COMPANY RESEARCH AND ANALYSIS REPORT

RIZAP Group, Inc.

2928

Sapporo Securities Exchange Ambitious

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Summary

The RIZAP-related businesses will reach their fully fledged growth stages in FY3/18. Non-body shaper revenue to increase to a scale of ¥10,000mn.

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. The point to focus on in FY3/18 will be the performance of the RIZAP-related businesses

At FISCO, we think the main point to focus on in FY3/18 will be the increase in revenue from the "RIZAP-related business." When speaking of the RIZAP-related businesses, up until recently there was in fact only one main business, the RIZAP body shaper business. But today, the Company has solidified its policy of embarking on fully-fledged multi-store development for its RIZAP-related businesses, led by RIZAP GOLF. Among the RIZAP-related businesses, it is possible that the scale of the revenue from the new businesses will expand almost instantly up to the targeted scale of ¥10,000mn.

2. From FY3/18, each Group company will enter a stage of fully-fledged top-line growth

FY3/17 was a year in which earnings improved at each Group company, regardless of whether or not they are listed. Various measures are being implemented by each of these companies, including to reduce costs, review merchandising, and consolidate brands, and this reflects their different business forms and conditions. But a point they have a common is that they have changed gears toward a stage of aiming for top-line growth from FY3/18.

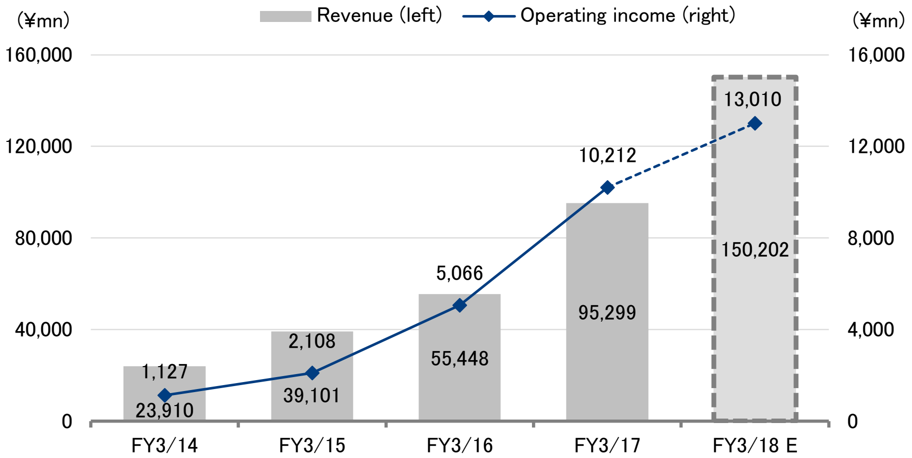
3. Earnings will continue to be at a high level in FY3/18

For the FY3/18 full-year results, 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% year-on-year (YoY)) and operating income of ¥13,010mn (up 27.4%). In FY3/17, there was the aspect that profits grew from a gain on bargain purchases ("negative goodwill), but in FY3/18 on an actual-performance basis, the plan is for operating income to increase by 3 times YoY. Within this amount, in the beauty and health segment, the Company forecasts that operating income will reach 2.4 times that of the previous fiscal year, from the doubling of earnings from the body shaper business and from RIZAP GOLF becoming profitable.

Key Points

- The subsidiaries' restructuring mode has been completed. Each company will enter a fully-fledged earnings-expansion stage in FY3/18.
- The "RIZAP business" has evolved into "RIZAP-related businesses" and entered a high-growth stage
- On an actual-performance basis, the Company-wide operating income is forecast to increase 3 times YoY and the beauty and health segment income 2.4 times

Results trends



Note: Sales up to FY3/16. Revenue from FY3/17 on the adoption of IFRS.
Source: Prepared by FISCO from the Company's financial results

Company profile

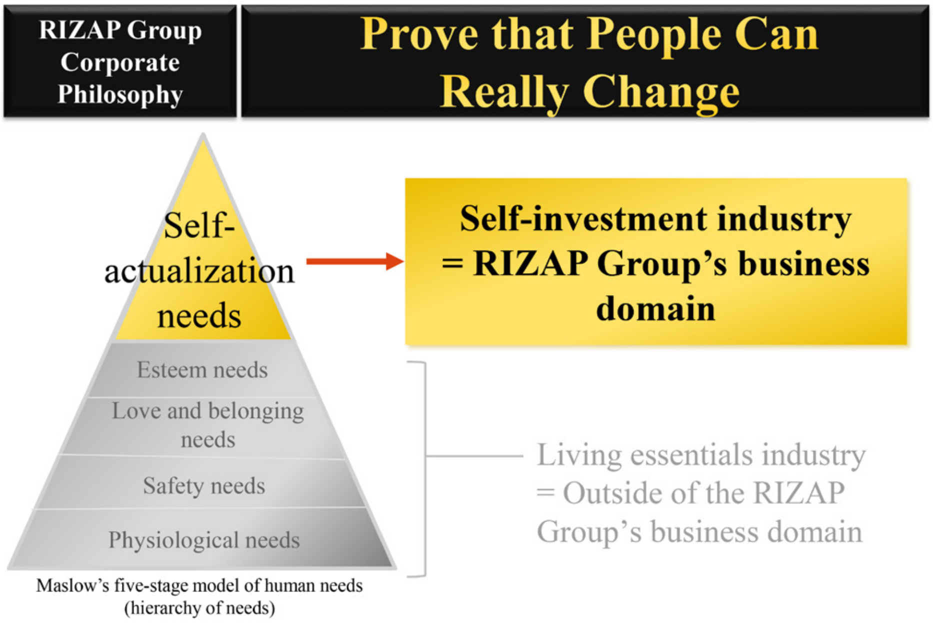
Based on its management philosophy of "Proving that 'people can change,'" the Company is growing rapidly in its business domain of the self-investment industry

1. History and business domain

The Company was established as the Kenkou Corporation in January 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 business 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 COMMIT2020, its medium-term management plan that sets high results targets.

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



Source: Prepared by FISCO from the Company's results briefing materials

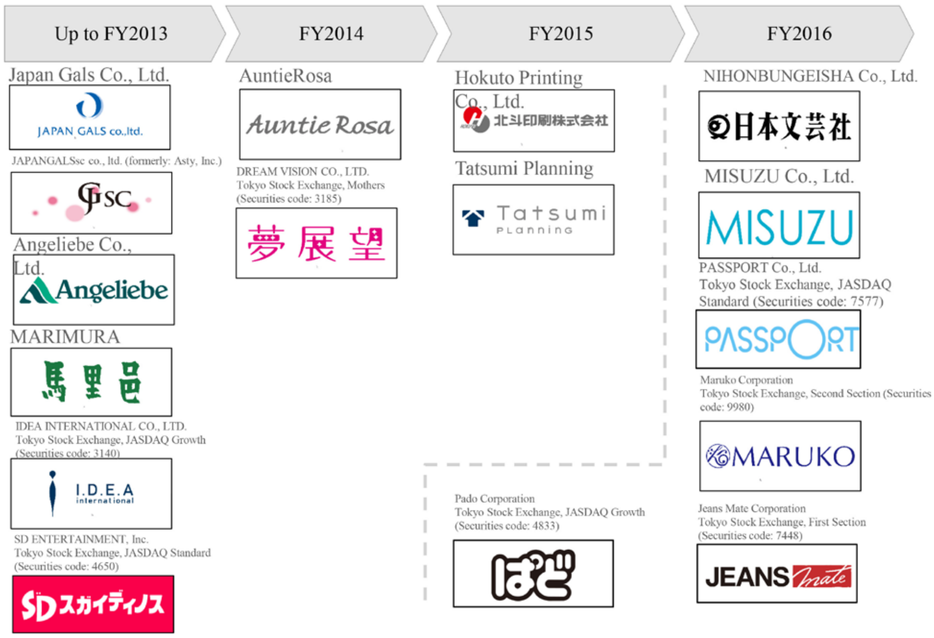
There are seven listed companies in the Group and it is developing four businesses, including for beauty and health.

2. Overview of the Company Group and its business segments

The Company's history can be said to be a history of M&A. The two businesses developed by the Company itself are the mail-order sales business (mainly carried out by the Kenkou Corporation) and the body shaper RIZAP business (mainly carried out by RIZAP). Other than these, it has entered-into and expanded its businesses through acquiring other companies and turning them into subsidiaries.

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.

The main companies that joined the Group through an M&A



Source: Prepared by FISCO from the Company's results briefing materials

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

The "beauty and health business" is mainly carried out by the body-maker 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>, and Hokuto Printing Co., Ltd..

The "apparel business" is carried out by maternity-wear company Angeliebe Co., Ltd., luxury ready-made clothing company MARIMURA, women's and men's clothing company Auntie Rosa, MISUZU Co., Ltd., the listed DREAM VISION CO., Ltd.<3185>, and Jeans Mate Corporation<7448>.

"The housing and lifestyle business" is comprised of IDEA International Co., Ltd. <3140> and Passport CO., Ltd.<7577>, 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.

On March 31, 2017, the Company made a subsidiary of Pado Corporation<4833> fromshare acquisition method. It clarified that its policy is to newly form a media business group and to advance into the media business from a group of companies comprised ofNIHONBUNGEISHA, Hokuto Printing and the RIZAP media marketing department, with Pado Corporation as the core company. Therefore, in FY3/18, it is possible that it will change and add to the business segments and reorganize the segments that the Group companies belong to.

Also, on June 28, 2017, the Company will make a subsidiary of Marusho hotta Co., Ltd. <8105> through ashare acquisition method. On the precondition that in the short term it will improve the profit structure of each business toward “building a foundation to promote a growth strategy” in the future, it intends to drastically review the current cost structure and generate profits on the scale of several hundreds of millions of yen. Toward continuous growth in the medium- to long-term, the Company will also carry out “business selection and consolidation” through extracting the issues in each business, and it is aiming for major increases in revenue and profits from the next fiscal year onwards while leveraging the synergies within the RIZAP Group. The amount to be paid for the acquisition is ¥1,925mn. The shareholding ratio of the RIZAP Group after the share acquisition method will be 62.27%, on a voting-rights basis.

Results trends

Achieved profitability for all segments

1. Overview of the FY3/17 results

In the FY3/17 results, the Company achieved major increases in both revenue and profits, with revenue of ¥95,299mn (up 76.7% YoY), operating income of ¥10,212mn (up 223.3%), profit before income taxes of ¥9,604mn (up 242.2%), and profit attributable to owners of parent of ¥7,678mn (up 383.7%).

Compared to the forecasts, revenue did not achieve its forecast by ¥4,701mn (4.7%), but every profit item from operating income down exceeded their forecasts and the Company was able to achieve its commitment to profits. With regards to revenue also, in light of the sense of scale, in that the aim was to double revenue to a scale of ¥50,000mn, at FISCO, we think that even a result of 4.7% below forecast can still be said to be sufficiently high to be worthy of a positive evaluation.

Overview of FY3/17 Results

(¥mn)

	FY3/16	FY3/17					
		Full year (E)	Full year	YoY		vs. forecast	
				Growth rate	Change	Growth rate	Change
Revenue	53,937	100,000	95,299	76.7%	41,362	-4.7%	-4,701
Operating income	3,159	10,150	10,212	223.3%	7,053	0.6%	62
Operating margin	5.9%	10.2%	10.7%	-	-	-	-
Profit before income taxes	2,806	9,500	9,604	242.2%	6,797	1.1%	104
Profit attributable to owners of parent	1,587	6,000	7,678	383.7%	6,090	28.0%	1,678

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

By segment, revenue increased for all business segments. In profits, both the apparel and entertainment segments returned to profitability, while all business segments were also profitable.

In the beauty and health business, revenue was ¥38,225mn (up 34.4% YoY) and operating income was ¥6,920mn (up 58.8%). In the mainstay RIZAP body shaper business, the increase in member numbers continued at a pace of 1,500 to 2,000 people a month, and cumulative member numbers reached approximately 80,000 people. The contract-renewal rate, which at FISCO we think is the most important KPI, increased 1.37 times YoY, which contributed to the improved profitability. Maruko achieved profitability through conducting thorough cost reductions and it is making steady progress toward increasing earnings from the next fiscal year onwards. The details are given below, but the Company is also making steady progress in developing the RIZAP-related businesses other than the body shaper business (including for golf, English, and cooking lessons), and a major point to focus on is that the preparations have now been completed for these businesses' fully-fledged development in FY3/18.

In the apparel business, revenue was ¥13,042mn (up 41.9% YoY) and operating income was ¥1,743mn (compared to a loss of ¥585mn in the previous fiscal year). Results at Angeliebe and Auntie Rosa trended favorably, while MARIMURA and MISUZU both achieved profitability on a full fiscal year basis. DREAM VISION continued to advance management reforms and achieved profitability in Q3 on a single-quarter basis.

In the housing and lifestyle business, revenue was ¥33,253mn (up 287.4% YoY) and operating income was ¥1,150mn (up 601.2%). IDEA International continued to steadily expand sales of kitchen appliances, such as hotplates, and travel goods. Tatsumi Planning, which operates an investment and custom-orders housing business, also steadily improved its results through utilizing its superior designs. Since PASSPORT joined the Group in May 2016, it has recorded an operating loss as it has been reducing retained inventory and investing in stores. But it has also been implementing cost-related structural reforms at the same time and has completed the preparations for improved results in this fiscal year.

In the entertainment business, revenue was ¥12,044mn (up 38.6% YoY) and operating income was ¥1,783mn (compared to a loss of ¥152mn in the previous fiscal year). SD ENTERTAINMENT recovered in Q4 and achieved YoY increases in revenue and profits. The printing company NIHONBUNGEISHA, which joined the Group in April 2016, has been working to increase synergies as its media strategy, including by publishing Women's RIZAP.

FY3/17 business segment trends

(¥mn)

		FY3/16			FY3/17				
								YoY	
		1H	2H	Full year	1H	2H	Full year	Growth rate	Value
Revenue	Beauty and health	14,359	14,094	28,435	17,392	20,833	38,225	34.4%	9,790
	Apparel	4,534	4,658	9,192	5,444	7,598	13,042	41.9%	3,850
	Housing and lifestyle	3,076	5,508	8,584	13,167	20,086	33,253	287.4%	24,669
	Entertainment	4,140	4,547	8,687	5,772	6,272	12,044	38.6%	3,357
	Subtotal	26,110	28,787	54,899	41,776	54,790	96,566	75.9%	41,667
	Adjustment	-419	-542	-961	-269	-997	-1,266	-	-305
	Total	25,691	28,246	53,937	41,507	53,792	95,299	76.7%	41,362
Operating income	Beauty and health	2,090	2,269	4,359	4,700	2,220	6,920	58.8%	2,561
	Apparel	-221	-364	-585	50	1,693	1,743	-	2,328
	Housing and lifestyle	25	139	164	642	508	1,150	601.2%	986
	Entertainment	-117	-35	-152	1,613	170	1,783	-	1,935
	Subtotal	1,777	2,009	3,786	7,006	4,592	11,598	206.3%	7,812
	Adjustment	-274	-353	-627	-613	-772	-1,385	-	-758
	Total	1,502	1,657	3,159	6,393	3,819	10,212	223.3%	7,053

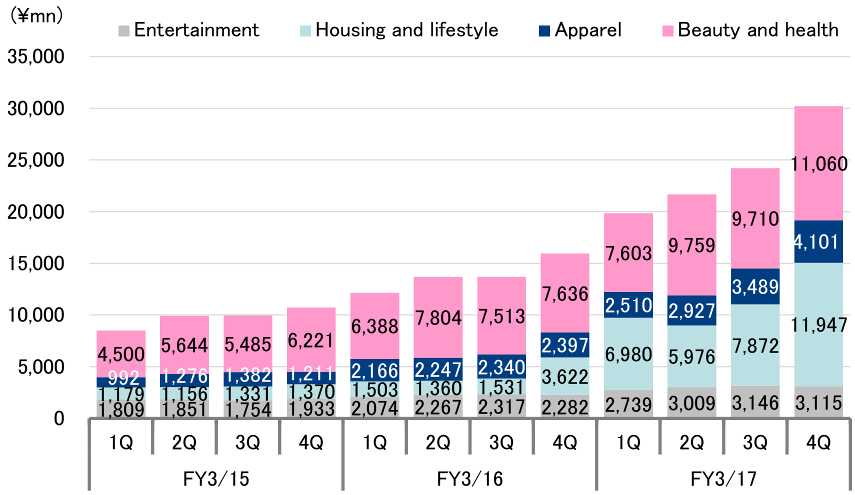
Note: Segment revenue include internal transactions
Source: Prepared by FISCO from the Company's financial results

In each business segment, revenue continues to expand with every fiscal period

2. Results trends on a quarterly basis

Looking at the results trends on a quarterly basis by segment, we see that in each segment, revenue continues to expand with every fiscal period. In FY3/17 Q4, revenue was ¥29,573mn, which was an increase of 93.8% on the same quarter in the previous fiscal year and a rise of 22.1% on the previous quarter. In addition, operating income was ¥2,211mn, which was up 864.3%, on the same quarter in the previous fiscal year and up 37.5% on the previous quarter. Profits were kept down in Q4 in the previous fiscal year from the strategic investment in advertising costs. So as a reaction to this, the growth rate when compared to the same quarter in the previous fiscal year appears greatly exaggerated, and it can be said that the increase of 37.5% on the previous quarter more accurately reflects the actual situation.

Trends in revenue by segment



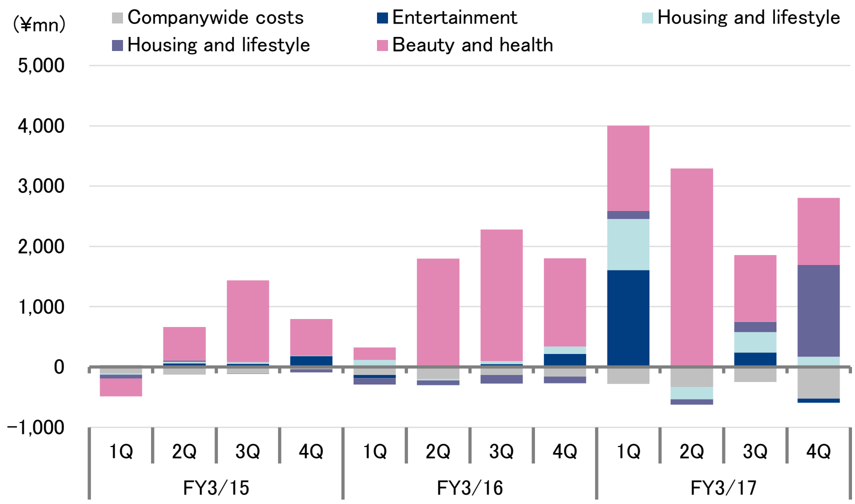
Source: Prepared by FISCO from the Company's financial results

Looking at the trends in profits, in the beauty and health segment, operating income trended at a high level in Q4 also. The reason why operating income was higher in Q2 was that it included ¥2,326mn from a gain on bargain purchases ("negative goodwill") following the acquisition of Maruko. Also, this segment includes the upfront investment for the RIZAP-related new businesses. It would seem that the RIZAP body shaper business is continuing to maintain a high level of profits to cover for the costs of these investments.

One more point to focus on in Q4 is the significant increase in operating income in the apparel segment. As previously mentioned, one after another the companies are becoming profitable, and the profitability of this segment is being rapidly actualized in this form.

Operating income in the entertainment segment greatly increased in Q1 from the effects of negative goodwill following an acquisition, the same as the previously described Maruko case.

Trends in operating income by segment



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

The subsidiaries' restructuring mode has been completed. Each company will enter a fully-fledged earnings-expansion stage in FY3/18.

3. Improvement in earnings at subsidiaries

Through its M&A, the Company aims to acquire at an inexpensive price companies that are suffering from a slumping performance and then revive their value through utilizing its expertise in advertising and through generating synergies with the other companies in the Group. In FY3/16 and FY3/17, it accelerated its M&A, mainly of listed companies, and FY3/17 was the year when the bottoming-out and improvement of the results of each of these Group companies was rapidly actualized.

It is important to note that each of these subsidiaries are still in the early stages of their respective medium- to long-term earnings growth process and that they will enter a stage of fully-fledged earnings growth in FY3/18. Looking toward the Company's future, it can be said that the important point that should be continuously and closely watched is the growth of these Group companies alongside the increase in earnings from the RIZAP-related businesses conducted by the Company itself.

Operating profit or loss conditions at the unlisted Group companies

Company name	Segment	FY basis		HY basis			
		FY3/16	FY3/17	FY3/16 1H	FY3/16 2H	FY3/17 1H	FY3/17 2H
RIZAP	Beauty and health	Profit	Profit	Profit	Profit	Profit	Profit
Kenkou Corporation, Inc.	Beauty and health	Profit	Profit	Profit	Profit	Loss	Profit
Japan Gals Co., Ltd.	Beauty and health	Profit	Profit	Profit	Profit	Profit	Profit
Hokuto Printing Co., Ltd.	Beauty and health	Profit	Profit	Profit	Profit	Profit	Profit
Angeliebe Co., Ltd.	Apparel	Profit	Profit	Loss	Profit	Profit	Profit
MARIMURA	Apparel	Loss	Profit	Loss	Loss	Loss	Profit
AuntieRosa	Apparel	Profit	Profit	Profit	Profit	Profit	Profit
MISUZU Co., Ltd.	Apparel	Loss	Profit	Loss	Profit	Loss	Profit
Tatsumi Planning	Housing and lifestyle	Loss	Profit	Loss	Loss	Profit	Profit
NIHONBUNGEISHA Co., Ltd.	Entertainment	Loss	Profit	Loss	Loss	Profit	Profit

Source: Prepared by FISCO from the Company's results briefing materials

Improvements in earnings at the listed Group companies

(¥mn)

Company name	Code	Completion date of the acquisition as a subsidiary	FY2015		FY2016		FY2017 E		Change	
			Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
IDEA INTERNATIONAL CO., LTD.	3140	2013/9/25	5,970	249	6,160	182	7,700	340	1,540	158
SD ENTERTAINMENT, Inc.	4650	2014/1/16	8,198	132	8,281	188	8,600	450	319	262
DREAM VISION CO., LTD.	3185	2015/3/31	3,669	-324	3,107	-154	5,283	780	2,176	934
PASSPORT Co., Ltd.	7577	2016/5/27	10,934	91	10,215	-552	10,000	300	-215	852
Maruko Corporation	9980	2016/7/5	13,479	-600	13,401	135	15,000	1,200	1,599	1,065
Jeans Mate Corporation	7448	2017/2/20	9,308	-663	9,195	-829	To be determined	To be determined	-	-
Pado Corporation	4833	2017/3/31	7,539	-175	6,997	-311	7,400	230	403	541

Note: as I.D.E.A. International results are for 6 months, FY16 is a 6 month fiscal period. Passport's FY16 (FY3/17) results were for 13 months following the change to the fiscal period. Jeans Mate has not published FY17 (FY2/18) results forecasts, so they are to be determined.

Among the listed subsidiaries, they are some noticeable cases that can be positively evaluated for the progress they are making in improving results and toward returning to a growth track in the future, and also for enhancing their policies for returns to shareholders. As a result, the situation is that the unrealized gain for the shares in subsidiaries held by the Company itself has greatly increased.

Valuation gains / losses from the RIZAP Group's listed subsidiaries

Company name	Code	Listed market	Completion date of the acquisition as a subsidiary	Ownership stake at the time of the acquisition	Acquisition price (¥)	Number of shares acquired (shares)	Acquisition amount (¥mn)	As of May 19, 2017 Share price (¥)	As of May 19, 2017 Valuation gain / loss (¥mn)	Share acquisition method
IDEA INTERNATIONAL	3140	TSE JASDAQ	2013/9/25	66.25%	208.5	3,559,200	742	1,839	5,803	Private-placement capital expansion
SD ENTERTAINMENT	4650	TSE JASDAQ	2014/1/16	72.03%	89	5,340,000	475	705	3,289	TOB from GEO
DREAM VISION	3185	TSE Mothers	2015/3/31	78.50%	192	3,900,000	748	1410	4,750	Private-placement capital expansion
			2017/3/30		456	265,200	121	1410	253	TOB
PASSPORT	7577	TSE JASDAQ	2016/5/27	65.83%	117	9,730,000	1,138	322	1,995	Private-placement capital expansion
Maruko	9980	TSE-2	2016/7/5	63.18%	50	55,000,000	2,750	297	13,585	Private-placement capital expansion
Jeans Mate	7448	TSE-1	2017/2/20	63.99%	160	5,748,753	920	348	1,081	TOB
					187	3,450,000	645	348	555	Private-placement capital expansion
Pado	4833	TSE JASDAQ Growth	2017/3/31	71.11%	74	13,513,515	1,000	395	4,338	Private-placement capital expansion
Total							8,420		35,397	

Note: IDEA International announced a 1:2 stock split, with June 1, 2017, as the effective date, but it is not taken into consideration here.
Source: Prepared by FISCO from each company's materials

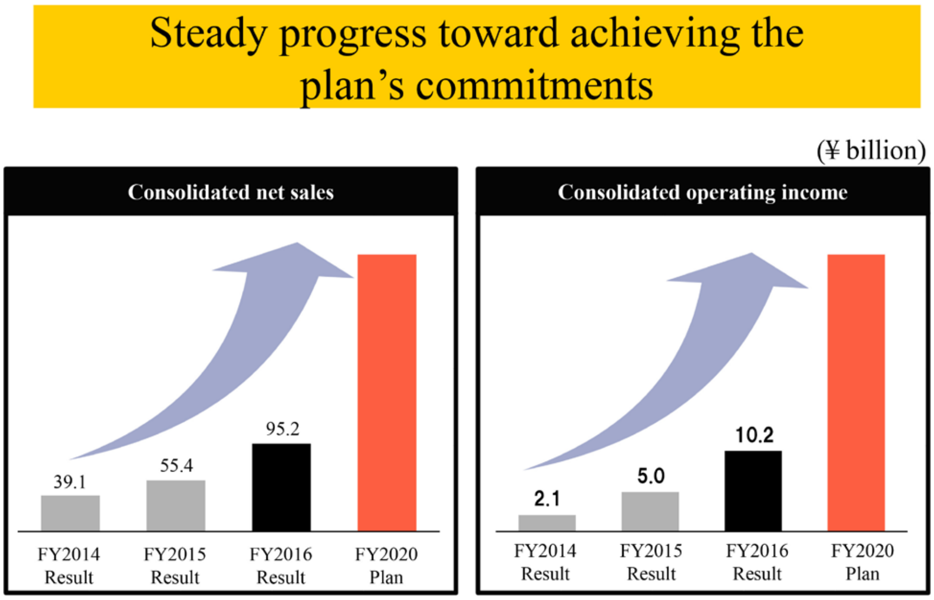
Medium- to long-term growth strategy

In addition to the improved results at the subsidiaries, the Company itself is also making steady progress in its growth strategy

1. Overall image of COMMIT2020 and the growth strategy, and the progress made

As is already widely known, the Company formulated the COMMIT2020 medium-term management plan targeting FY20 (FY3/21) as its final year, and is currently implementing measures for it. The numerical targets for the plan's final year of FY20 are consolidated revenue of ¥300,000mn and consolidated operating income of ¥35,000mn.

Growth targets



Source: Prepared by FISCO from the Company's results briefing materials

The Company started its business in one corner of the healthcare and beauty market from the keyword of "kenkou (health)," and subsequently it expanded its business domain to the "self-investment industry." As a result, it also expanded the industries and markets it was involved in, and the scale of its target markets has very rapidly increased to over ¥7 trillion, from the previous ¥2 trillion for the healthcare and beauty market alone.

Targeting this enormous market, the Company is implementing 4 growth strategies to realize its results targets, of revenue of ¥300,000mn and operating income of ¥35,000mn. These are 1) grow the existing businesses, 2) launch new business, 3) implement a strategy of business alliances, and 4) pursue M&A and synergies.

Among these, for 4) purse M&A and synergies, as mentioned previously each of the Group companies showed a steady improvement in earnings in FY3/17 and this growth strategy is starting to progress just as expected. The Group companies have confidence in their futures and this is reflected in their announcements of policies to actively return profits to shareholders. It can be said that the Company has gained a certain level of recognition among investors for its M&A growth strategy.

Conversely, the growth strategies 1) to 3) are those being pursued mainly by the Company itself. Among them, 1) grow existing businesses signifies the growth of the RIZAP body shaper business, while 2) launch new businesses, signifies growth from RIZAP GOLF and RIZAP ENGLISH, which have been talked about since the past. At FISCO, we have continuously covered the Company for the past 3 years and think that on the start of FY3/18, it will enter a stage of integrating these two growth strategies and increasing profits while leveraging synergies. These points are described in more detail below.

Has evolved the "RIZAP business" into "RIZAP-related businesses" and entered a stage of high growth

2. Evolution of the RIZAP-related Business

The Company has achieved growth up to the present time mainly from the RIZAP body shaper business. The high level of profitability in this business is well known, but there has also been an evaluation of it that a shadow has appeared over its growth. But at FISCO, we do not think this is a correct understanding of the situation.

The Company's focus in the last one or two years has been on investing the profits earned from the RIZAP body shaper business into launching new businesses that will continue-on from the body shaper business. The Company's strength can be said to be its marketing capabilities, and this also includes its brand management capabilities. In addition to not damaging the brand, an essential condition has been to further increase the value of the RIZAP brand that ranks third in the commercials favorable-impression rankings. Based on this, it selected various new business under the RIZAP brand, such as golf, English, and cooking lessons, and has been advancing their development.

List of RIZAP-related Businesses

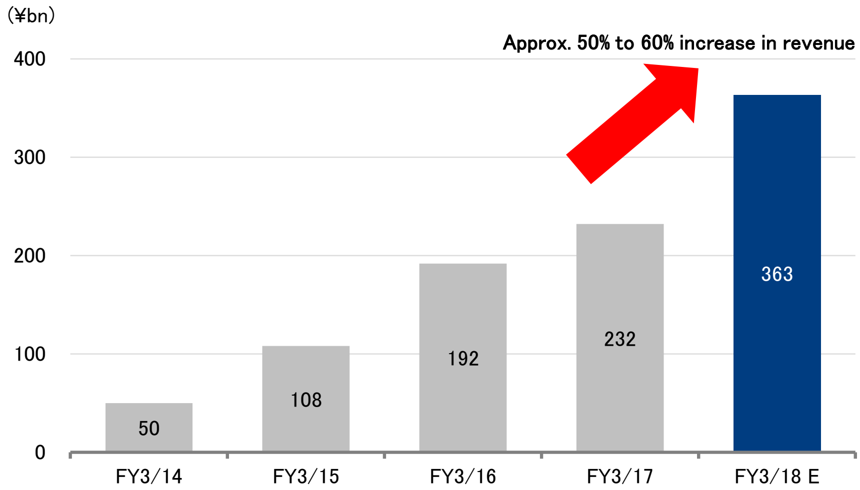
Business brand	Type of business/Business format	No. of stores		Revenue	
		End-FY3/17	End-FY3/18 (E)	FY3/17	FY3/18 (E)
RIZAP	Body-building	120	120-130	Approx. ¥23,000mn	Approx. ¥28,000mn
RIZAP GOLF	Golf lessons	6	Approx. 50 schools	Several hundred million yen	Approx. ¥5,000mn
RIZAP ENGLISH	English conversation school	2	Approx. 10 schools	Tens of millions of yen	Approx. ¥1,000mn to ¥1,500mn
RIZAP COOK	Cooking classes	1	Approx. 10 schools	Tens of millions of yen	Approx. ¥1,000mn to ¥1,500mn
RIZAP	Sports apparel	-	Approx. 10 stores	Tens of millions of yen	Approx. ¥1,000mn
RIZAP KIDS	Children's movement classes	1	2 to 3 schools	Millions of yen	Tens of millions of yen
Overview of the RIZAP-related Business		130	190-200	¥23,200mn	¥36,000mn to ¥37,000mn

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

In addition to the RIZAP body shaper business, the Company discloses information on RIZAP-related businesses as additional, new businesses under the RIZAP brand. Up to FY3/17, revenue from these new businesses was on the level of tens of millions of yen, while in terms of profits, as they were still in the upfront investment stage, in actual terms the only profitable business was the RIZAP body shaper business. But it seems that profits that were announced may have been lower than the actual situation, as the costs of the upfront investment were being covered by the profits from the body shaper business.

However, in FY3/18, it is possible that the total revenue from the new businesses other than the body shaper business will very rapidly increase to in the range of ¥8,000mn to ¥10,000mn. As a result, combined with the growth of the body shaper business itself, at FISCO we estimate that revenue from the RIZAP-related businesses will rapidly rise from the FY3/17 result of ¥23,200mn to in the range of ¥36,000mn to ¥37,000mn in FY3/18. In profits also, some of these businesses are clearly becoming profitable, while it seems that profits from the body shaper business will also remain firm.

Trend in the RIZAP-related business revenue



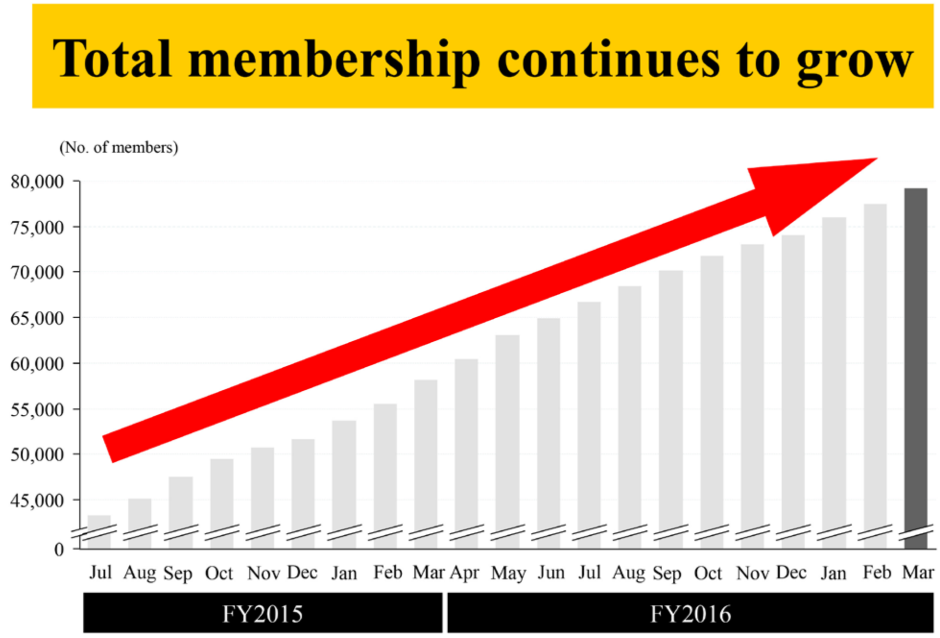
Source: prepared by FISCO from Company materials. The FY3/18 revenue increase rate is an estimate by FISCO.

Continue to grow on the three axes of LTV, seniors, and productivity improvements

3. The growth strategy for the RIZAP body shaper business

The RIZAP business of personal gyms is currently continuing to grow. The pace of increase of new members is the KPI (key performance indicator) for measuring the revenue trend in the RIZAP business. The cumulative number of members exceeded 70,000 people in January 2017 and had reached around 80,000 people by May 2017. New members are continuing to join at a pace of approximately 2,000 people per month. New gyms are also being steadily opened to accept these new members, and by the end of March 2017, the Company had achieved its target of opening 120 gyms. It was also close to completing its nationwide chain of having gyms in all 47 prefectures.

Trends in RIZAP cumulative member numbers



Source: Prepared by FISCO from the Company's results briefing materials

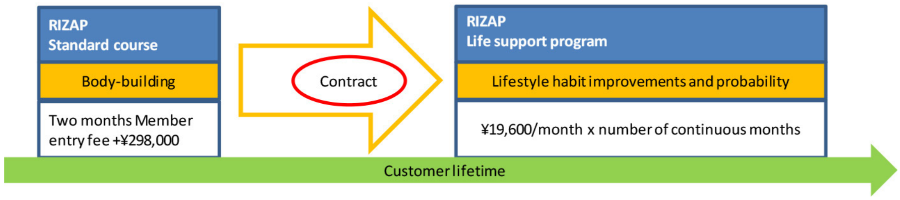
There are currently several growth engines for the RIZAP business, but at FISCO, we think the following three are particularly important; 1) increasing LTV (lifetime value) per member, 2) expanding the number of potential members by targeting seniors as members, and 3) increasing gym revenue by improving the productivity of the gyms and trainers. In addition to these three, the previous reports described other growth strategies, including developing a RIZAP business for corporations and also business alliances utilizing the strength of the RIZA brand.

(1) The status of the policies to improve the LTV

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.

To improve the contract-renewal rate, one policy being implemented by the Company is the life support program. This 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 months)." We can easily see that a difference of several times emerges in the revenue per member from this switch from a flow-type to a stock-type model. The key to the success or failure of this policy will be customer satisfaction (CS), and on this point, the situation up to the present time, such as from the results of questionnaire surveys, suggests reasons for confidence.

Contract renewal to the life support program and expected revenue



Source: Prepared by FISCO from the Company materials

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 of June 2017, 80 gyms had installed machine rooms, which is two thirds of the 120 gyms nationwide.

As a result of these policies, the number of life support program guests had increased by 10.5 times by April 2017 compared to January 2016, which is when it had only just been introduced. Relating to this, the number of non-active members, which is a KPI for existing members, declined 23%, and instead the number of contract-renewal members increased 37% (both are a comparison of March 2016 to March 2017). So it can be said that the Company is making steady progress in shifting the RIZAP body shaper business to a stock-type business model.

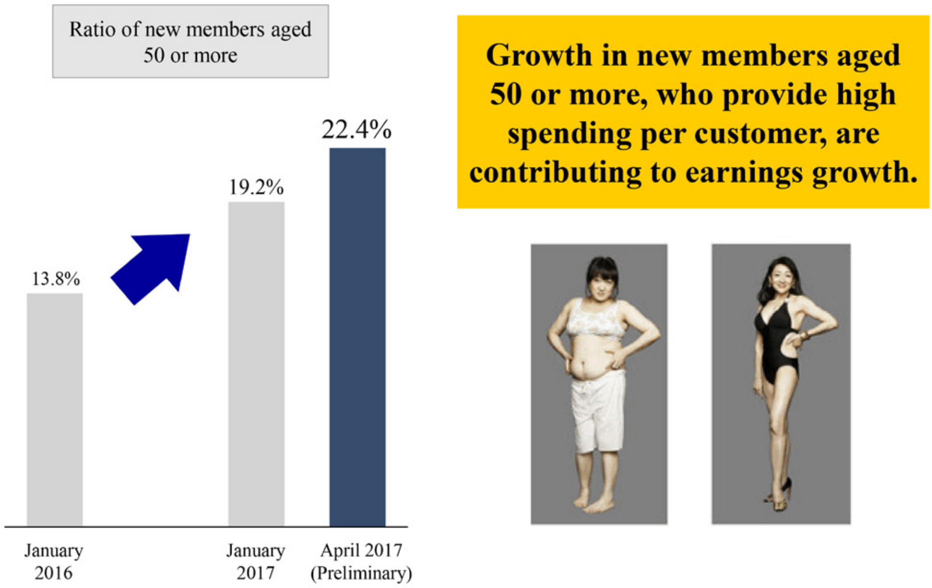
(2) The situation for capturing seniors as members

Capturing seniors as members is another point that the Company is focusing on more than in the past. While there are many advantages to opening-up the seniors market, at FISCO we think the following two are particularly important. First is the point that as seniors have more free time than young people, they can be attracted to the gyms during the daytime on weekdays, which is when the utilization rates of the gyms and trainers are low. This will increase the overall utilization rates, which can be expected to contribute to higher gym revenue and improved profitability. This is also an important point for the measures to improve the productivity of the gyms and trainers that are described below.

Second is the point that what seniors tend to want is not short-term body shaping, but long-term health maintenance. Fundamentally, the body shaper program is a short-term, two-month program (but as previously explained, currently the Company is aiming to extend the length of contracts through additional programs, like the life support program). As a result, they tend to prefer a long-term contract when they first join as they have in mind health maintenance and improving their age-based physical fitness, which would seem to be a profit model that overlaps with the previously described LTV model.

The Company is current steadily conducting marketing that targets seniors. It broadcasts a 29 minute infomercial aimed at seniors that aims to convince them to join a gym through politely explaining the advantages of doing so, and it also broadcasts both the 15 seconds and 30 seconds before-and-after commercials. There has been a significant increase in the number of inquiries from people in their fifties, who can be said to be relatively young among the seniors, as they seem to be responding particularly positively to the commercial featuring the celebrity Edo Harumi. As a result, the percentage of total new members who are in their fifties has constantly exceeded 20%, and it regarded as only a matter of time until this is on the 30% level.

Situation for capturing seniors as members



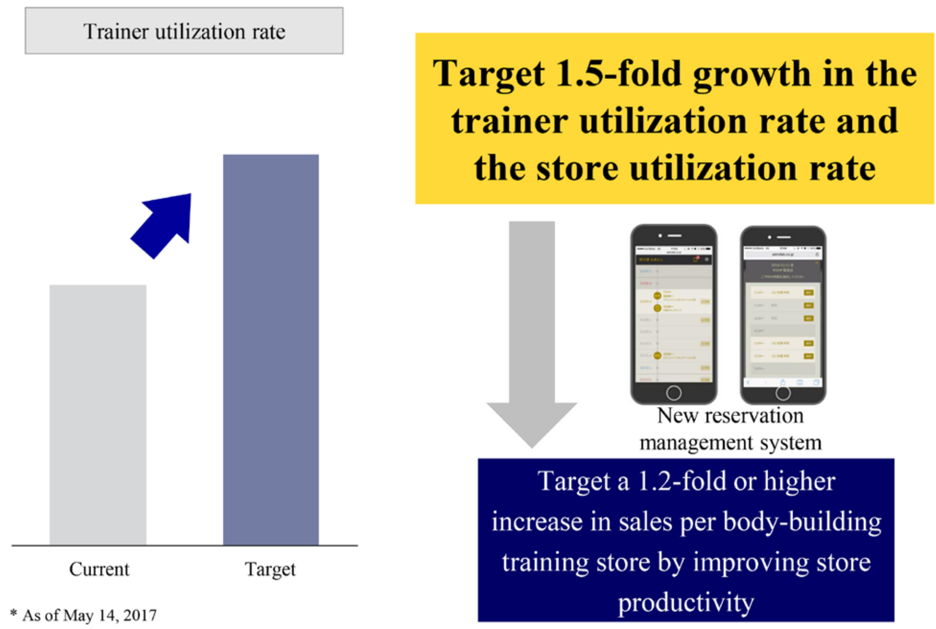
Source: Prepared by FISCO from the Company's results briefing materials

(3) Measures to improve trainer productivity

The current situation for the demand-supply balance in the RIZAP business is clearly one of excess demand; in other words, the capacity of the gyms and the trainers is not keeping up with customer demand. One reason for this is that the percentage of working-age members (in their twenties to forties) 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 there is the aspect, that a not inconsiderable opportunity loss is occurring.

On this point, the Company is introducing a new reservation management system with the aim of improving the productivity of gyms and the gym usage rate by 1.5 times compared to the current situation. Through the introduction of this system, the plan is to raise the revenue per gym by 1.2 times compared to currently. If this is combined with the previously described measures to raise the unit price per member and to increase the utilization rates during the daytime on weekdays by capturing seniors as members, at FISCO we think that gym revenue is set to increase to an even greater extent.

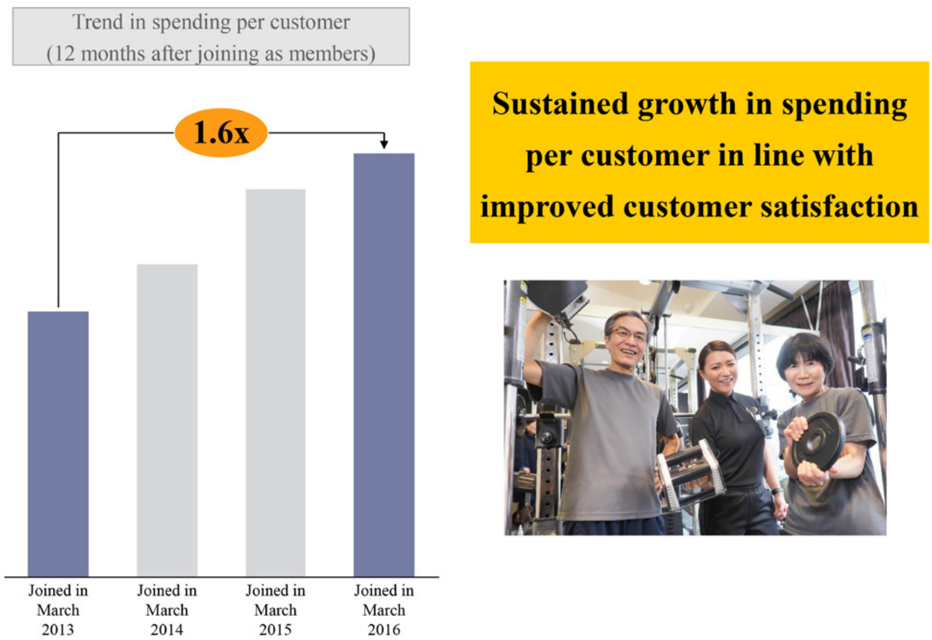
Measures to improve trainer productivity



Source: Prepared by FISCO from the Company's results briefing materials

The member unit price is clearly showing an upward curve due to the above-mentioned series of measures. On comparing members joining in March 2013 to those joining in March 2016, we find that the member unit price in the 12 months after becoming a member rose by 1.6 times. The measures for both the life support program and for capturing seniors are still at an early stage, so there remains considerable room for growth. Therefore, at FISCO we expect to see further and significant growth in the member unit price from now onwards.

Trends in the member unit price



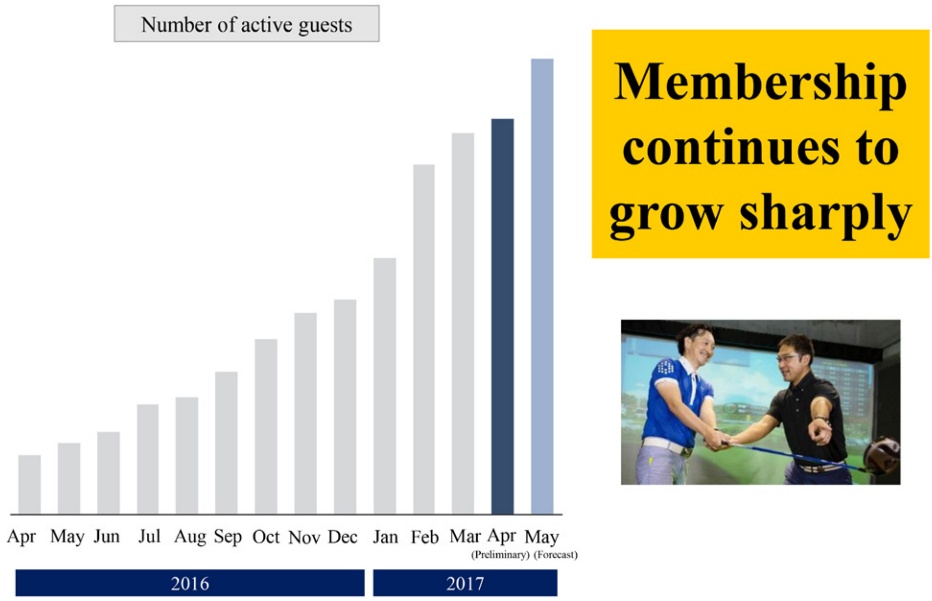
Source: Prepared by FISCO from the Company's results briefing materials

RIZAP GOLF will accelerate store openings in FY3/18, aiming for a chain of 50 schools by the end of the period

4. RIZAP GOLF's growth strategy

RIZAP GOLF is a golf-lessons business based on the concept of "aiming to get below 100 in 2 months." Member numbers have been steadily growing since its launch. In the current fiscal year, the Company has contracted with professional golfer Ryo Ishikawa who it is using in commercials, and it is expected that the pace of the increase in member numbers will further accelerate.

Trend in RIZAP GOLF member numbers



Source: Prepared by FISCO from the Company's results briefing materials

The school network is the most developed among the networks of the RIZAP-related businesses and at the end of March 20017, it consisted of 6 schools. In May 2017, the Company opened a further 3 schools (in Ginza, Umeda, and Kobe), and it has continued to actively open schools across the current fiscal year and plans to expand the network to around 50 schools by the end of March 2018. In terms of the impact of this business on earnings, in light of the examples of past results of the RIZAP businesses, it is expected to increase revenue on the scale of ¥5,000mn.

A feature of RIZAP GOLF is the high ratio of product sales. Centered on the Company's original brand of golf gear, it concludes product-sales agreements with approximately 60% of new members (preliminary value for May 2017 members). This value for the RIZAP body shaper business is exceptionally high, at 74% (same), but at FISCO we think that the same as the body shaper business, RIZAP GOLF has the potential to grow to become a business with a high customer unit price.

Fully-fledged school openings for RIZAP ENGLISH and RIZAP COOK in FY3/18 also

5. RIZAP ENGLISH / RIZAP COOK / RIZAP KIDS

(1) RIZAP ENGLISH

The Company is currently opening 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 there is the sense that the Company is responding with a fully-fledged business development. In FY3/18, it plans to expand the network to around 10 schools.

In terms of earnings, in FY3/17 they seem to have been on the level of tens of millions of yen, but they are expected to rapidly grow in FY3/18 alongside the increase in the number of schools. On applying past RIZAP results as a rule of thumb, we can expect revenue from a 10 school network to reach a scale of ¥1,000mn to ¥1,500mn.

(2) RIZAP COOK

So far, the Company has been test marketing R-COOK in this business. Based on the R-COOK concept of “Our commitment to our top-class chefs dramatically improving your cooking only two months,” since starting cooking classes at the first school in Jiyugaoka in November 2016, it has been rotating the PDCA cycle. The lessons have proven to be extremely popular and after changing the name to RIZAP COOK on June 1, 2017, the Company decided to embark on the fully-fledged development of a multi-school network. It is aiming to have a network of 10 schools by the end of FY3/18. In terms of earnings, the model includes price bands, the same as the RIZAP body shaper business, so at FISCO we think that just like RIZAP ENGLISH, a 10 school network has the potential to generate revenue on the scale of ¥1,000mn to ¥1,500mn.

(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. During FY3/18, the Company is rotating the PDCA cycle for the program, operations, and marketing, toward the fully-fledged development of this business at an early stage.

A strong response for sports apparel utilizing the RIZAP brand and high performance

6. The RIZAP sports apparel growth strategy

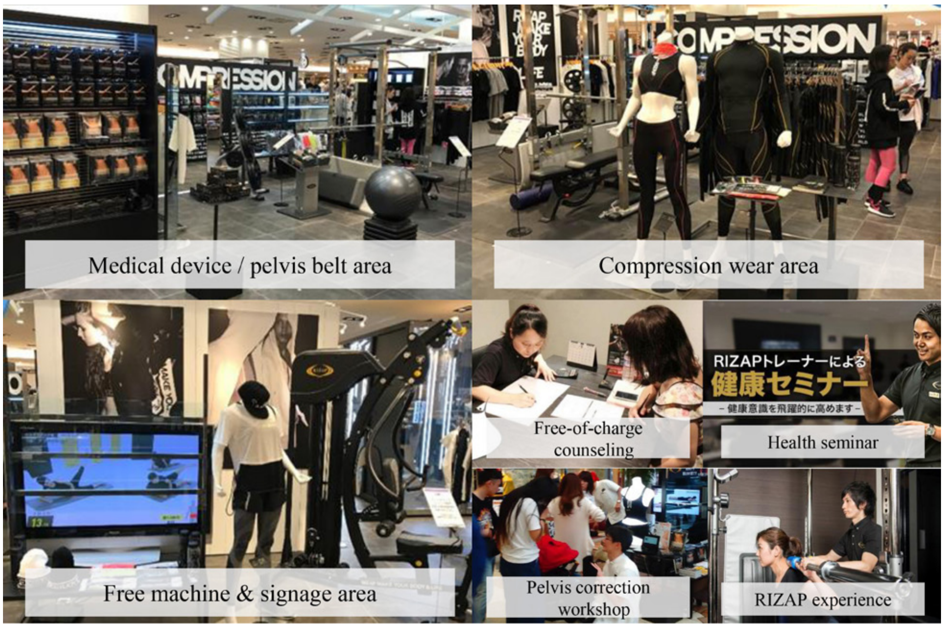
The Company has decided to embark on the fully-fledged development of sports apparel as a product-sales business within the RIZAP-related businesses. The apparel are mainly functional items such as compression wear, medical equipment, and pelvis belts.

Compression wear places moderate pressure on the body when it is worn, which is considered to have positive effects including reducing fatigue, improving stamina, and amplifying the benefits of training. In addition to overseas brands, such as Under Armour of the United States, Japanese manufacturers like Wacoal <3591> and Mizuno <8022> have entered this market. It can be said that this market is the best fit for RIZAP, which has the powerful body shaper brand.

The Company opened a RIZAP sports apparel shop at the Osaka Hankyu Umeda main store for a limited period of two weeks in late March. The results were extremely positive, and this shop ranked first for revenue twice (two days) by sales floor and by day.

Based on these results, the Company decided on the fully-fledged development of this business in FY3/18, and on May 23, it concluded an agreement with Yamano Holdings <7571> to acquire its sports business. The acquired business is a sports equipment retail store business being deployed in a total of 16 stores, including at "Powers," "Sports World," "S.R.C," "Shockwave," and "Ikebukuro Syuzanso," and it is considered that the Company will develop the RIZAP sports apparel business utilizing these stores. The annual sales of the acquired business were ¥3,724mn in FY3/16. Although no revenue targets on a stand-alone basis have been announced for the RIZAP sports apparel business, at FISCO we estimate that the aim is for revenue of around ¥1,000mn.

RIZAP Sports Apparel Business



Source: Prepared by FISCO from the Company's results briefing materials

Business outlook

On an actual-performance basis, aiming to increase Company-wide operating income by 3 times YoY and beauty and health segment income by 2.4 times

For the FY3/18 full-year results, 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%).

Overview of the FY3/18 results forecasts

(¥mn)

	FY3/17		FY3/18				
						YoY	
	1H	Full year	1H (E)	Growth rate	Full year (E)	Growth rate	Change
Revenue	41,507	95,299	68,986	66.2%	150,202	57.6%	54,903
Operating income	6,393	10,212	4,053	-36.6%	13,010	27.4%	2,798
Operating income margin	15.4%	10.7%	5.9%	-	8.7%	-	
Profit before income taxes	6,064	9,604	3,560	-41.2%	11,983	24.8%	2,379
Profit attributable to owners of parent	4,262	7,678	2,268	-46.8%	8,007	4.3%	329

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

Revenue will 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 ¥14,000mn from the RIZAP-related businesses, approximately ¥30,000mn from the listed subsidiaries, and ¥10,000mn to ¥12,000mn as the total from other subsidiaries and M&A. The breakdown for the RIZAP-related businesses is as previously described, while the breakdown for the listed subsidiaries can be easily obtained from adding the results forecasts announced by each respective company (estimates for Jeans Mate). With regards to the increase in revenue from other subsidiaries and M&A, on considering the effects such as from the acquisition of the business from Yamano Holdings that has already been announced, at FISCO we do not think at all that the estimate is excessive.

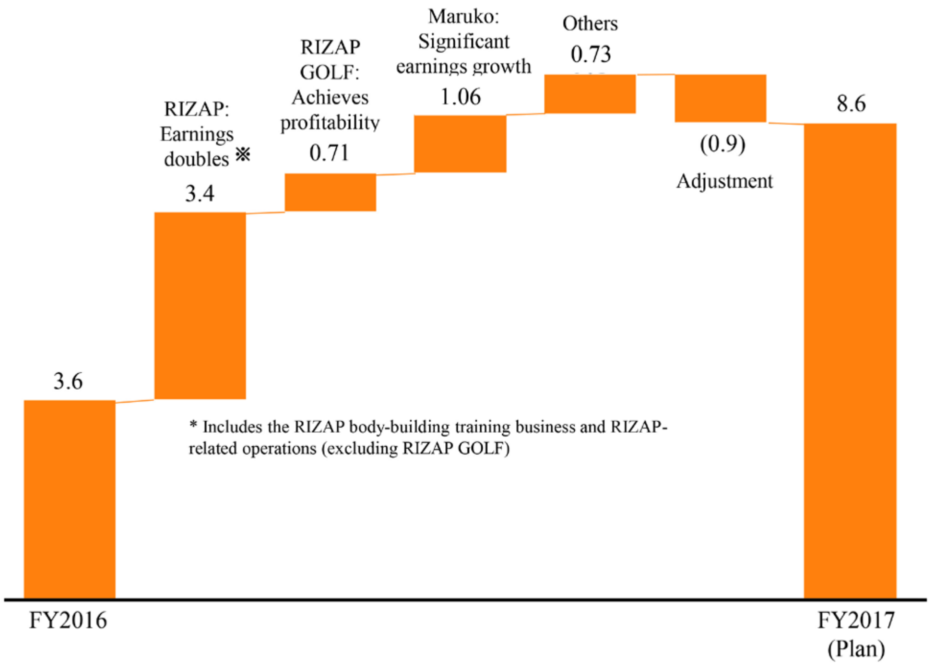
The Company also discloses detailed information on profits. As previously mentioned, the FY3/17 results included a gain on bargain purchases (negative goodwill) of approximately ¥5,800mn, which pushed-up operating income. On an actual-performance basis after excluding this special factor, operating income increased around ¥4,000mn.

An increase of ¥13,000mn on an actual-performance basis is what the Company is forecasting for FY3/18. In the apparel business, both DREAM VISION and Jeans Mate are expected to achieve profitability. Also, in the related lifestyle business, in addition to PASSPORT being profitable, that fact that IDEA International upwardly revised its results forecasts for FY6/17 has been incorporated.

The Company has also announced a detailed profits breakdown for the beauty and health segment, which is the core business. In the FY3/17 results, on an actual-performance basis, segment operating income was approximately ¥3,600mn, and it is considered that practically all of this was from the RIZAP (body shaper) business. The FY3/18 segment income target is ¥8,600mn, which is an increase of approximately ¥5,000mn. Breaking this down, the respective targets are as follows: income from RIZAP-related businesses (excluding RIZAP GOLF) to increase ¥3,400mn YoY; RIZAP GOLF to become profitable and income to rise ¥710mn; alongside the profits growth at Maruko, income to increase ¥1,060mn; and in other businesses, income to climb ¥730mn.

At FISCO, we think that the main point here is the target for the RIZAP-related businesses as a whole, of income to increase approximately ¥4,110mn YoY (the total for RIZAP, of ¥3,400mn, and for RIZAP GOLF).This indicates that as previously mentioned, not only are the profitability and growth potential of the RIZAP body shaper business not declining, when understood in terms of the RIZAP-related businesses, it suggests that growth will start in earnest from now on.

Analysis of the profit-change factors in the beauty and health segment



Source: Prepared by FISCO from the Company's results briefing materials

Statement of Financial Position

(¥mn)

	IFRS		
	Transition date (Apr. 1, 2015)	End-FY3/16	End-FY3/17
Current assets	22,724	32,522	62,086
Cash, deposits and equivalents	8,366	10,483	24,643
Trade and other receivables	8,974	12,062	20,544
Non-current assets	16,400	21,255	33,562
Property, plant and equipment	9,647	11,331	17,616
Goodwill	2,473	4,675	6,291
Intangible assets	846	689	1,013
Investments, etc.	3,434	4,560	8,642
Total assets	39,125	53,777	95,648
Current liabilities	19,898	27,296	43,636
Trade and other payables	10,766	13,756	24,326
Interest-bearing debt	7,820	10,914	15,996
Non-current liabilities	12,286	15,344	30,557
Interest-bearing debt	10,371	12,853	25,204
Total equity attributable to owners of parent	6,077	10,226	17,018
Capital stock	132	1,400	1,400
Capital surplus	200	1,799	1,692
Retained earnings	5,720	7,001	13,696
Other capital composition items	23	25	228
Non-controlling interests	863	910	4,436
Total equity	6,940	11,137	21,454
Total liabilities and capital	39,125	53,777	95,648

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

Cash Flow Statement

(¥mn)

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

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

Shareholder return policy

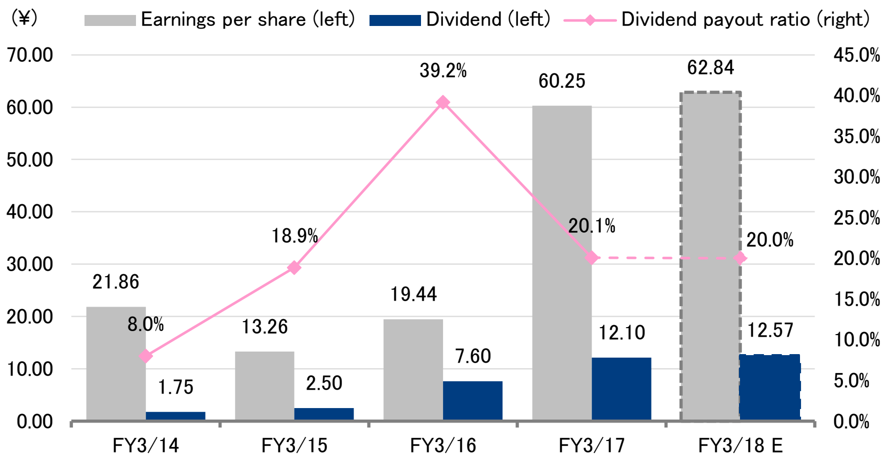
Determines dividend based on the guideline of a consolidated dividend payout ratio of 20%

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 FY3/17, the Company revised the guideline for dividends to a consolidated dividend payout ratio of 20%. In the FY3/17 results, earnings per share (EPS) was ¥60.25. Therefore, it raised the dividend from the previous forecast of ¥9.42 to ¥12.10, which was an increase of ¥4.5 on the dividend of ¥7.6 in the previous fiscal year.

For FY3/18, the Company is forecasting net income per share of ¥62.84 and as the calculation of a dividend payout ratio of 20% of this, it has announced a full-year dividend forecast of ¥12.57.

Earnings per share, dividend, and dividend payout ratio



Note: Earnings and dividend per share have been adjusted for the split
Source: Prepared by FISCO from the Company's financial results

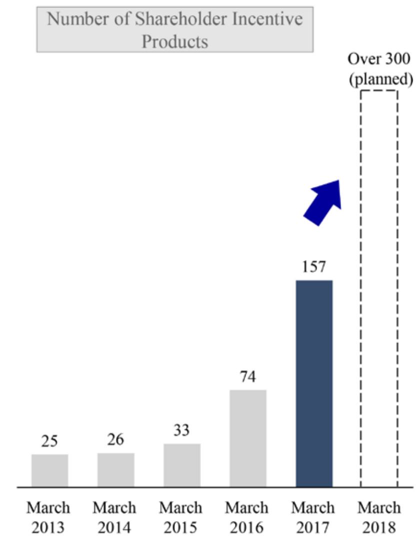
The Company has also established a shareholder gift program in which shareholders can select a RIZAP Group product depending on the number of shares that they hold. Reflecting the expansion in the Group companies from the M&A, the number of items available to shareholders in the gift program at the end of FY3/17 had doubled compared to the end of the previous fiscal year, to 157 items. Moreover, the plan is to double this again to 300 items by the end of FY3/18. A shareholder holding the minimum unit of 100 shares can receive a product up to a value of ¥4,000.

Standard Guidelines for Shareholder Benefits

100 shares	Can select the gift they want from among the Company Group's product up to a value of ¥4,000
200 shares	Can select the gift they want from among the Company Group's product up to a value of ¥6,000
400 shares	Can select the gift they want from among the Company Group's product up to a value of ¥12,000
800 shares	Can select the gift they want from among the Company Group's product up to a value of ¥24,000
1,200 shares and above	Can select the gift they want from among the Company Group's product up to a value of ¥30,000
2,000 shares and above	Can select the gift they want from among the Company Group's product up to a value of ¥36,000

Source: The Company's website

Gifts given as shareholder benefits



Source: Prepared by FISCO from the Company's results briefing materials

The Company had been investigating changing the market it is listed on from the standpoint of increasing the freedom of trading by shareholders, but it has temporarily stopped this work following the discovering of suspected insider trading by the former president of one of the subsidiaries. However, in April of this year, the Securities and Exchange Surveillance Committee decided not to press criminal charges against the former president, which for the time being signaled the end to this case of insider trading. Therefore, at FISCO we think that it is possible that in the future the Company will re-start the work to investigate changing the market it is listed on.

Disclaimer