COMPANY RESEARCH AND ANALYSIS REPORT

RIZAP Group, Inc.

2928

Sapporo Securities Exchange Ambitious

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Index

Summary

Accelerating growth from the twin axes of “RIZAP-related businesses” and “Group companies”

RIZAP Group, Inc. <2928> (hereafter, also “the Company,” formerly named Kenkou Corporation) started with a mail-order business and subsequently expanded its business fields and scope while actively utilizing M&As with an emphasis on “health.” The Group covers the “self-investment industry” as its business domain and operates beauty and health, apparel, housing and lifestyle, and entertainment businesses.

1. Earnings increased above forecast in FY3/18 Q1; conducted large-scale upfront investment

In FY3/18 Q1, revenue was ¥28,652mn (up 44.5% year on year (YoY)) and operating income was ¥2,701mn (down 27.5%). Profits declined as the result of the Company conducting upfront investment in order to accelerate growth in the future, and it is not a cause for concern. Instead, we should pay attention to the high level of progress made toward achieving the 1H forecasts, including 66.6% of the operating income forecast. The positive factors were the steady expansion of the RIZAP-related businesses and the headway made in the restructuring of the Group companies, and steady progress is being made for the growth strategies on both of these two axes.

2. RIZAP-related businesses are currently achieving record highs; RIZAP GOLF has entered a period of rapid expansion

Within the approximately ¥3bn of upfront investment in Q1, around ¥2.6bn was invested in the RIZAP-related businesses. By reflecting on this, we can get a sense of this significant profit potential of the RIZAP-related businesses. In these businesses, the Company is steadily developing various measures for the body shaper business, which is an existing business, including to improve LTV and productivity and for the fully fledged deployment of the corporate program. Each of the new businesses is also steadily expanding, but among them, RIZAP GOLF has entered the same rapid-growth stage that the body shaper business went through in the past. In a situation of waiting lists to become members, the Company plans to secure trainers through holding its own golf tournament and to rapidly establish and maintain a human resources structure.

3. Is also making steady progress in improving results at Group subsidiaries; the plan is for all listed subsidiaries to be profitable for the full fiscal year

Steady progress is also being made in improving management at Group subsidiaries. In Q1, DREAM VISION CO., LTD.<3185>, PASSPORT Co., Ltd. <7577>, and Maruko Corporation <9980> became profitable, while profits also greatly increased at IDEA INTERNATIONAL CO., LTD. <3140>, whose fiscal year ends in June, following repeated upward revisions to its forecasts. The other listed companies are also working on cost structure reforms and other measures, and the plan is for all listed subsidiaries to be profitable for the FY3/18 full year. IDEA INTERNATIONAL and Maruko have raised funds to accelerate their growth strategies, but the Company should be able to raise sufficient funds internally for the RIZAP-related businesses. Fund-raising for the other subsidiaries has also settled down and it seems that the focus now is on implementing growth strategies.

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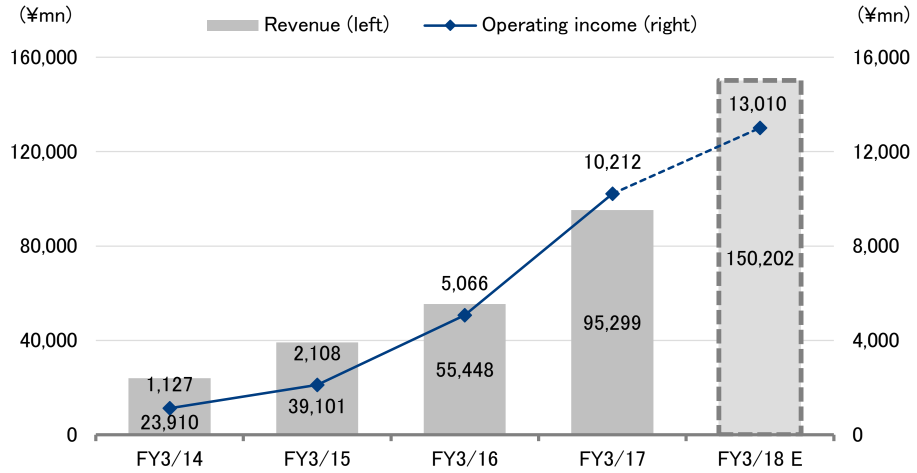
Key Points

- The size of the upfront investment once again points to the significant profit potential of the RIZAP-related businesses
- Profits at listed subsidiaries are steadily improving. All listed subsidiaries are expected to become profitable and record operating income in FY2017.
- RIZAP GOLF has entered the same period of rapid expansion as that experienced by body shaper. It is dealing with the issue of securing trainers by holding its own golf tournaments, and this business is expected to be profitable in this fiscal period.

Results trends



Source: Prepared by FISCO from the Company's financial results

Company profile

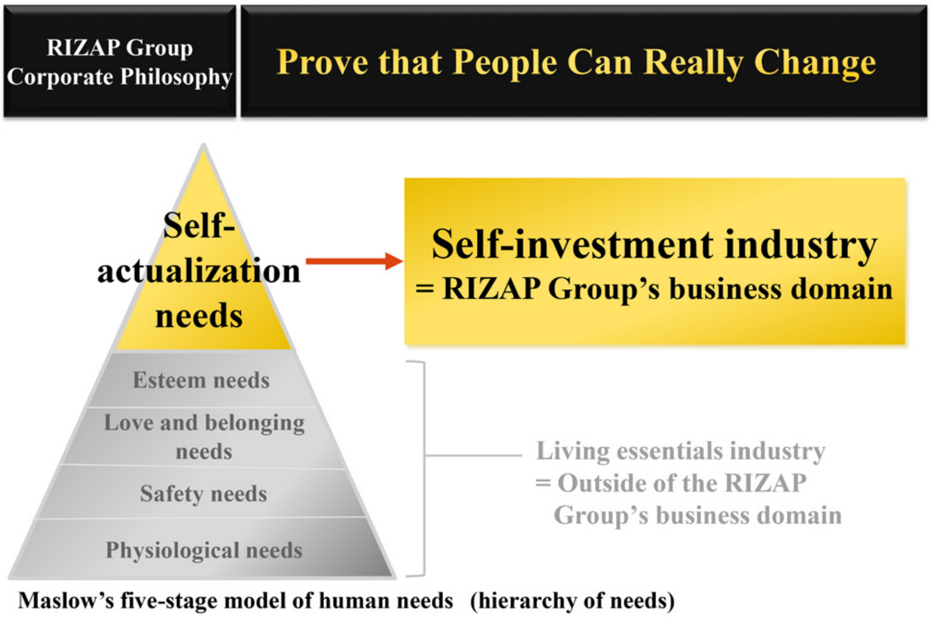
Based on its management philosophy of “Proving that ‘people can change,’” the Company is growing rapidly in its business domain of the self-investment industry

1. History and business domain

The Company was established as the Kenkou Corporation in April 2003 for the purpose of mail order sales of health foods. From this start in “health,” it has expanded its business domain and content while actively utilizing M&A. In July 2016, the Company transferred the mail-order sales business to the operating company through a company split, and it became a pure holding company. At the same time, it changed its company name to RIZAP Group Inc. It is currently developing four businesses; beauty and health, apparel, housing and lifestyle, and entertainment.

The Company considers the Group's business domain to be "the self-investment industry" and it provides products and services to satisfy the "desire for self-actualization." "The self-investment industry" is a market that can expand without limit, unlike the "industry for necessities for daily life," and the Company's basic approach is that if it can launch products and services tailored to this market, it will be able to rapidly increase earnings from being highly profitable and from obtaining highly sustainable profits. This basic philosophy is the theoretical and intellectual pillar behind COMMIT 2020, its medium-term management plan that sets high targets.

RIZAP Group's business domain and the "self-investment industry"



Source: The Company's results briefing materials

There are eight listed companies in the Group and it is developing four businesses, including for beauty and health

2. Overview of the Group and its business segments

The Company started out with the mail-order sales business (mainly carried out by the Kenkou Corporation) and eventually developed the body shaper RIZAP business (mainly carried out by RIZAP). At the same time, it is growing by acquiring and making subsidiaries of other companies.

When acquiring a company, the viewpoint that the Company always takes is whether it can provide value in the previously described "self-investment industry," or in other words, whether it can generate synergies with the other companies in the RIZAP Group. Even in those cases where synergies with the existing businesses are hard to see at first glance, the Company's aim and intention for the acquisition can be understood from this viewpoint. In its previous M&A, it has had a lot of success in raising the value of the companies it acquired, and at FISCO we think that the reason for this can also be found in this viewpoint.

Currently, the Company's business is constituted of four business segments. The main constituent companies and their business forms are as follows.

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The “beauty and health business” is mainly carried out by the body shaper business company RIZAP, RIZAP Innovation that develops new businesses under the RIZAP brand, Kenkou Corporation that conducts the mail-order business, Japan Gals Co, Ltd., body-shaper underwear company Maruko Corporation <9980>, media business operator Pado Corporation <4833>, and Hokuto Printing Co., Ltd.

The “apparel business” is conducted by the listed companies of DREAM VISION, Jeans Mate Corporation <7448>, and Marusho hotta Co., Ltd. <8105>, and also the non-listed companies of maternity ware company Angeliebe Co., Ltd., luxury ready-made clothing company MARIMURA, women’s and men’s clothing company Auntie Rosa, and MISUZU Co., Ltd.

The “housing and lifestyle business” is comprised of IDEA INTERNATIONAL and PASSPORT, which carry out the planning, development, manufacture, and sales of lifestyle products, and Tatsumi Planning, which is involved in custom-ordered housing and renovation.

The “entertainment business” is comprised mainly of SD ENTERTAINMENT, Inc. <4650>, which manages entertainment facilities, and NIHONBUNGEISHA Co., Ltd., a publishing company.

Results trends

Sales increased for the 8th consecutive period
Although operating income declined YoY due to the upfront investment, achieved 66.6% of the 1H operating income forecast

1. Overview of the FY3/18 Q1 results

In FY3/18 Q1 results, the Company posted revenue of ¥28,652mn (up 44.5% YoY), operating income of ¥2,701mn (down 27.5%), profit before income taxes of ¥2,552mn (down 29.4%), and profit attributable to owners of parent of ¥2,167mn (down 18.7%).

The details are given below, but basically the reason for the decline in profits YoY was that the Company conducted upfront investment of approximately ¥3bn. So at FISCO, we think this is absolutely no cause for concern, and that instead, we should be focusing on the rates of progress for the 1H forecasts. It can be said to have made extremely steadily progress, achieving 41.5% of the revenue forecast and 66.6% of the operating income forecast.

Overview of FY3/18 Q1 results

(¥mn)

	FY3/17			FY3/18				
	Q1 results	1H	Full year	Q1	YoY growth rate	1H progress rate vs. forecast	1H (E)	Growth rate
Revenue	19,834	41,507	95,299	28,652	44.5%	41.5%	68,986	66.2%
Operating income	3,725	6,393	10,212	2,701	-27.5%	66.6%	4,053	-36.6%
Operating margin	18.8	15.4%	10.7%	9.4%	-	-	5.9%	-
Profit before income taxes	3,614	6,064	9,604	2,552	-29.4%	71.7%	3,560	-41.2%
Profit attributable to owners of parent	2,666	4,262	7,678	2,167	-18.7%	95.6%	2,268	-46.8%

Source: Prepared by FISCO from the Company's financial results

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Below we present results by segments.

In the beauty and health business, revenue was ¥14,394mn (up 89.0% YoY) and operating income was ¥764mn (down 46.0%). In the mainstay RIZAP body shaper business, the Company actively conducted advertising in Q1 and the number of new members greatly increased, and cumulative member numbers had reached approximately 87,000 people by the end of June 2017 (89,000 people at the end of July). The contract renewal rate, which at FISCO we think is the most important KPI, is steadily rising, and it has approximately doubled compared to 2 years ago in FY3/16 1H. Also, as a result of the launch of the new reservation management system, the utilization rate and revenue per booth are increasing significantly and continue to play the role of driving the expansion in earnings. Maruko achieved profitability in Q1 for the first time in 9 fiscal periods. In the RIZAP-related businesses other than the body shaper business, the number of RIZAP GOLF schools had increased to 12 by the end of July, while member numbers and revenue are rising in each of RIZAP ENGLISH, RIZAP COOK, and RIZAP KIDS.

In the apparel business, revenue was ¥5,355mn (up 113.1% YoY) and operating income was ¥2,329mn (up 17.0 times). Revenue steadily increased at DREAM VISION, MARIMURA and Angeliebe, all companies that have been in the Group for some time, while Jeans Mate, which joined the Group in February 2017, helped the apparel business more than double its revenue YoY. DREAM VISION improved its operating income by more than ¥800mn (including from negative goodwill on making TRECENTI Co., Ltd. a subsidiary), while profits also greatly increased following the recording of negative goodwill after Marusho hotta was made a subsidiary.

In the housing and lifestyle business, revenue was ¥6,760mn (down 4.9% YoY) and operating income was ¥168mn (down 80.1%). IDEA INTERNATIONAL continued to steadily expand sales of kitchen appliances, such as hotplates, and travel goods, and its revenue increased significantly. Since PASSPORT joined the Group in May 2016, it has been advancing cost structural reforms and other measures, and as a result, it became profitable in Q1. The decline in revenue and profits was due to the effects of the postponement of a large-scale order in Tatsumi Planning's photovoltaic power generation business.

In the entertainment business, revenue was ¥2,940mn (up 6.9% YoY) and the operating loss was ¥53mn (compared to operating income of ¥1,606mn in the previous fiscal year). SD ENTERTAINMENT worked to accelerate investment in growth in the fitness business and to implement a strategy to beat the competition in the GAME business. NIHONBUNGEISHA, a publishing company that joined the Group in April 2016, has been working to further expand synergies by repeatedly publishing RIZAP-related books. In the same period in the previous fiscal year, profits were significantly increased by the recording of negative goodwill on NIHONBUNGEISHA being made a subsidiary, but results returned to normal in Q1, and profits decreased YoY for this reason.

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FY3/18 Q1 business trends by segment

(¥mn)

	FY3/17				FY3/18		
						YoY	
	Q1	Q2	1H	Full year	Q1 results	Growth rate	Value
Revenue							
Beauty and health	7,614	9,778	17,392	38,225	14,394	89.0%	6,779
Apparel	2,512	2,931	5,444	13,042	5,355	113.1%	2,842
Housing and lifestyle	7,110	6,056	13,167	33,253	6,760	-4.9%	-349
Entertainment	2,751	3,020	5,772	12,044	2,940	6.9%	188
Subtotal	19,989	21,787	41,776	96,566	29,451	47.3%	9,461
Adjustment	-155	-113	-269	-1,266	-798	-	-642
Total	19,834	21,673	41,507	95,299	28,652	44.5%	8,818
Operating income							
Beauty and health	1,414	3,285	4,700	6,920	764	-46.0%	-650
Apparel	136	-86	50	1,743	2,329	1,602.1%	2,193
Housing and lifestyle	847	-204	642	1,150	168	-80.1%	-678
Entertainment	1,606	7	1,613	1,783	-53	-	-1,659
Subtotal	4,004	3,001	7,006	11,598	3,209	-19.9%	-795
Adjustment	-278	-334	-613	-1,385	-507	-	-228
Total	3,725	2,667	6,393	10,212	2,701	-27.5%	-1,023

Note: Segment revenue includes internal transactions.
Source: Prepared by FISCO from the Company's financial results

The size of the upfront investment once again points to the profit potential of the RIZAP-related businesses

2. Details of the upfront investment

As previously stated, the reason why operating income declined YoY in Q1 was that the Company conducted upfront investment to increase earnings from Q3 onward. Since the past, it has repeated a pattern of actively conducting advertising in Q1 and Q2, and then recouping this investment as earnings in Q3 and Q4. In FY3/17, it temporarily broke this pattern and actively invested in advertising in FY3/16 Q4, but in FY3/18 Q1, it returned to its previous pattern.

Breakdown of upfront investment in FY3/18 Q1

Implemented concentrated upfront investment in 1Q toward major growth in this fiscal period (¥3.01 billion in total)

1. Upfront investment in the RIZAP-related businesses

	Breakdown	Amount
1	Increases in marketing costs (advertising costs and sales-promotions costs)	¥1.13 billion
2	Operating losses in RIZAP GOLF, ENGLISH, KIDS, and COOK	¥0.64 billion
3	Store development and systems investment	¥0.34 billion
4	Investing in human resources to strengthen RIZAP for seniors	¥0.2 billion
5	Others (operating losses at RIZAP Apparel, overseas RIZAP, etc.)	¥0.32 billion
	Total	¥2.63 billion

2. Decrease in profits at the Group companies undergoing structural reforms, etc.

	Breakdown	Amount
1	Operating loss at Pado	¥0.11 billion
2	Operating loss at Jeans Mate (April to June)	¥0.7 billion
3	Decrease in profits at Tatsumi Planning※	¥0.2 billion
	Total	¥0.38 billion

*Decrease in profits due the postponement of a large-scale project in the photovoltaic power generation business (order expected to be received by September)

Source: The Company's results briefing materials

For the RIZAP-related businesses, the investment was for costs to enhance stores and human resources, with an awareness of marketing expenses and increasing losses. FISCO is focusing on how this upfront investment can be read as indicating the extent that the profitability of the RIZAP-related businesses can improve and their potential for the future.

RIZAP-related businesses are included in the beauty and health business segment and in Q1, operating income in this segment was ¥764mn. If we add the upfront investment in the RIZAP-related businesses of approximately ¥2,630mn, we can estimate that the effective operating income in this segment in Q1 was around ¥3,400mn. So based on the estimation that ¥3,400mn x 4 quarters = annual segment income of ¥13,600mn, we can get a sense of the strength of the profit potential of the RIZAP-related businesses (this segment's operating income includes income from non-RIZAP businesses, such as mail order sales, but most of it would seem to be from RIZAP).

Conversely, in Q1, the Group companies did not invest in marketing expenses, and on totaling the operating loss at a newly consolidated subsidiary and the impact of factors causing profits to decline at existing subsidiaries. These so-called "factors decreasing profits YoY" were around ¥380mn, which in a broad sense can be considered to be upfront investment. From this breakdown, at FISCO we were surprised that each subsidiary is achieving results from their own efforts, because the Company, in a real sense, did not invest in advertising and other marketing expenses for these Group companies, so earnings improved at each of them without relying on the support of the Company. The Company's policy is to first spend substantively on expenses at subsidiaries only in the phase of fully pursuing Group synergies. We have great expectations for an expansion in earnings at the point in time when activities are conducted in earnest as the Group as a whole, such as for investing in marketing expenses and mutual exchanges of customers between Group companies.

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Earnings are steadily improving at the listed subsidiaries and all are expected to be profitable and record operating income in FY2017

3. Improvement in earnings at subsidiaries

The Company has 8 listed subsidiaries and more than 10 non-listed subsidiaries. Looking at those listed subsidiaries that disclose their financial information, at FISCO we highly evaluate the steady improvement in results that they are achieving as a whole.

The four companies whose results improved significantly up to Q1 are IDEA INTERNATIONAL, Maruko, DREAM VISION, and PASSPORT. After IDEA INTERNATIONAL joined the Group in 2013, it worked to rebuild its brand and product lineup, and as a result it has become firmly established as a profitable company with leading products, including miscellaneous kitchen goods and travel goods.

Maruko joined the Group in 2016, and it achieved profitability for the first time in 9 years in Q1 as a result of various efforts, including introducing in-company installment payment sales, launching new brands in a low price range, and improving sales and production systems. In addition, in the current fiscal year it is forecasting a substantial increase in profits, up nearly 10 times YoY.

DREAM VISION has been taking drastic measures for its product planning and sales, and thanks to these measures, profits increased greatly in the existing apparel EC business and it achieved profitability for the first time in a Q1. The profit amount in this Q1 was increased by the recording of negative goodwill following the acquisition of a subsidiary, but it is worth noting that as of Q1, it has achieved 97% of its full fiscal year forecast for operating income.

PASSPORT has renewed 11 stores based on a new concept, and revenue rose 10% and customer numbers increased 22% compared to before this renewal, and as a result it achieved profitability in Q1. Going forward, in addition to expanding the transition to the new concept to all stores, it is aiming to achieve profitability for the full fiscal year by strengthening new category products.

Results at the listed subsidiaries

Company name	Code	Completion date of the acquisition as a subsidiary	FY2016 Q1		FY2016 full year		FY2017 Q1		FY2017 full year E	
			Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
IDEA INTERNATIONAL CO., LTD.	3140	2013/9/25	1,445	-3	6,160	182	1,493	-19	7,205	401
SD ENTERTAINMENT, Inc.	4650	2014/1/16	1,857	-9	8,281	188	1,887	-68	8,600	450
DREAM VISION CO., LTD.	3185	2015/3/31	674	-73	3,107	-154	1,293	756	5,283	780
PASSPORT Co., Ltd.	7577	2016/5/27	2,619	-381	10,215	-552	2,026	14	10,000	300
Maruko Corporation	9980	2016/7/5	2,675	-690	13,401	135	3,398	42	15,000	1,200
Jeans Mate Corporation	7448	2017/2/20	2,145	-149	9,195	-829	2,010	-218	11,550	300
Pado Corporation	4833	2017/3/31	1,646	-133	6,997	-311	1,622	-113	7,400	230
Marusho hotta Co., Ltd.	8105	2017/6/28	1,733	29	7,488	86	1,696	-8	7,500	111

Note: As IDEA INTERNATIONAL's fiscal year ends in June, the FY2017 result represents that for the year ended June 2017. PASSPORT's FY2016 (FY3/17) results were for an irregular fiscal period of 13 months following the change to the fiscal period. Jeans Mate's FY2017 (FY3/18) results are for an irregular fiscal period of 13 months 11 days following the change to the fiscal period.
Source: Prepared by FISCO from each company's financial results

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Among the remaining four companies that recorded an operating loss in Q1, at SD ENTERTAINMENT, this was due to the upfront investment conducted in Q1, and results are expected to recover from Q2 onwards. Marusho hotta just joined the Group in June 2017, and an evaluation of the improvement to its results after joining the Group should be made from Q2 onwards. Previously it was a profitable company, and the operating loss in Q1 was due to one-off structural-reform expenses, including to integrate offices and systems.

Since joining the Group, Jeans Mate and Pado have been conducting cost structural reforms, upfront investment, and other measures, and both companies plan to become profitable and record operating income on a full fiscal year basis. They appear to have made steady progress up to the current time, but it is still early days since they joined the Group and this Q1 was too soon for the effects of these measures to become apparent.

The listed subsidiaries have been highly evaluated for their various efforts, including the progress made in improving earnings and in strengthening returns to shareholders, and overall, their share prices have been trending strongly. There are subsidiaries whose share prices have risen sharply, but even in the current situation where share prices have settled down to a certain extent, the listed subsidiaries' unrealized gains continue to be at high levels.

Valuation gains / losses from the listed subsidiaries

Company name	Code	Listed market	Ownership stake at the time of the acquisition	Acquisition price (¥)	Number of shares acquired (shares)	Acquisition amount (¥mn)	As of Aug. 21, 2017		Share acquisition method
							Share price (¥)	Valuation gain / loss (¥mn)	
IDEA INTERNATIONAL	3140	TSE JASDAQ	66.25%	104.3	7,118,400	742	1,000	6,376	Private-placement capital expansion
SD ENTERTAINMENT	4650	TSE JASDAQ	72.03%	89	5,340,000	475	991	4,817	TOB from GEO
DREAM VISION	3185	TSE Mothers	78.50%	192	3,900,000	748	1,415	4,770	Private-placement capital expansion
				456	265,200	121	1,415	254	TOB
PASSPORT	7577	TSE JASDAQ	65.83%	117	9,730,000	1,138	498	3,707	Private-placement capital expansion
Maruko	9980	TSE-2	63.18%	50	55,000,000	2,750	392	18,810	Private-placement capital expansion
Jeans Mate	7448	TSE-1	63.99%	160	5,748,753	920	604	2,552	TOB
				187	3,450,000	645	604	1,439	Private-placement capital expansion
Pado	4833	TSE JASDAQ Growth	71.11%	74	13,513,515	1,000	492	5,649	Private-placement capital expansion
Marusho hotta	8105	TSE-2	62.27%	55	35,000,000	1,925	361	10,710	Private-placement capital expansion
Total						10,464		59,084	

Source: Prepared by FISCO from each company's materials

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Medium to long-term growth strategy and the progress made

Growth on the two axes of the RIZAP-related businesses and Group companies

1. Overall image of the growth strategy and the progress made

The Company has formulated the COMMIT 2020 medium-term management plan targeting FY3/21 as its final year. The numerical targets for the plan's final year are revenue of ¥300,000mn and consolidated operating income of ¥35,000mn.

With regards to the Company's business domain of the self-investment industry, the scale of the market it is targeting is estimated to be ¥7 trillion. For this market, it is implementing 4 growth strategies; 1) growth from existing business, 2) launch of new businesses, 3) a business collaboration strategy, and 4) M&A and synergies.

When focusing on the businesses themselves and their content, it is possible to replace these strategies with the growth axes of "growth of RIZAP-related businesses" and "growth of Group companies." To ascertain and understand the growth strategies in relation to the actual actions of the Company, we can say that it is more useful to divide them into two in this way.

Up to the present time, clear progress has been made by both the RIZAP-related businesses and the Group companies. The trends in results at Group companies are described in the "Results trends" section, so to avoid repeating them here, the description below is mainly of the RIZAP-related businesses.

The focus in the body shaper business is on the new corporate program
Steady progress is also being made in the other growth strategies

2. RIZAP body shaper business

(1) Overall image of the body shaper business growth strategy

As described in the previous report, "RIZAP," which started from the body shaper business, has expanded its business domains to become the RIZAP-related businesses of lessons for golf, English, and cooking. These new businesses are entering periods of rapid growth, but currently it is still widely recognized that the body shaper business constitutes the core of earnings.

At the same time as being the main pillar of earnings, the body shaper business is the main growth engine. As before, new members continue to increase at a pace of 1,500 to 2,000 people a month, and as of the end of July 2017, cumulative member numbers had reached 89,000 people. Member numbers are a KPI for the Company, and at the same time they are a major asset. Its specific measures to utilize this asset for growth include 1) raising the lifetime value (LTV) per member, 2) expanding the customer base by capturing seniors as customers, 3) increasing store sales by improving productivity, and 4) expanding the business for corporations and related customers.

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The progress made in Q1 for improving LTV and productivity, and for the business for corporations and related, is described below.

(2) Measures to improve LTV: Introducing the Body Management Program (BMP)

The Company had introduced its Life Support Program (LSP) and had been working on measures to raise the LTV of members. Raising the LTV signifies switching the RIZAP business model from a flow type to a stock type. On the unit of revenue per member, in the case of the standard course only, it is on the scale of hundreds of thousands of yen, of "entrance fee + ¥298,000 + product sales." However, by retaining those members who have finished the standard course as active members through some form of contract renewal, revenue per member dramatically increases.

The Life Support Program enables members to aim to maintain their body shape and health through receiving twice monthly counseling from trainers for ¥19,600. In the case of a contract-renewal member, revenue per member becomes "entrance fee + ¥298,000 + product sales + (¥19,600 × number of continuous LSP months)."

Along with the LSP, the Company is also continuing to introduce machine rooms. This entails refurbishing one part of the booth as a machine room and installing training machines, and members are able to freely use the machines to maintain and improve their body shapes. While there is no direct trainer guidance, in addition to distributing training sheets so that members can appropriately manage their training themselves, they are provided with periodic counseling.

As a result of introducing this program, the Company is making steady progress in converting the body shaper business to a stock-type profit structure. Specifically, the percentage of members who renew their contract on the end of the standard course has approximately doubled compared to one year ago. Also, the percentage of members who remain members one year after they joined has risen by around 2.1 times over the same period.

The Company has unveiled the slogan of "Becoming partners to our guests for their lifetime," and at the same time, it developed the aforementioned LSP and has newly introduced the "Body Management Program (BMP)." The content of BMP is essentially unchanged from LSP. At FISCO, we think the focus for BMP should be making the approximately 1,000 trainers into full-time employees, which can be expected to improve their motivation and retention rate. Also, we highly evaluate this step as evidence that "Becoming guests' lifelong partner" is not merely a slogan or sales catchphrase for the Company, but is something that it is seriously working to achieve. The before-and-after body shaper TV commercials are extremely impactful and have proven to be very popular, but we think that making trainers full-time employees will have at least the same effect as these commercials in terms of improving the popularity of the business.

(3) Improving productivity: Introducing a new reservation management system

The Company has responded to the continual increase in member numbers in the body shaper business by recruiting a large number of trainers and increasing the number of stores. Although the extreme situation has improved, the situation is still that, depending on the day of the week and the time of day, the number of trainers is not keeping up with customer demand. One reason for this is that the percentage of working-age members (in their 20s to 40s) is high and they tend to train at the same times, of early in the mornings, the evenings, and weekends and holidays. But another reason according to the Company's own analysis is that its reservation system has not been sufficiently computerized and this could be causing considerable opportunity loss.

To solve this problem, in April 2017 the Company launched a new online reservation management system. Its effects are proving to be greater than initially anticipated. By June 2017, which is around three months after the launch of the new reservation system, the utilization rate per booth was around 1.6 times and revenue per booth was approximately 1.8 times compared to January of the same year, when the old system was still being used. The new system can be judged to be extremely effective based on the two points: in a typical year, the utilization rate is high in January due to the New Year holiday period, and that even compared to this month, the utilization rate greatly increased. Then, the upward trend in the utilization rate has been accelerating since the launch of the new system. It would seem that there is still room for the utilization rate to rise even higher, and we can expect it to rise further in conjunction with the Company's other measures, such as to capture seniors as customers.

(4) Business for corporations and related: The fully fledged start of the "corporate program"

The Company has become even more confident about the effectiveness of the RIZAP method based on the joint research it has conducted with many universities and medical institutions and the data it has gathered up to the present time. From this situation, it has decided to evolve the body shaper business model and to advance from "one-to-one" to "one-to-N" (where "N" stands for "numerous").

Specifically, it plans to utilize the results of the "RIZAP method" that it has accumulated in the body shaper business and to provide health promotion services to corporations and local governments. While the service to individuals is one-to-one, for corporations and local governments, it will be in the form of one-to-numerous, in which a trainer is dispatched to these organizations to provide guidance for groups.

The Company has so far been providing health seminars based on the RIZAP method to corporations, and in total, 125 companies and 6,000 people have attended these seminars. Also, in its business for local governments, it partnered with Makinohara City in Shizuoka Prefecture to provide a health promotion program for the elderly utilizing the RIZAP method.

Based on this track record, the Company has embarked on a collaboration with Benefit One Inc. <2412> for a corporate program. Benefit One is a major corporate welfare service provider, and it provides services to 7,170 companies. The Company intends to utilize this customer base and encourage them to introduce its health promotion program based on the RIZAP method.

In terms of the content of the corporate program, the basic framework is that the RIZAP trainer visits a company and provides a group lesson, and in return, the Company collects a fee of several hundred thousand yen per visit. As the frequency of the lessons and other aspects are set freely according to the client company's wishes, revenue will vary widely depending on the scale of the company and other factors. But supposing that the trainer visits 4 times per month, we can estimate annual revenue will be in excess of ¥10 million, based on several hundred thousand yen x 4 times x 12 months. A major focus point will be the extent to which revenue from the corporate program, which the Company has now launched fully in collaboration with Benefit One, will increase in its first fiscal year.

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The golf business is recreating the body shaper business' period of rapid expansion
It is dealing with the issue of securing trainers by holding its own golf tournaments and is expected to become profitable in this fiscal period

3. RIZAP GOLF's progress

Among the RIZAP-related new businesses, the golf business, which is developing the RIZAP GOLF brand, currently has the greatest momentum.

Following the contract with the professional golfer Ryo Ishikawa for him to appear in commercials from this spring, applications from people wanting to become members have greatly accelerated. There were 12 schools at the end of March 2017 and the plan is to increase this number to 25 by the end of March 2018.

According to the Company, for each of the KPI of the number of inquiries at the current time and the contract rate, the golf business is achieving the same rapid growth as did the RIZAP body shaper business (specifically, the process of increasing store numbers to 50 stores). Therefore, just as was faced by the body shaper business, the most important issue facing the golf business that it must resolve is securing trainers.

In order to acquire trainers, the Company has decided to hold its own golf tournaments. The tournaments are open to both pros and amateurs, and it intends to recruit excellent trainers from among the competitors. Following the first tournament on July 21, it plans to hold 30 major tournaments in half a year. So far, it has recruited an average of 5 trainers per tournament and it intends to recruit 150 to 200 trainers over the 30 tournaments toward establishing a structure of 200 to 250 trainers, when combined with its existing trainers.

At FISCO, we evaluate the Company holding its own golf tournaments to be an extremely effective measure from the perspective of recruitment costs per trainer. If the recruitment goes smoothly and it establishes a structure of 200 trainers, it will be able to realize an enhanced network of 25 schools, which is considered to be fully sufficient in order to realize the annual sales of ¥5bn that the Company is aiming for. While timing is an issue, we think that the structure will be practically in place by December.

Regarding earnings, the Company itself has announced that it expects RIZAP GOLF to become profitable during FY3/18. On this point also, we can see it following the same pattern as that followed by the RIZAP body shaper business in the past. For some time, the Company has considered that RIZAP GOLF will be able to reproduce the success of the body shaper business, but others were of a more skeptical view. If in the current period, the number of schools rapidly increases in response to demand and it becomes profitable, then even though the process is still underway, it can be said that this is evidence that RIZAP GOLF is following the same path as that followed by the body shaper business.

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Is steadily developing schools for each of ENGLISH, COOK, and KIDS
Expectations are also rising for RIZAP Apparel

4. Trends in the other RIZAP-related businesses

(1) RIZAP ENGLISH

The Company currently operates two schools in Ikebukuro and Shinjuku. It opened the first school in July 2016 and during FY3/17, it focused on refining methods and operations rather than expanding the school network. During that time, the number of students steadily increased and it seems the Company has become confident the time is right for fully fledged business development. In FY3/18, it plans to expand the network.

There was no change in Q1 in the number of schools. The number of sessions has been steadily increasing and a new speaking course was established from August. The establishment of new schools is set to accelerate from Q2 onwards.

(2) RIZAP COOK

In RIZAP COOK, the cooking lessons began in November 2016 under the R-COOK brand at a school in Jiyugaoka, based on the concept of "Our commitment to our top-class chefs dramatically improving your cooking in only two months." The Company changed the name to RIZAP COOK from June 1, 2017, and decided on the fully fledged development of a network of multiple schools. It seems to be aiming for a network of 10 schools by the end of March 2018.

There were no major changes in Q1 and this business continues to grow steadily. Member numbers are steadily increasing. Based on this, a new school was opened in Ikebukuro on August 17, followed by a Kichijoji school on September 7, while a new Ginza school is scheduled to open at the end of September.

(3) RIZAP KIDS

The Company has opened one school in Denenchofu and is currently conducting a pilot test. The concept is exercise-guidance studios with an approach that enables children to use their abilities. The basic period, of 16 lessons in 2 months, and the setting of the fees is the same as for the other RIZAP programs.

Revenue has rapidly increased since July 2017 as a result of rotating the PDCA cycle in FY3/17 for programs, operations, and marketing, and conducting upfront investment in them. Based on this, the plan is to open two more schools in October and November of this year.

(4) RIZAP Apparel

Until now, the Company has been exploring the market's reaction through repeatedly conducting sales in temporary stores, including at special booths within department stores. In a situation in which record sales have been achieved at each of these stores, it became increasingly confident of this business succeeding. Based on this, it plans to open a real store this fall.

Although the specific details, such as where it will open stores, are not yet clear, it seems that the Company will utilize the store network of the sports goods retail business that it acquired from Yamano Holdings Corporation <7571> in May. At FISCO, we think that RIZAP Apparel might be able to achieve annual sales of ¥500mn to ¥1bn on a standalone basis, and that the sports goods retail business as a whole could reach annual sales of around ¥3bn.

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The prerequisite is that fund raising has a growth story leading to the expansion of ROE
It is set to settle down, temporarily

5. The approach for fund raising

In order to implement the growth strategy described above, there is the tendency to think it possible that fund raising will be conducted in the future, but at FISCO, we think this possibility is low. During the results briefing, President and Representative Director Takeshi Seto stated that the needs of the Company itself for fund raising are low. The background to this may be the steady acquisition of new members in the RIZAP business, including in the related businesses. At the same time, it seems that the Company has applied the brakes to the reliance of the subsidiaries on it as their parent company, and at the current time, fund raising by the Company for its subsidiaries does not seem to be an option.

Within the Group, two subsidiaries, IDEA INTERNATIONAL and Maruko, conducted equity financing (raising funds through issuing new shares) in Q1, and they raised approximately ¥10bn in total. The background to this is that in terms of results, both companies have become wholly profitable (Maruko on a forecast basis), they also both have multiple investment projects for growth that could improve their ROE (return on equity).

The Company does not intend for the other listed subsidiaries to conduct equity financing unless they have a clear equity story like these two companies. The first option is for each subsidiary to aim to improve its profitability through cost structural reforms and business reforms, and to work to raise funds internally, and then after that, raising funds externally will be considered at the stage where a story for further growth and to improve ROE has been clearly depicted.

Business outlook

Expects to achieve the initial forecasts from the growth of the RIZAP-related businesses and improved earnings of Group companies

For FY3/18, the Company is forecasting that revenue and profits will increase substantially, the same as in the previous fiscal year, with revenue of ¥150,202mn (up 57.6% YoY), operating income of ¥13,010mn (up 27.4%), profit before income taxes of ¥11,983mn (up 24.8%), and profit attributable to owners of parent of ¥8,007mn (up 4.3%). There has been no change to the initial forecast.

Overview of the FY3/18 forecasts

(¥mn)

	FY3/17			FY3/18							
										YoY	
	Q1 results	1H	Full year	Q1	YoY growth rate	1H progress rate vs. forecast	1H (E)	Growth rate	Full year (E)	Growth rate	Value
Revenue	19,834	41,507	95,299	28,652	44.5%	41.5%	68,986	66.2%	150,202	57.6%	54,903
Operating income	3,725	6,393	10,212	2,701	-27.5%	66.6%	4,053	-36.6%	13,010	27.4%	2,798
Operating income margin	18.8%	15.4%	10.7%	9.4%	-	-	5.9%	-	8.7%	-	-
Profit before income taxes	3,614	6,064	9,604	2,552	-29.4%	71.7%	3,560	-41.2%	11,983	24.8%	2,379
Profit attributable to owners of parent	2,666	4,262	7,678	2,167	-18.7%	95.6%	2,268	-46.8%	8,007	4.3%	329

Source: Prepared by FISCO from the Company's financial results

In terms of the approach to the FY3/18 forecasts, fundamentally there has been no change to that described in the previous report. As is explained below, it is considered that its approach is reasonably explained by the organic growth of the mainstay RIZAP-related businesses and the expansion of results of the group of consolidated listed and non-listed subsidiaries.

At the stage of the end of Q1, the point that differs from our expectations at FISCO was the recording of negative goodwill of ¥1,514mn following Marusho hotta being made a subsidiary (we did not expect negative goodwill to be recorded in FY3/18). This caused profits to increase, but in Q1, the Company conducted upfront investment of more than ¥3,000mn, which is around double this negative goodwill amount, and moreover it will conduct additional upfront investment on a scale of ¥1,000mn in Q2. As the Company has not changed its full fiscal year operating income forecast, on an actual performance basis, operating income has increased substantively from the initial forecast and we think it is more likely that full fiscal year forecasts will be achieved.

Revenue is forecast to increase ¥54,903mn YoY. The Company has not disclosed a detailed breakdown of this increase, but at FISCO, we estimate it to be as follows; ¥13,000mn to ¥15,000mn from the RIZAP-related businesses, approximately ¥30,000mn from the listed subsidiaries, and ¥10,000mn as the total from other subsidiaries and M&A. The breakdown for the listed subsidiaries can be easily obtained from adding the results forecasts announced by each company.

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Trend in the RIZAP-related business revenue

Business brand	Type of business/ business format	No. of stores		Revenue	
		End-FY3/17	End-FY3/18 (E)	FY3/17	FY3/18 (E)
RIZAP	Body shaping	120	120-130	Approx. ¥23,000mn	Approx. ¥28,000mn
RIZAP GOLF	Golf lessons	6	25	Several hundred million yen	Approx. ¥4,000mn to ¥5,000mn
RIZAP ENGLISH	English conversation school	2	5-10	Tens of millions of yen	Approx. ¥500mn to ¥1,000mn
RIZAP COOK	Cooking classes	1	5-10	Tens of millions of yen	Approx. ¥500mn to ¥1,000mn
RIZAP	Sports apparel	-	Approx. 10	Tens of millions of yen	Approx. ¥3,000mn
RIZAP KIDS	Children's exercise classes	1	2-3	Millions of yen	Tens of millions of yen
All RIZAP-related businesses		130	190-200	¥23,200mn	¥36,000mn to ¥38,000mn

Note: The FY3/18 revenue forecast values are FISCO estimates.
Source: Prepared by FISCO from Company materials and interviews

With regards to profits, there is no doubt that results in Q1 exceeded the Company's expectations, even on taking into consideration the fact that there was the special factor of negative goodwill. It allocated this amount to upfront investment and it plans to conduct additional upfront investment in Q2 as well. As a result of this, at FISCO we think it is highly likely that profits in Q3 and Q4 will be higher than initially expected. The question is whether or not this will be reflected on the PL (profit and loss) statement. If operating income for the current period exceeds the initial forecast, we consider that it is very possible that this amount will be allocated to upfront investment for the next fiscal period and onwards.

The segment we should be paying attention to is the beauty and health business segment, which includes the RIZAP-related businesses. Among these businesses, RIZAP GOLF is worthy of particular attention. If progress is made in the current fiscal period according to plan, it will become the second business pillar after the body shaper business, and it is expected that from the next fiscal period onwards, it will become a major engine for the sustainable growth of earnings. Another point to focus on is the body shaper corporate program. It goes without saying that the potential market for this program is huge, and expectations are rising about how much growth it can achieve in this first fiscal year through the collaboration with Benefit One.

One more point to focus on is the improvement of earnings at the listed subsidiaries. The goal is for all these companies to become profitable in the current fiscal year. At FISCO, we believe that achieving this goal would not only enhance the Company's assessment for being able to regenerate companies, it would also eradicate a large degree of the negative views held about it.

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Simplified statements of income

(¥mn)

	FY3/16 full year	FY3/17 full year	FY3/18			
			Q1 results	1H (E)	2H (E)	Full year (E)
Revenue	53,937	95,299	28,652	68,986	81,216	150,202
YoY	-	76.7%	44.5%	66.2%	51.0%	57.6%
Gross profit	32,513	46,034	14,518	-	-	-
YoY	-	41.6%	42.7%	-	-	-
Gross margin	60.3%	48.3%	50.7%	-	-	-
SG&A expenses	28,635	41,738	14,486	-	-	-
YoY	-	45.8%	75.2%	-	-	-
SG&A expenses ratio (to sales)	53.1%	43.8%	50.6%	-	-	-
Other income	227	6,687	2,923	-	-	-
Other expenses	947	770	253	-	-	-
Operating income	3,159	10,212	2,701	4,053	8,957	13,010
YoY	-	223.3%	-27.5%	-36.6%	134.5%	27.4%
Operating income margin	5.8%	10.7%	9.4%	5.9%	11.0%	8.7%
Profit before income taxes	2,806	9,604	2,552	3,560	8,423	11,983
YoY	-	242.2%	-29.4%	-41.2%	138.0%	24.8%
Profit attributable to owners of parent	1,587	7,678	2,167	2,268	5,739	8,007
YoY	-	455.5%	-18.7%	-46.8%	57.8%	4.3%
EPS after the stock split (¥)	6.26	30.13	8.51	8.90	22.52	31.42
Dividend after the stock split (¥)	-	6.05	-	-	-	6.29

Source: Prepared by FISCO from the Company's financial results

Statement of financial position

(¥mn)

	IFRS transition date (Apr. 1, 2015)	End-FY3/16	End-FY3/17	End-FY3/18 Q1
Current assets	22,724	32,522	62,086	64,736
Cash, deposits and equivalents	8,366	10,483	24,643	22,150
Trade and other receivables	8,974	12,062	20,544	20,945
Non-current assets	16,400	21,255	33,562	36,488
Property, plant and equipment	9,647	11,331	17,616	19,179
Goodwill	2,473	4,675	6,291	6,291
Intangible assets	846	689	1,013	1,287
Total assets	39,125	53,777	95,648	101,225
Current liabilities	19,898	27,296	43,636	45,908
Trade and other payables	10,766	13,756	24,326	25,313
Interest-bearing debt	7,820	10,914	15,996	17,249
Non-current liabilities	12,286	15,344	30,557	31,998
Interest-bearing debt	10,371	12,853	25,204	26,751
Total equity attributable to owners of parent	6,077	10,226	17,018	17,367
Capital stock	132	1,400	1,400	1,400
Capital surplus	200	1,799	1,692	1,399
Retained earnings	5,720	7,001	13,696	14,359
Other capital composition items	23	25	228	207
Non-controlling interests	863	910	4,436	5,951
Total equity	6,940	11,137	21,454	23,318
Total liabilities and capital	39,125	53,777	95,648	101,225

Source: Prepared by FISCO from the Company's financial results

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Cash flow statement

(¥mn)

	End-FY3/16	End-FY3/17	End-FY3/18 Q1
Cash flow from operating activities	868	175	-285
Cash flow from investing activities	-3,973	2,914	-2,919
Cash flow from financing activities	5,137	11,088	727
Cash, deposits and equivalents conversion difference	-27	-18	-16
Change in cash, deposits and equivalents	2,004	14,160	-2,493
Cash, deposits and equivalents at the start of the period	8,478	10,483	24,643
Cash, deposits and equivalents at the end of the period	10,483	24,643	22,150

Source: Prepared by FISCO from the Company's financial results

Shareholder return policy

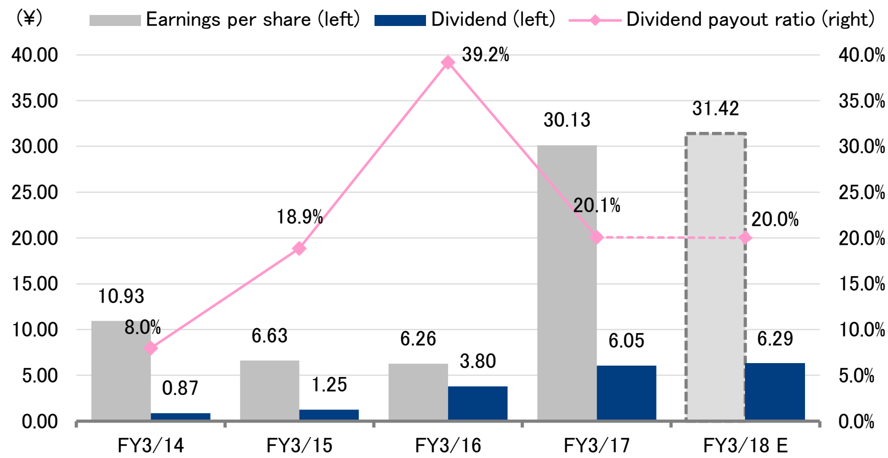
Announced a 1:2 share split
In addition to significantly expanding the shareholder benefit program, the benefit-program yield for existing shareholders will be greatly increased by the share split

The Company positions returning profits to shareholders as an important management issue. While having a basic stance of returning profits to shareholders and having a shareholder gift program, it strives to strengthen returns, mainly to individual investors. There has been no change to this stance and policy. In terms of the dividend amount, since FY3/17 the Company has revised the standard for the dividend to a consolidated dividend payout ratio of 20%.

The Company recently announced that it would be conducting a 2 for 1 share split on October 1, 2017, in order to create an environment in which individual investors can more easily invest in it. At the current share price level, an investment of close to ¥200,000 is required to purchase a unit of shares (100 shares), but after the share split, this will be reduced to under ¥100,000.

On considering the share split mentioned above, the full year FY3/18 forecast for net income per share is ¥31.42 and the dividend forecast is ¥6.29. Both are essentially unchanged from the previous forecasts. In a comparison after adjusting for the share split, the dividend will rise ¥0.24 YoY.

Earnings per share, dividend, and dividend payout ratio



Note: Reflects the 1:2 share split of October 1, 2017 (scheduled)
Source: Prepared by FISCO from the Company's financial results

The Company has established a shareholder benefits program, in which shareholders listed in the register of shareholders at the end of the fiscal year (March 31) can choose a RIZAP Group product according to the number of shares that they hold. Due to the share split mentioned above, the benefit-program yield for shareholders who purchased the Company's shares prior to the share split will rise by up to two times.

The Company has also recently made changes that further enhance the appeal of is shareholder benefit program. The first change is that it has increased the number of products from which shareholders may choose. The number of companies in the Group has risen through M&A. Reflecting this, it plans to increase the number of products in the shareholder benefits program from 157 at the end of FY3/17 to more than 300 by the end of FY3/18. The second change is the increase in the value of the benefit for large shareholders. Previously, shareholders holding 2,000 or more shares (prior to the share split) could choose a product with a maximum value of ¥36,000. But now, it has newly established a "premium class," in which shareholders who hold 4,000 or more shares or 8,000 or more shares (both after the share split) can receive a Group product with values of ¥72,000 or ¥144,000, respectively.

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