
ROE	8%	17%	20%	21%
Cash ROIC	10%	10%	10%	10%
FCF Conv.*	-311%	41%	43%	55%
Incr. FCF ROI**	-25%	24%	5%	14%

*FCF Conv. = FCF ÷ Net Income

**Incremental FCF ROI = FCF Growth (FY) ÷ Invested Capital Growth (FY-1)

GENDA recently announced that it will implement a strategic shift regarding public equity offerings by selectively pursuing growth investments, including M&A, and aiming to achieve positive free cash flow (FCF = EBITDA - tax - capex) starting next fiscal year. At CGS, we place significant importance on this strategic shift and its execution from the perspective of the company's equity valuation. Based on discussions with Mr. Watanabe, Managing Director and CFO, we conducted an independent quantitative analysis of the specific impact. Key takeaway and our conclusion regarding GENDA's shift toward positive FCF are as follows:

1) **GENDA will tighten investment discipline for both M&A and organic growth within its capital allocation strategy.** Specifically, M&A will focus on roll-ups in core areas, while investments outside the core will be limited and highly selective. For organic growth investments, the company has raised the expected IRR hurdle rate under a non–going concern assumption and removed the previous requirement of 10% revenue growth for existing businesses, shifting toward a more balanced approach with investment efficiency. In particular, for organic growth, priority will be given to allocating capital to new domestic arcade openings and add-on investments in U.S. arcades, both of which demonstrate strong IRR and NPV profiles.

2) **GENDA is targeting ¥5 billion FCF in FY1/2027.** CGS projects that the company's invested capital will increase by approximately ¥172 billion over the next three years (FY1/2026 – FY1/2028). On the other hand, capex outside the arcade business will be reduced beginning next fiscal year, resulting in approx. ¥27 billion improvement in FCF (FY1/2027 – FY1/2029). This means that CGS expects the incremental ROI on an FCF basis to improve significantly from negative to around 16% over the next three years, which we believe should have a positive impact on the valuation.

3) **GENDA plans not to conduct public offerings for M&A reserve purposes over the next three years.** However, this does not apply if equity financing becomes necessary for an attractive large-scale acquisition. CGS believes that, however, unless the size of M&A significantly exceeds ¥40 billion per year incorporated in our forecasts, the risk of equity financing through new share issuance will remain limited for the time being. We expect that through debt financing and the use of treasury shares for share-based acquisitions, GENDA will be able to continue its series of M&A over the medium term.

Rationale Behind Strategic Shift in Capital Allocation Policy

GENDA announced a shift in its capital allocation strategy in conjunction with the release of its Q2 results in September and Q3 results in December for FY1/2026. Specifically, **for M&A, the company will focus on roll-ups in its core areas of arcades and karaoke, while limiting and carefully selecting acquisitions outside these core domains. For organic growth investments, GENDA will also tighten investment discipline and has changed its policy to turn FCF (= EBITDA - tax - capex) positive from next fiscal year**. The decision was driven by several factors. First, public offerings to secure standby funds for M&A - previously prioritized to accelerate deal execution - created supply-demand concerns for the stock which exceeded the company's expectations. In addition, past organic growth investments revealed a gap between actual IRR and initial assumptions, particularly in areas outside arcades. Furthermore, under GENDA's strategy of pursuing M&A while leveraging debt, some creditors among the more than 50 partner banks and leasing companies raised concerns about continued borrowing increases while FCF remained negative. In response to these challenges, GENDA has made a swift decision to change course, moving toward stricter discipline for both M&A and organic growth investments to turn FCF positive.

Ex. 1: GENDA Announced Strategic Shift in Capital Allocation to Achieve Positive Free Cash Flow

Source: Company material

As for specific changes to investment discipline in organic growth, the company will first raise the expected IRR hurdle rate from the previous 10% to 15%. GENDA's IRR assessment does not assume a going concern for each business, but rather evaluates within a defined investment recovery period (e.g. If the IRR is 15% over seven years, the payback period would be four years, and ROIC would be 25%). In addition, the previous requirement of 10% revenue growth for existing businesses will be removed to better balance investment efficiency. **Based on these principles, organic growth investments will prioritize new domestic arcade openings and add-on investments in U.S. arcades, both of which show strong IRR and NPV profiles. Furthermore, to focus on PMI and operational improvements in North America, the company plans to suspend M&A activity in that region for the time being. CGS believes these strategic shifts will have a significant impact on two key areas: the company's future incremental ROI and its equity financing risk.**

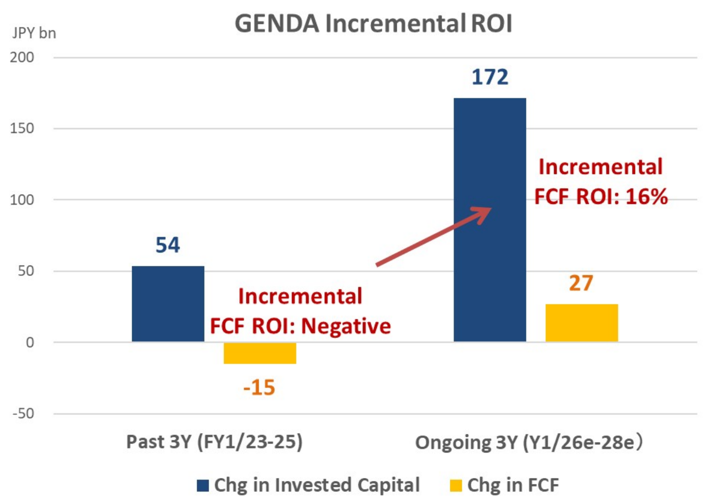
Stricter Investment Discipline to Boost Incremental ROI to 16% on an FCF Basis and Reduce Equity Financing Risk

1. Impact on FCF-based Incremental ROI

One of the major implications of this capital allocation strategy shift for investors is that the company will begin generating FCF, a key driver of enterprise value. GENDA aims to generate ¥5 billion in FCF next fiscal year (¥16.5 billion steady-state CF before growth capex). More important point for evaluation is how efficiently FCF will be generated while sustaining growth, which we analyzed here in detail. Our conclusion is that, over the next three years, incremental ROI on FCF (defined as FCF increase ÷ invested capital increase) is expected to improve significantly from negative levels to approx. 16%. Please note that this quantitative analysis is based on CGS's proprietary forecast model.

Since FY1/2025, GENDA has significantly expanded its capex, and FCF is expected to remain negative this fiscal year following last year's trend. As a result, CGS estimates that the company has increased invested capital by approximately ¥54 billion over the past three fiscal years, while cumulative FCF—including this year—is projected to land at around negative ¥15 billion. In the past, for companies like GENDA with negative FCF, CGS has focused on incremental ROI based on operating cash flow returns to analyze the quality of capital allocation. Going forward, however, **as FCF—an essential driver of enterprise value—turns positive, it will be possible to measure incremental ROI purely on an FCF basis (= OpCF – capex), enabling investors to assess the quality of GENDA's capital allocation more fundamentally. CGS forecasts that invested capital will increase by approximately ¥172 billion over the next three years (FY1/2026 to FY1/2028). In contrast, under the new strategy, capex outside the arcade business—accounting for roughly 30% of this year's growth investments—will be significantly reduced and optimized from about ¥27 billion this year, resulting in an estimated ¥27 billion improvement in FCF (= OpCF – capex, (FY1/2027 to FY1/2029). Thus, incremental ROI on an FCF basis is expected to improve dramatically from negative to 16% over the next three years, which we think should have a highly positive impact on the company's medium- to long-term equity valuation.**

Ex. 2: GENDA's Incremental ROI on an FCF Basis Set for Significant Improvement



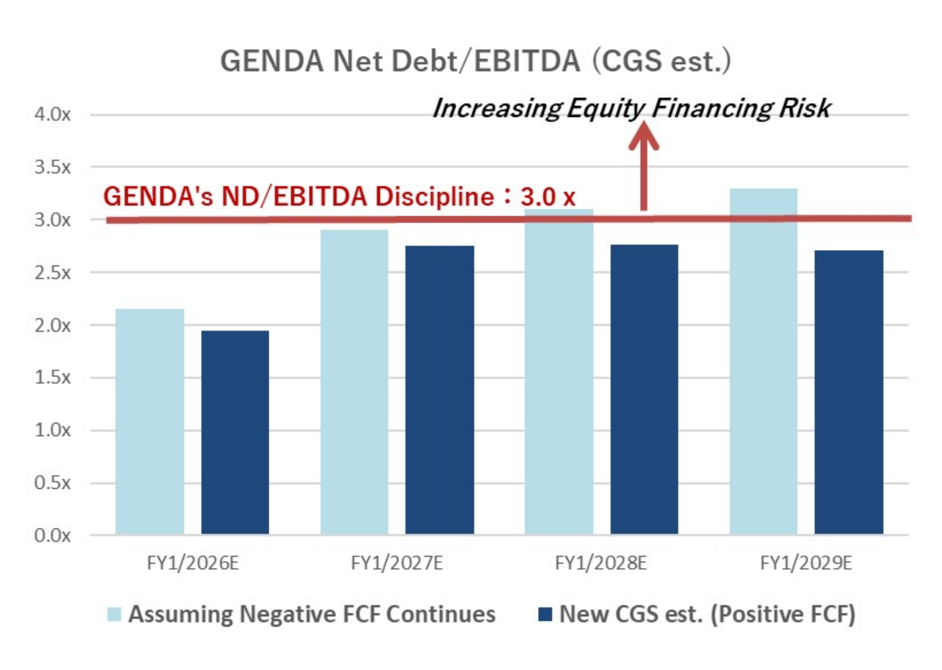
*The increase in FCF includes the incremental FCF generated through the fiscal period following the invested capital increase (Past 3Y: FY124-26e; Ongoing 3Y: FY1/27e-29e). *Source: Company financial statements, CGS estimates*

2. Impact on Equity Financing Risk

This strategic shift also carries significant implications for investors when assessing the company's equity financing risk. In short, **in addition to being highly selective with M&A, GENDA has committed not to conduct public offerings for M&A reserve purposes for at least the next three years by allocating FCF to fund acquisitions. Management has noted, however, that this policy does not apply if equity financing becomes necessary for an attractive large-scale acquisition. On this point, CGS believes that, unless the size of M&A significantly exceeds the ¥40 billion per year level incorporated in our forecasts, the risk of public offerings will remain limited for the foreseeable future.**

The company's financial leverage discipline is based on a Net Debt/EBITDA ratio of up to 3x. Assuming annual M&A activity of around ¥40 billion, as incorporated in CGS's base-case forecasts, continued negative FCF would push the ratio above 3x by FY1/2028, implying a need for additional equity financing. However, under the new strategy, as FCF turns positive, CGS expects that—provided M&A does not significantly exceed the ¥40 billion per year level—the ratio can be maintained around 2.7x, making it practically feasible to pursue an acquisition strategy funded solely through debt. Furthermore, given the recent decline in the company's valuation (EV/EBITDA of 4.4x based on CGS estimates for FY1/2027e), GENDA announced a share buyback of up to ¥3 billion alongside its Q3 earnings release. We expect the company plans to utilize treasury shares for share-based M&A at appropriate timing, leading to further reduction of the need for equity financing through new share issuance. Based on these factors, **CGS believes that unless the scale of M&A significantly exceeds our assumed level of ¥40 billion per year (excluding M&A funded with treasury shares), the risk of equity financing via new share issuance will remain limited, and the company can continue its serial M&A strategy through debt financing and the use of treasury shares.**

Ex. 3: Shift to Positive FCF Expected to Mitigate Equity Financing Risk



Source: CGS est.

CGS Financial Model

JPY mn	FY23	FY24	FY25E	FY26E	FY27E	FY28E	FY28E Base Case	FY28E Bull Case	FY28E Bear Case
Income Statement									
Sales	55,697	111,786	164,301	210,891	262,436	316,558	316,558	373,845	252,504
COGS	42,738	86,328	126,791	162,625	202,224	243,749	243,749	276,645	199,478
Gross Profit	12,959	25,458	37,511	48,267	60,212	72,808	72,808	97,200	53,026
SG&A	7,589	17,493	27,662	27,239	30,907	35,936	35,936	44,415	32,451
Operating Profit	5,370	7,965	9,849	21,027	29,305	36,872	36,872	52,785	20,575
Pretax Profit	4,414	6,690	8,757	19,328	27,073	34,183	34,183	49,728	18,568
Income Tax	217	3,166	4,716	7,115	9,931	12,174	12,174	17,615	6,709
Minority Interest	18	219	0	0	0	0	0	0	0
Net Income	4,178	3,304	4,041	12,213	17,143	22,009	22,009	32,113	11,859
EBIT	5,370	7,965	9,849	21,027	29,305	36,872	36,872	52,785	20,575
D&A	2,732	7,426	12,697	11,498	15,621	20,005	20,005	23,580	16,008
EBITDA	8,102	15,391	22,545	32,525	44,926	56,877	56,877	76,365	36,583
Depreciation	2,549	6,077	8,979	11,498	15,621	20,005	20,005	23,580	16,008
Amortization	181	1,349	3,718	0	0	0	0	0	0
EBITA	5,553	9,314	13,567	21,027	29,305	36,872	36,872	52,785	20,575
EBITA ex. M&A fee	5,652	10,471	14,567	22,027	30,605	37,472	37,472	53,385	21,175
Net Income ex. Goodwill Amort.	4,359	4,653	7,759	12,213	17,143	22,009	22,009	32,113	11,859
Net Income ex. Goodwill Amort&M&A fee.	4,511	5,931	8,759	13,213	18,443	22,609	22,609	32,713	12,459
Diluted Shares Outstanding	138.1	156.1	184.0	181.9	181.9	181.9	181.9	181.9	181.9
GAAP EPS (Diluted)	30	21	22	67	94	121	121	177	65
Cash EPS (Diluted)	32	29.8	42.2	67.2	94.3	121.0	121	177	65
Cash EPS (Diluted) ex. M&A fee	33	38	48	73	101	124	124	180	69
DPS	0	0	0	0	0	0	0	0	0
Payout Ratio	0%	0%	0%	0%	0%	0%	0%	0%	0%
COGS/Sales	76.7%	77.2%	77.2%	77.1%	77.1%	77.0%	77.0%	74.0%	79.0%
Gross Margin	23.3%	22.8%	22.8%	22.9%	22.9%	23.0%	23.0%	26.0%	21.0%
Other SG&A/Sales	13.6%	15.6%	16.8%	12.9%	11.8%	11.4%	11.4%	11.9%	12.9%
OPM	9.6%	7.1%	6.0%	10.0%	11.2%	11.6%	11.6%	14.1%	8.1%
EBITDA Margin	14.5%	13.8%	13.7%	15.4%	17.1%	18.0%	18.0%	20.4%	14.5%
Cash Flow Statement									
Net Income	4,178	3,304	4,041	12,213	17,143	22,009	22,009	32,113	11,859
D&A	2,549	7,426	12,697	11,498	15,621	20,005	20,005	23,580	16,008
Changes in Working Capital	184	-2,130	-1,360	-1,819	-3,938	-3,527	-3,527	-4,740	-2,123
OCF	7,602	8,890	15,377	21,892	28,826	38,487	38,487	50,953	25,744
CAPEX	-5,132	-11,693	-27,931	-16,871	-21,520	-26,274	-26,274	-31,029	-20,958
FCF	2,470	-2,803	-12,554	5,021	7,307	12,213	12,213	19,924	4,786
Acquisitions	-3,861	-7,019	-50,000	-40,000	-40,000	-40,000	-40,000	-50,000	-25,000
Cash Dividends Paid	0	0	0	0	0	0	0	0	0
FCF III (OCF - ICF -Div)	-2,732	-4,222	-62,554	-34,979	-32,693	-27,787	-27,787	-30,076	-20,214
Share Issuance (Repurchase)	4,084	10,053	16,952	-1,500	0	0	0	0	0
Issuance (Reduction) of Debt - Net	3,912	15,415	43,000	38,000	33,000	28,000	28,000	35,000	15,000
Net Change in Cash	5,242	20,475	-2,602	1,521	307	213	213	4,924	-5,214
Conversion									
OCF/EBITDA	94%	58%	68%	67%	64%	68%	68%	67%	70%
FCF/NI	59%	-85%	-311%	41%	43%	55%	55%	62%	40%

Note: GENDA conducted 1:2 stock split on March 31, 2025. The number of shares for past fiscal years has also been adjusted to reflect the split.

CGS Financial Model

JPY mn	FY23	FY24	FY25E	FY26E	FY27E	FY28E	FY28E Base Case	FY28E Bull Case	FY28E Bear Case
Balance Sheet									
Cash & Cash Equivalents, ST Inv	12,379	25,649	23,047	24,568	24,874	25,087	25,087	30,946	14,263
Accounts Receivable	3,689	7,021	8,321	9,525	12,572	15,164	15,164	17,909	12,096
Inventories	4,374	8,235	9,607	11,186	14,464	17,434	17,434	19,786	14,267
Total Current Assets	23,567	45,646	45,715	50,019	56,651	62,426	62,426	73,382	45,367
Net PP&E	12,581	31,466	65,919	83,292	101,191	119,460	119,460	132,394	101,138
LT Investments	135	769	769	769	769	769	769	769	769
Intangible/Goodwill	5,698	21,290	60,072	88,072	116,072	144,072	144,072	173,322	100,197
Total LT Assets	28,574	68,722	141,957	187,330	233,229	279,498	279,498	321,682	217,301
Total Assets	52,141	114,368	187,672	237,350	289,879	341,924	341,924	395,063	262,669
ST Debt & Curr. Portion LT Debt	7,620	20,424	20,424	20,424	20,424	20,424	20,424	20,424	20,424
Accounts Payable	3,213	5,253	6,564	7,529	9,916	11,952	11,952	13,565	9,781
Total Current Liabilities	16,892	39,770	41,081	42,046	44,433	46,469	46,469	48,082	44,298
LT Debt	11,370	30,861	73,861	111,861	144,861	172,861	172,861	200,861	120,861
Total LT Liabilities	15,585	38,907	81,907	119,907	152,907	180,907	180,907	208,907	128,907
Total Liabilities	32,477	78,677	122,988	161,953	197,340	227,376	227,376	256,989	173,205
Total Equity	19,664	35,690	64,684	75,397	92,540	114,548	114,548	138,074	89,463
Total Liabilities & Shareholder's Equity	52,141	114,367	187,672	237,350	289,879	341,924	341,924	395,063	262,669
CCC									
Days of Sales Outstanding (DSO)	19	17	18	16	17	17	17	17	17
Days of Inventory Outstanding (DIO)	28	27	28	25	26	26	26	26	26
Days of Payables Outstanding (DPO)	20	18	19	17	18	18	18	18	18
Cash Conversion Cycle (Days)	28	26	27	25	26	26	26	26	26
Cash ROIC	25%	15%	10%	10%	10%	10%	10%	13%	7%
Net Debt / EBITDA	0.7	1.0	2.1	2.8	2.8	2.7	2.7	2.3	3.2

Note: GENDA conducted 1:2 stock split on March 31, 2025. The number of shares for past fiscal years has also been adjusted to reflect the split.

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