Reflecting probability of greater profit growth, company again raises planned dividend payment

On January 11, 2012, the company announced its results for the first three quarters of fiscal year (FY) 2/12, i.e., the nine months through November 2011. Sales grew by 7.7% year-on-year (y-o-y), to ¥13,689 million, and operating profit increased by 6.7% y-o-y, to ¥1,003 million, both reaching all-time highs. Established businesses, such as the Tomas private preparatory schools and the Meimonkai service that dispatches private tutors to homes, prospered, and newer businesses, such as the Shinga's Club day-care centers and the International Tomas English language schools, built solid foundations.

The Riso Kyoiku group, which caters to a wide range of ages, continues to expand in Japan's private education industry, where competition is intensifying as the country's population of youth continues to decline. To maintain growth, the company is adopting a strategy of horizontal integration, which entails centralizing the functions of each business in main centers. The company expects this centralization to facilitate the sharing of information among businesses and the retention of customers. The first step in this strategy is being taken in January 2012 with the establishment of the Johoku office in the Ikebukuro district of Tokyo that will house all of the company's businesses operating in that district except its Meimonkai service. These businesses will then interact more than they have in the past. In coming months, similar central offices for the company's businesses will be set up in leading districts of Tokyo.

For FY2/12, the company maintained its original forecasts. However, because the company anticipates greater business growth from FY2/13, when it expects its new businesses to contribute fully, it announced that it would raise the dividend it plans to pay at the end of the fiscal year from ¥120-130 to ¥135-145, which would make its full-year dividend payment ¥245-255. Management's positive stance towards shareholder returns suggests that the company will increase its dividend payments in future fiscal years accompanying profit growth.

Points

• New businesses are developing rapidly, so the company again increased its dividend payment planned for FY2/12

• Among these rapidly developing new businesses are the Shinga’s Club day-care centers and the International Tomas English language schools

• The company expects its new strategy of centralizing the operations of all businesses at one location to contribute to faster growth
Results in the first three quarters of FY2/12

Despite a difficult operating environment, sales and profits continued to grow, reflecting the company’s commitment to high-quality education.

On January 11, 2012, the company announced its results for the first three quarters of FY2/12, the nine months through November 2011. Sales grew by 7.7% y-o-y, to ¥13,689 million, operating profit increased by 7.7% y-o-y, to ¥1,032 million, recurring profit grew by 6.7% y-o-y, to ¥1,003 million, and net profit advanced by 7.3% y-o-y, to ¥408 million.

The Shinga’s Club day-care center business and the International Tomas English language school business were started in the second quarter of FY2/12, so they incurred initial costs, yet they did not hinder earnings. The sales and profit growth achieved during the first three quarters amid a challenging operating environment for private educational services reflects the company’s stress on educational quality and its moderate approach to expansion. Segment performance was as follows.

Private preparatory schools

This division comprises the company’s 65 Tomas private preparatory schools and its 3 International Tomas English-language schools. In the first three quarters of FY2/12, division sales increased by 6.0% y-o-y, to ¥7,960 million, and division operating profit grew by 29.7%, to ¥432 million. During these quarters, the division opened a new Tomas school in north Urawa City and a new International Tomas school in the Meguro district of Tokyo, and renovated and expanded its Tomas school in Kasai. These new and expanded schools attracted more students, contributing to sales and profit growth.
Dispatch of tutors to homes

This division comprises 28 Meimonkai offices that dispatch tutors to homes. It has grown the most rapidly of all company divisions in recent years, attracting more students due to the high quality of instruction offered, as shown by the high levels of acceptance of tutored students by prestigious schools. In the first three quarters of FY2/12, division sales grew by 18.7% y-o-y, to ¥2,944 million, and operating profit jumped by 50.0% to ¥253 million. This growth was supported by the opening of two new schools, in Kokura, Fukuoka Prefecture; and in Azamino, Kanagawa Prefecture; and by the renewal and expansion of three schools, in Senrichiouu, Osaka; Nagoya, Aichi Prefecture; and Shibuya, Tokyo.

Preschools

This division comprises 25 Shingakai preschools, Japan’s pioneer in preschool education, and 3 new Shinga’s Club day-care centers, which provide education and long-term care for gifted children. In the first three quarters, sales in this division rose by 3.4% y-o-y, to ¥2,099 million. This profit decline was attributed to the impact of the March 11, 2011 earthquake and tsunami disasters on Shingakai preschools in the affected area in the first half of the fiscal year. In the third quarter alone, division sales grew by 14% y-o-y, and division operating profit increased by 15% y-o-y. Furthermore, the company expects the Shinga’s Club day-care centers to contribute to profit soon. Thus, it foresees renewed profit growth for this division.

Teleconference education using the Internet

This division comprises the School e-Station interactive tutorial service through terminals at private high schools, begun two years ago, and the electronic Education Magazine, which provides information about schools to subscribers. In the first three quarters of FY2/12, division sales increased by 12.6% y-o-y, to ¥321 million. The concept of the School e-Station interactive tutorial service was rapidly accepted by the education community, and this increase supporting sales growth. Profits declined because the division spent more on sales, including hiring new salespeople. However, the School e-Station service is beginning to yield positive results for the schools that use it, and more schools have begun to inquire about adopting it. This service is also very profitable, as it requires few fixed costs. Thus, the company anticipates substantial profits from it in the future.

Other services

This division comprises residential training for personal enrichment and activities to attract new students to Riso Kyoiku schools. The sales reflected the division’s restraint in conducting outdoor activities after the disasters of March 11. Division sales have been recovering, and the company aims for sales and profit growth in this division in FY2/12.
Results in the first three quarters of FY2/12

Breakdown of Sales and Operating Profit by Division in Q1-3 FY2/12 vs. Q1-3 FY2/11

<table>
<thead>
<tr>
<th>Sales</th>
<th>Q1-3 FY2/11 (¥mn)</th>
<th>Q1-3 FY2/12 (¥mn)</th>
<th>Rate of change (% y-o-y)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private preparatory schools</td>
<td>7,510</td>
<td>7,960</td>
<td>6.0%</td>
</tr>
<tr>
<td>Dispatch of tutors to homes</td>
<td>2,522</td>
<td>2,994</td>
<td>18.7%</td>
</tr>
<tr>
<td>Preschools</td>
<td>2,029</td>
<td>2,099</td>
<td>3.4%</td>
</tr>
<tr>
<td>Teleconference education via Internet</td>
<td>286</td>
<td>321</td>
<td>12.6%</td>
</tr>
<tr>
<td>Other services</td>
<td>360</td>
<td>316</td>
<td>-12.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,706</strong></td>
<td><strong>13,690</strong></td>
<td><strong>7.7%</strong></td>
</tr>
</tbody>
</table>

Company expects new businesses to contribute to greater profit growth

Profit from new businesses likely to supplement steadily growing profits from established businesses

The company’s results in the first three quarters of FY2/12 were broadly in line with its original forecasts. Thus, the company has maintained its original forecasts for FY2/12: sales growth of 7.8%, to ¥20,210 million, operating profit growth of 15.7%, to ¥3,118 million, recurring profit growth of 15.0%, to ¥3,064 million, and net profit growth of 16.2%, to ¥1,588 million. Ordinarily, the company achieves its strongest results in the fourth quarter of each fiscal year, which immediately precedes school entrance examinations. In fact, the company normally earns more than half of its annual operating profit in the fourth quarter.

By pursuing a policy of cautious growth, the company has achieved record results each year, but its sales and profits may grow faster from FY2/13, due to greater contributions from new businesses. The Shinga’s Club day-care centers and International Tomas English language schools, both begun in 2011, are rapidly developing, and more private high schools are adopting the School e-Station interactive tutorial service. At the same time, with the opening of new Tomas private preparatory schools and Meimonkai offices, the number of students served by these businesses is increasing, contributing to their stable growth.

By continuing its current growth strategy, the company aims to achieve sales of ¥30 billion and EPS of ¥800 in its 3-year plan to FY2/14). Given the high profitability of the new Shinga’s Club day-care centers and the School e-Station service, the company also aims to raise its recurring profit margin to 18-20% by FY2/14, from just over 14% now. The company foresees the following prospects for its new businesses.
1. Shinga’s Club

Riso Kyoiku opened its first Shinga’s Club day-care center for the long-term care and education of gifted children in the Meguro district of Tokyo in May 2011. Since then, it has opened two other centers, in the Iidabashi and Ikebukuro districts of Tokyo. These centers have proven to be very popular, and the company now estimates that this new business will generate sales of ¥220 million and operating profit of ¥20 million in FY2/12. In FY2/13, the company plans to open four new Shinga’s Club day-care centers, including one in the Ginza district of Tokyo and another in Yokohama City, Kanagawa Prefecture. That year, the company projects that this business will yield sales of ¥1,000 million and operating profit of ¥200 million. Hereafter, the company intends to open about four new Shinga’s Club day-care centers per year, at locations of its Shingakai offices. Each day-care center is estimated to earn annual sales of ¥200 million. If a new Shinga’s Club day-care center were established at each of the company’s current Shingakai offices, these centers would supply annual sales of about ¥5 billion.

The Shinga’s Club day-care centers are targeted to high-income couples who both work and who want to enter their children into famous, private kindergartens or elementary schools. These day-care centers accept children from age one through the third grade of elementary school. They are large, accommodating 100-120 children each. However, they are not cheap, costing at least ¥150,000 per month. A number of options are offered, so annual fees range from ¥1.8 million to ¥2.5 million. Therefore, the service caters mainly to well-to-do households, such as those including a doctor, lawyer or business executive. Nonetheless, the demand for the service has been very strong. Shingakai is Japan’s pre-eminent brand in private kindergarten education, and Riso Kyoiku expects the affiliation of the Shinga’s Club day-care centers with Shingakai to support the steady expansion of these centers.
The Shinga’s Club day-care centers offer a wide range of courses

As the Japanese market for foreign language conversation classes bottoms out, Riso Kyoiku starts expanding its English-language schools aggressively

2. International Tomas English-language schools

In 2008, Riso Kyoiku set up an English-conversation school in the Ogikubo district of Tokyo on an experimental basis. Like the Tomas schools, this school offered one-on-one instruction and personalized curricula to fit each student’s goals. A student can continue a course of study until he or she has achieved his/her goals. Whereas most English-language schools require students to pay for an entire course at the start of instruction, the experimental school charged students monthly.

From the Japanese government’s fiscal 2011, i.e., the year through March 2012, English conversation must be taught in all public elementary schools in Japan. Thus, the need for English conversation skills has grown. Hence, after three years of operating the experimental school, the company converted it into a fully commercial business in 2011, opened another school in the Meguro district of Tokyo in June 2011 and a third school in the Ikebukuro district of Tokyo in December. For FY2/2012, the company estimates that its International Tomas schools will generate revenues of ¥150 million and operating profit of ¥10 million.
Each International Tomas school accepts about 200-250 students, and each student pays ¥500,000 – 700,000 per year. Hereafter, the company hopes to open 6-7 International Tomas English-language schools per year, if it can lease or acquire facilities in districts where the company wants to expand business. Sales from this business in FY2/13 will depend on the number of new schools opened, but the company estimates that they should amount to a few hundred million yen. Group company Riso Kyoiku Planning Co. employs 5-6 specialists in recruiting students, and the company intends to increase this number to about 20 to recruit enough students for the new schools planned.

According to Japan’s Ministry of Economics, Trade and Industry, the Japanese market for private foreign-language conversation education rapidly shrank in FY2007 due to the bankruptcy of the largest English-language school in Japan, and continued to contract over the next three fiscal years. However, some small signs of market recovery have emerged in FY2011. For example, as mentioned previously, the government now requires the teaching of English conversation in all public elementary schools. Thus, the demand for mastering English conversation has grown. Having developed advanced educational know-how by operating its Tomas private preparatory schools, Riso Kyoiku appears ready to apply this know-how to build up its International Tomas English-language schools.

Japanese Market for Private Foreign-Language Conversation Education

Y-o-y Rates of Change in Sales and Number of New Students in Japan’s Market for Private Foreign-language Conversation Education (100 = 0%)

Source: “Survey of Selected Service Industries” MITI, Dec 2011
The potential demand for this service is large

3. School e-Station

School e-Station is an interactive teleconference system that offers instruction to students in their school after they have completed their normal hours of instruction or their club activities. Known colloquially as Hello e-Sensei, this system allows a student to connect with a teacher in 10 seconds and receive private tutoring.

Two years ago, a private high school asked Riso Kyoiku to install this system to improve the academic performance of its students. Private high schools are experiencing increasing competition for students as Japan’s population of children declines. Thus, they seek ways to differentiate themselves from competitors. The most effective way to do so is to improve academic performance better. The School e-Station system quickly improved the academic performances of students notably, and the system gained credibility in the education community. Now, it is being adopted rapidly by private high schools in Greater Tokyo. Riso Kyoiku has increased the sales force for this service to about 10 people, from three initially, and more than 30 schools are negotiating to install the system.

Riso Kyoiku is considering offering the School e-Station system to middle schools and elementary schools. As a start, it may install the service in a joint middle school-high school in Kanagawa Prefecture. The subsidiary is also considering offering the School e-Station service outside Greater Tokyo over the medium term. There are approximately 1,500 private high schools in Japan, of which, about 400 are in Greater Tokyo. These numbers indicate the growth potential of the service. Riso Kyoiku aims to install the system in 15-20 schools per year, targeting a customer base of 300 private high schools over the medium term.

In FY2/12, the company estimates that the School e-Station system service will generate sales of ¥500-600 million, almost double its sales in FY2/11, and operating profit of ¥10 million. In the medium term, the company targets annual sales of ¥3 billion and annual operating profit of ¥1 billion, for an operating profit margin of 35% (1/3 = 33%). This service yields the highest operating profit margin of any of Riso Kyoiku’s businesses because it requires no fixed costs such as those to lease facilities or general administrative costs. Riso Kyoiku is the only private provider of educational services in Japan that offers such a service. The potential market for this service is large, so the service will probably grow rapidly over the medium term.
Company aims to retain students by centralizing businesses

From 2012, Riso Kyoiku is adopting a new strategy of horizontal integration. The group’s businesses cater to different age groups, but the classrooms for most of these businesses are in different locations. The company believes that by centralizing its businesses, it will facilitate the sharing of information among them and help retain students.

For example, if the Tomas private preparatory schools and the International Tomas English-language schools were located in the same buildings as the Shinga’s Club day-care centers and the Shingakai preschools, the parents of children enrolled in the day-care centers and preschools would be able to easily understand the services offered by the Tomas private preparatory schools and the International Tomas English-language schools and would probably enroll their children in these programs. Furthermore, such centralization of businesses would reduce costs and increase operational efficiency for Riso Kyoiku.

The company set up its first central office, the Johoku office, in the Ikebukuro district of Tokyo in January 2012. It rented a new, 7-story building only two minutes by foot from Ikebukuro Train Station. Each story has a floor space of 528 square meters. All of the company’s businesses offered in the Ikebukuro district except the Meimonkai preschools are located in this building. The first floor houses a cafeteria for students and staff members. The rent paid for this entire new building is only slightly more than the company had been paying for separate facilities previously. Thus, the change had no real impact on profitability.

Hereafter, the company plans to establish similar central offices in prime districts of Greater Tokyo. In the first half of 2012, it aims to set up central offices in Yokohama City, Kanagawa Prefecture, and in the Ginza district of Tokyo. Then, it will proceed to set up central offices in the Shinjuku, Shibuya, and Kichijoji districts of Tokyo, as well as in Saitama Prefecture and Chiba Prefecture. Last year, real estate prices in Greater Tokyo declined, so the company is well positioned to negotiate beneficial terms for the rent of prime properties. This advantage will probably contribute to profit growth.

New Johoku Office in Ikebukuro, Tokyo

Opened on December 5, 2011, the Johoku Office is located at a prime site along Meiji Avenue only a 2-minute walk from Ikebukuro Station.
Dividend Policy

Profit Growth Allows the Company to Continue to Increase Dividends

As detailed above, the company projects record-high profits for FY2/12, despite challenging operating conditions in the industry, reflecting the steady expansion of its established businesses and the early contributions of its new businesses. Furthermore, the company foresees faster profit growth in FY2/13 and beyond as its newer businesses contribute more. Thus, it announced that it would raise the dividend it plans to pay at the end of the fiscal year from ¥120-130 to ¥135-145, which would make its full-year dividend payment ¥245-255. The company has set a dividend payout ratio of more than 50%, so it will probably continue to increase its dividend payments in coming years.

In July 2010, the company adopted a system by which it would pay dividends based partially on its share price. According to this system, the company would pay as a dividend the higher of two calculations: 1) its earnings per share multiplied by 40% of consolidated payout ratio or 2) the company’s average share price at the end of the first half of a fiscal year and at the end of the full fiscal year multiplied by 3% of stock-dividend ratio (with an upper limit of a 75% consolidated dividend payout ratio). In FY2/2011, however, the company’s consolidated dividend payout ratio was 55.9%, higher than it would have been using either of the two calculations. The company will probably maintain a dividend payout ratio of about 50%. Moreover the company’s stock price is underlying upward trend, the company might actually pay dividends based on 2) calculation measure (average share price multiplied by 3%) if the price will reach much higher than ¥8,000.

Company Again Raised its Planned Dividend Payment for FY2/12

<table>
<thead>
<tr>
<th></th>
<th>First-half dividend</th>
<th>Second-half Dividend</th>
<th>Full-year dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dividend payout ratio</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY2/2010</td>
<td>40 → 75</td>
<td>45 → 80</td>
<td>155</td>
</tr>
<tr>
<td>FY2/2011</td>
<td>85 → 100</td>
<td>85 → 110</td>
<td>210</td>
</tr>
<tr>
<td>FY2/2012E</td>
<td>100 → 110</td>
<td>110</td>
<td>245~255</td>
</tr>
</tbody>
</table>

*FY2/2011 Results were record highs
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