

Riso Kyoiku Co., Ltd.

4714

Tokyo Stock Exchange First Section

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<http://www.fisco.co.jp>

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■ Summary

Closely monitor COVID-19 impact, though making steady advances in building a foundation for growth

Riso Kyoiku Co., Ltd. <4714> (hereafter, also “the Company”) is an educational services company that has established a unique business model by combining “genuine one-on-one instruction” and “academic advancement” and is steadily broadening its scope. The Company’s group includes Shingakai Co., Ltd., which provides entrance exam preparation for kindergartens and elementary schools, Meimonkai Co., Ltd., which dispatches professional home tutors, School TOMAS Co., Ltd., which provides in-school one-on-one instruction, and Plus One Kyoiku Co., Ltd., which plans tour-style experiences and runs gymnastics classes.

1. Posted consecutive all-time high results in FY2/20

The Company announced FY2/20 consolidated results with higher sales and profits in a 5th consecutive fiscal year at ¥26,704mn in net sales (+9.0% YoY) and ¥2,716mn in operating profit (+7.4%). Healthy gains in student volumes in core business segments, including TOMAS, Meimonkai, and Shingakai, led the growth. Student volumes compared to end-FY2/19 increased 10.2% at TOMAS, 3.9% at Meimonkai, and 10.8% at Shingakai. The Company added three TOMAS schools, five Meimonkai schools, two Shinga’s Club schools, one TOMAS GYMNASTICS SCHOOL, and one school for the new spec. TOMAS brand that provides one-on-one instruction that specializes in entrance exams for the most difficult schools. Besides contributions from the new schools, student volumes steadily expanded at existing schools too. Furthermore, the number of client schools deploying school TOMAS, the in-school one-on-one instruction business, increased from 36 schools at end-FY2/19 to 55 schools. Net sales grew by a robust 24.7% YoY, and this business reached an operating profit and hence added to overall profit growth.

2. Response to COVID-19

TOMAS suspended operations of all schools on April 8 following Japan’s issuance of a state of emergency declaration accompanying the COVID-19 outbreak. However, it announced the restart of one-on-one instruction with thorough measures to prevent infections for interested people on April 22 due to requests from students and guardians to resume classes. Meimonkai continued dispatching home tutors as usual because stay home requests did not extend to home tutors and adopted the same measures as TOMAS for classroom instruction. Shingakai, meanwhile, extended the period of school suspensions to May 6. The Company did not disclose FY2/21 guidance because of uncertainty about the impact of COVID-19. Nevertheless, during March, net sales increased 20% YoY at TOMAS and Meimonkai and new TOMAS students rose by a healthy 10% amid ordinary school closures. The Company intends to revise schedules after re-openings to make up for missed classes during the shutdown. We believe it is capable of keeping adverse impact on income results to a temporary level as long as the situation does not worsen further, such as an extended state of emergency period. While the Company has not decided the dividend yet, it is reviewing the situation with the intent of paying dividends.

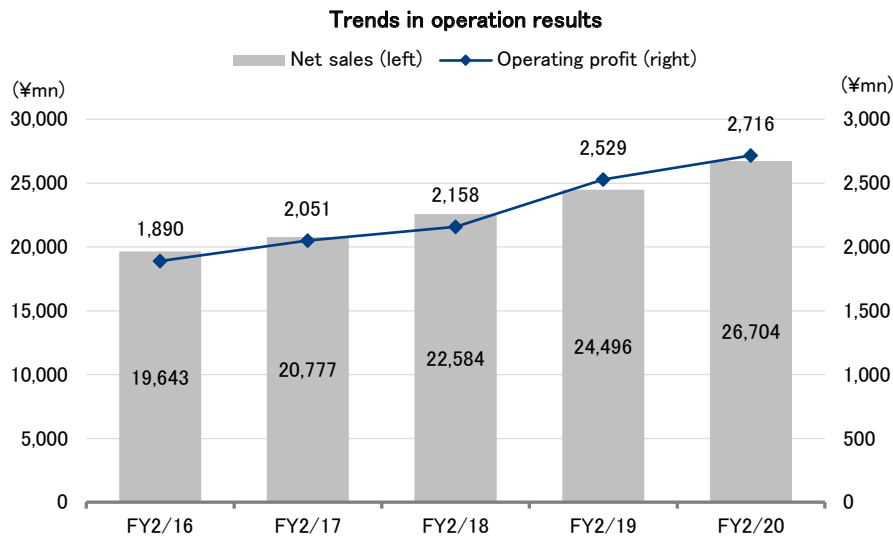
Summary

3. Growth strategy

In the three-year medium-term management plan currently being implemented, the Company aims to reach ¥33,000mn in net sales and ¥3,810mn in operating profit in FY2/22. It sees this period as continuation of the “second golden growth phase” during which it wants to expand TOMAS business in the Tokyo metropolitan area and TOMEIKAI business in other areas (outside of the Tokyo metropolitan area) and Shinga’s Club (after-school care and childcare services) with vibrant demand. The Company is also receiving strong inquiries for school TOMAS and hopes to reach deployment at 100 schools in the near term. Recruitment of talented student part-time teachers is a key issue for expansion of TOMAS, TOMEIKAI, and school TOMAS businesses, and the Company plans to establish a joint venture with Surugadai Gakuen Educational Institute, following formation of a capital and business alliance in 2019, for recruiting, training, and dispatching teachers and aims to secure teachers utilizing a network that includes Sundai Preparatory School and others. Despite the possibility of adverse impact in the near term from the COVID-19 situation, we expect the Company to continue steady growth that leverages its strength in provision of high-quality educational service in various businesses.

Key Points

- Currently in a “second golden growth phase” with tailwind from the shrinking youth population based on a foundation of high-quality educational services
- 5th straight sales increase and consecutive all-time highs in operating and ordinary profits in FY2/20
- Pursues sustainable growth in all businesses through increases in student and classroom volumes



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

■ Company profile

Established in 1985 for the purpose of delivering high-quality education service

1. Company history

Mitsugu Iwasa, currently a director and chairman, took over 14 classrooms from Kodomo Pia as the latter, a business in which he was part of the management team switched to emphasis on selling educational equipment, and established Nihon Kyoiku Kosha K.K. in July 1985 for the purpose of delivering high-quality one-on-one educational service.

The Company initially started with a group learning format of classrooms under the name of Riso Kyoiku Kenkyusho (Risoken) that consisted of six students per class, classes organized by academic capabilities, and 100% full-time teachers. In March 1990, the Company developed and started provision of a unique “genuine one-on-one individual instruction system” and changed the service name to “Tokyo Man-to-man School.” Management subsequently changed the service name to TOMAS (initially as a nickname in 1997 and then as the official name in 2000), which has continued since then.

The Company has actively diversified educational services too. It opened the Meimonkai home tutor center and entered the home tutoring market in May 1989. In 2000, it established Nihon Edunet Co., Ltd. (now, School TOMAS Co., Ltd.) that offers genuine one-on-one instruction in a real-time interactive format utilizing Internet teleconferencing. It also established School Tour Ship Co., Ltd., which provides character-building training camp education (now, Plus One Kyoiku Co., Ltd.), in 2002 and acquired shares of Shingakai, which offers entrance exam preparation for well-known kindergartens and elementary schools, and made it a subsidiary in 2003. In July 2019, the Company formed a capital and business alliance with Surugadai Gakuen Educational Institute and established Sundai TOMAS Co., Ltd. (the Company owns a 51% stake) to support spec. TOMAS, a provider of one-to-one instruction that specializes in entrance exams for the most difficult schools.

The Company conducted OTC registration of its shares with the Japan Securities Dealers Association in 1998, listed shares on the Tokyo Stock Exchange Second Section (TSE-2) in 2001, and moved its shares to the TSE First Section (TSE-1) in June 2002 (where they currently trade).

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Company profile

Company history

Date	History
July 1985	Established Nihon Kyoiku Kosha K.K. to accommodate the acquisition of 14 classrooms from Kodomo Pia with the purpose of providing high-quality one-on-one educational instruction services and started opening classrooms under the Riso Kyoiku Kenkyusho name
May 1989	Established the Meimonkai home tutor center and entered the home tutor market, began individual instruction with a professional tutor group that differs from student tutors and opened the Mejiro School
March 1990	Developed the unique "one-on-one individual instruction system (each equipped with a whiteboard)" and changed the service name to "Tokyo Man-to-man School." Opened the Shin-Nakano School as the first school with this format.
October 1998	Renamed from Nihon Kyoiku Kosha K.K. to Riso Kyoiku Co., Ltd.
December 1998	Conducted OTC registration of shares with the Japanese Securities Dealers Association
July 2000	Established Nihon Edunet Co., Ltd. with the aim of conducting genuine one-to-one instruction in an interactive environment utilizing Internet video conferencing
March 2001	Listed shares on the Tokyo Stock Exchange Second Section (TSE-2)
June 2002	Listed shares on the Tokyo Stock Exchange First Section (TSE-1)
December 2002	Established School Tour Ship Co., Ltd. with the aim of conducting character-building training camp education
January 2003	Established Meimonkai Co., Ltd. as a spin-off of the home tutor dispatching business, acquired Shingakai Co., Ltd., which provides kindergarten and elementary school entrance exam preparation, as a wholly owned subsidiary
July 2005	Transferred the student recruitment business division to School Tour Ship Co., Ltd. and renamed it as Riso Kyoiku Kikaku Co., Ltd.
October 2013	Established Inter TOMAS Co., Ltd. as a spin-off of the English school division, established Plus One Kyoiku Co., Ltd. as a spin-off of the character-building training camp education business, renamed Nihon Edunet Co., Ltd. as School TOMAS Co., Ltd., renamed Riso Kyoiku Kikaku Co., Ltd. as TOMAS Kikaku Co., Ltd.
November 2016	Established TOMAS ENGLISH TRAINING CENTER, INC. (99.9% owned by School TOMAS), an online English conversation business for school operators, in Cebu IT Park
September 2019	Established joint-venture company Sundai TOMAS (owns a 51% stake) based on a capital and business alliance with Sundai Preparatory School
February 2020	Opened the first school for spec. TOMAS, a new brand, in Jiyugaoka under Sundai TOMAS. Absorbed Inter TOMAS Co., Ltd. and TOMAS Kikaku Co., Ltd.

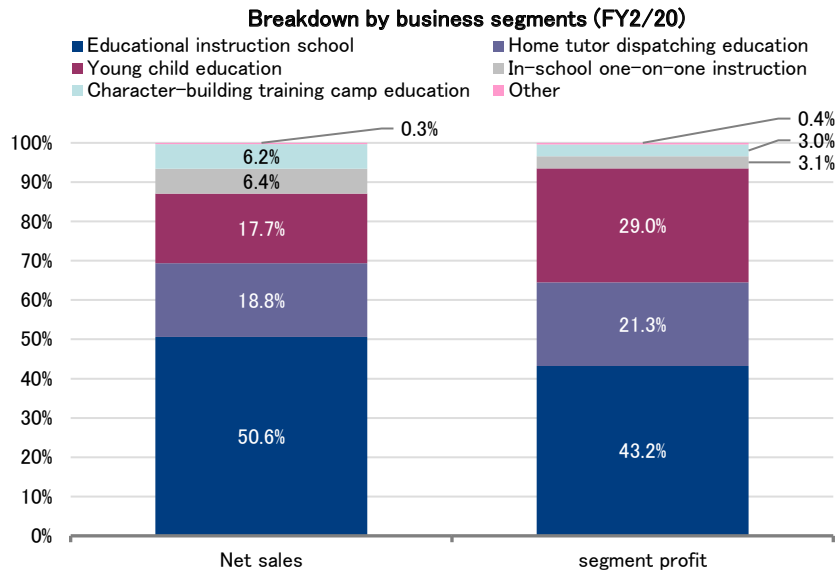
Source: Prepared by FISCO from the Company's securities report and press releases

Building educational service businesses mainly through TOMAS, Meimonkai, and Shingakai

2. Business overview

The Company and its five major subsidiaries are steadily building educational services mainly driven by educational instruction schools. As business segments, the Company provides disclosure for educational instruction school business, home tutor dispatching education business, young child education business, in-school one-on-one instruction business, and character-building training camp education business. In FY2/20, educational instruction school business, the core field, accounted for 50.6% of sales and 43.2% of segment profit. Together with home tutor dispatching education business and young child education business, these three segments dominate the Company's results.

Company profile



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

Educational instruction school business consists of mainstay genuine one-on-one instruction school TOMAS with 84 schools in the Tokyo metropolitan area (as of end-February 2020, same below), 12 English conversation Inter TOMAS schools, and two medical school exam preparation one-on-one instruction MEDIC TOMAS schools. Additionally, it opened spec. TOMAS (Jiyugaoka school), a provider of one-to-one instruction that specializes in entrance exams for the most difficult schools, in February 2020 under subsidiary Sundai TOMAS. TOMAS business generates the majority of segment sales, and Inter TOMAS has grown to about ¥500mn in annual sales.

TOMAS is a genuine individualized instruction school with a one-on-one format that covers from elementary students to high school students and prepares and provides curriculum optimized to personal skills in order to realize the goal of passing the exam at a target school. Teachers are mainly students, adults, and other part-time staff, and full-time employees handle consultation about learning content and support services. In addition, spec. TOMAS has its own entrance test. The Jiyugaoka school teaches 3rd–6th year elementary students and employs teachers as full-time staff with the goal of passing exams for the most difficult schools. Since it opened in February, it has been operating smoothly with about 50 students. The school introduces students who do not pass the entrance test to nearby TOMAS.

Home tutor dispatching education business has 34 Meimonkai schools nationwide that dispatch adult professional teachers as home tutors. It also operates seven TOMEIKAI schools as individualized instruction schools with service area outside of the Tokyo metropolitan area (four schools in the Kyushu area, two schools in the Tokai area, and one school in the Koshinetsu area). TOMEIKAI schools hire student teachers and thus seek locations with medical universities or other universities that have many talented students nearby.

Young child education business consists of Shingakai, a pioneer in entrance exam instruction for top kindergartens and elementary schools, with 23 schools mainly in the Tokyo metropolitan area (20 schools in metro Tokyo, three schools in Keihanshin), and Shinga's Club, an after-school care and childcare business with vibrant demand, with 21 schools in the Tokyo metropolitan area (15 after-school care schools and six childcare schools).

Company profile

In-school one-on-one instruction business involves provision of individualized instruction utilizing after-class time based on contracts between School TOMAS and individual schools. It also includes Hello eSensei online English conversation service over the Internet. Fifty-five schools have deployed service (65 schools on a contract basis), including Hello eSensei, mainly private high schools.

Character-building training camp education business consists of six schools each for soccer and gymnastics run by Plus One Kyoiku and planning and provision of School Tour Ship, an experience-type educational program using weekend days and summer vacation and other extended holidays. This program aims to cultivate action-taking and decision-making capabilities through participation in School Tour Ship that provides various experiences.

Overview of business segments and main companies

Business segments	Company name	Business description	Service regions
Educational instruction school business	Rison Kyoiku	Educational instruction school business. Mainly operates TOMAS genuine one-on-one instruction schools as well as Inter TOMAS English conversation schools and MEDIC TOMAS medical department entrance exam individualized instruction schools	Tokyo metropolitan area
	Sundai TOMAS	Operates spec. TOMAS one-on-one instruction schools that specialize in entrance exams for the most difficult schools	Tokyo metropolitan area (likely to expand in the future)
Home tutor dispatching education business	Meimonkai	Operates Meimonkai that dispatches home tutors and TOMEIKAI one-on-one instruction schools in regional areas (outside of Tokyo and the three surrounding prefectures)	Dispatches home tutors nationwide TOMEIKAI offers services outside of the Tokyo metropolitan area
Young child education business	Shingakai	Operates Shingakai, a school that handles entrance exam instruction for top kindergartens and elementary schools, and Shinga's Club, a childcare and after-school care business	Shingakai has schools in the Tokyo metropolitan area and Keihanshin Shinga's Club has locations in the Tokyo metropolitan area
In-school one-on-one instruction business	School TOMAS	Offers In-school one-on-one instruction and "Hello eSensei" online English conversation business run by a subsidiary located on Cebu Island	Nationwide
Character-building training camp education business	Plus One Kyoiku	Operates a school business with a soccer school and gymnastics school and a tour business that cultivates action-taking and decision-making capabilities through various experiences	-

Source: Prepared by FISCO from the Company's securities report and results briefing materials and others

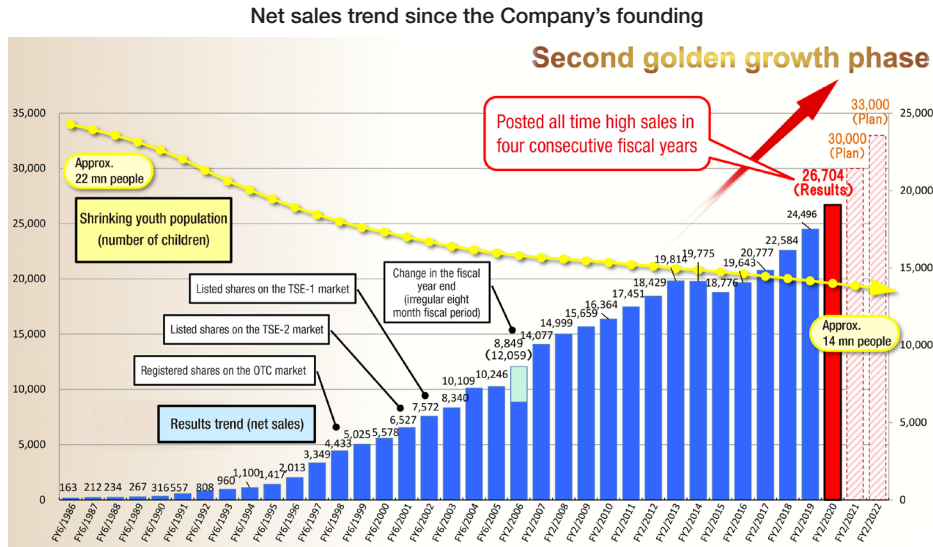
Currently in a “second golden growth phase” with tailwind from the shrinking youth population based on a foundation of high-quality educational service

3. Characteristics and strengths

While the Company has a variety of characteristics and strengths, we think the following two are particularly important – 1) consistently expanding income results over the long term and 2) realizing high profitability. We think the advantageous business model built by the Company is the source of these two characteristics and understanding these capabilities is likely to improve understanding and certainty of the medium to long-term growth scenario.

Company profile

The Company reported ¥163mn in net sales in FY6/86, its founding year, and sustained steady sales growth through FY2/13 (although sales dropped in FY2/06 with its abnormal eight-month period due to the fiscal year change, they were higher on a real basis that converts sales to a 12-month format). Results subsequently stalled until FY2/16 on discovery of improper accounting and related response. In FY2/17, however, the Company posted all-time high net sales for the first time in four years. Sales have been rising again since then, and the Company refers to the period from FY2/17 as a “second golden growth phase.”



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

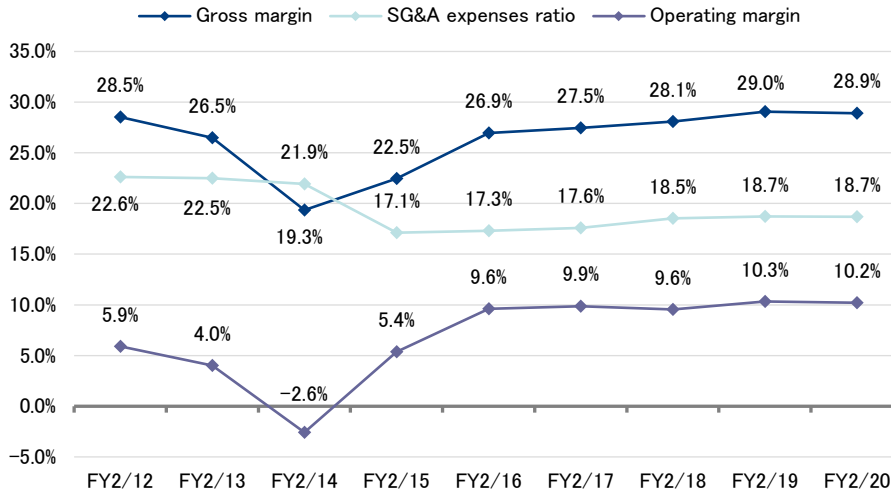
We think an important point is the Company's success in increasing student volumes in all major businesses (TOMAS, Meimonkai, and Shingakai) and sustaining growth despite a tough industry environment with fierce competition to acquire students amid peaking of the educational advancement and preparatory school market because of a shrinking youth population and increase in market participants.

Looking at gross margin, SG&A expenses ratio, and operating margin trends, meanwhile, operating margin held in double digits in FY2/20, the latest fiscal year, at 10.2%. The Company itself is not satisfied with current operating margin of about 10% and is making its utmost efforts to reach the near-term goal of 15%. The 10% margin level is higher than average margin in the educational advancement and preparatory school industry. While multiple listed peers realize higher operating margin than the Company, these firms either use group instruction as the core business model or acquire royalty income through franchise businesses. Very few peers that mainly conduct one-on-one instruction only in directly run schools, such as the Company, or utilize a mix of group and individualized instruction have double-digit operating margin.

We believe the Company is capable of attaining 15% operating margin considering its investments in new school openings and new business ramp-up through FY2/20. While it might have potential to pursue even higher margin after that point, management is also putting emphasis on compliance and other areas and needs to sustain a certain amount of spending on internal management operations compared to past years (during the pre-listing era of operating margin above 20%). From this perspective, we think the 15% operating margin goal is a reasonable level.

Company profile

Long-term trends in gross margin, the SG&A expenses ratio, and operating margin



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

Our understanding is that the same source drives the Company's strengths of stable sales growth and high profitability. Current director and chairman Iwasa took into account the implications of China's one-child policy in founding the Company. One is the prospect of shrinking the youth population because of the one-child policy, and the other is increase in the amount spent per child on education costs as a result of the smaller youth population. In other words, the Company held a relatively advantageous position from the outset thanks to launching the business in anticipation of a shrinking youth population and building a business model from this perspective. With its insight into likely increase in education costs spent per child too, the Company succeeded in transforming the headwind of a shrinking segment into a tailwind.

Key points in harnessing shrinkage of the youth population as a tailwind are 1) provision of high-quality educational services with genuine individualized instruction using a one-on-one format and 2) focus on advancement instruction as the goal. These two are common aspects of the Company's TOMAS service and other business formats. The Company is currently the only firm actively promoting individual instruction that combines both aspects. The most typical model in the individual instruction market at this point is a quasi-approach with a ratio of one teacher to a few (2-3) students for the purpose of supplementing school coursework. We think a major reason why other companies do not adopt its model is high business risk. Since service fees must be higher in order to implement truly individual instruction, supplementing coursework is not enough to justify these fees. The tough reality is that only academic advancement results are capable of justifying high course fees. Almost no newcomers are entering the market with the same business model as the Company for this reason, and this has solidified the Company's strong brand presence as a one-on-one educational advancement and preparatory school.

Company profile

The Company itself started with group instruction using a class format of six students at a similar academic level per teacher to fulfill provision of high-quality individual instruction when it was initially founded and only introduced genuine one-on-one instruction that Mr. Iwasa envisioned five years after launching the Company in 1990. While we think executive opinions and policy aims clashed internally during this period, adoption and thorough application of a mentality that the “educational instruction school industry is a service business” ultimately led to realization of genuine individual instruction. With this stance, the Company moved forward in the aim of delivering high customer satisfaction. High customer satisfaction in the educational instruction school and preparatory school industry comes from getting into the desired school. The Company has always retained the mentality of being a service business from its founding up to the present and defined pursuits of academic advancement results as its mission as a service firm as the top management goal. We think this business model of “pursuing academic advancement results” is the source of the Company’s strength and supports the above-mentioned two characteristics of stable sales growth and high profitability.

An example of the Company’s management approach with high awareness as a service company is its style of having full-time employees focus on management. As explained above, the mainstay TOMAS business utilizes part-time students and adults as instructors and has full-time employees assigned to each classroom site serve as coordinators between instructors and children and students and their guardians. Specifically, they engage in the following tasks – 1) identify genuine aims and goals of students and guardians, 2) develop curriculum with the instructor based on this information, and 3) explain progress updates, subsequent instruction policy, and other details to guardians after lessons begin. Repetition of this cycle maintains a high level of customer satisfaction on a normal basis and contributes to the biggest customer satisfaction of getting into the desired school.

Regarding whether the Company is capable of sustaining stable growth and high profitability in the future, while this depends on the length of the investment time horizon, we see a sufficiently strong prospect of achieving these goals with a timeline of 5–10 years. This view reflects the likely existence of a certain amount of demand for the Company’s business model (high-priced, high-quality services). We also consider low risk of excessive competition because of market entry by other firms in this segment for reasons explained above. This is because of significant business risk involved in copying or recreating the business model that the Company has built over many years since its founding. The high entry barrier for the Company’s business model that pursues educational advancement results is a third characteristic.

Results trends

5th straight sales increase and consecutive all-time highs in operating and ordinary profits in FY2/20

1. FY2/20 results

The Company announced FY2/20 consolidated results with higher net sales in a 5th consecutive fiscal year and higher operating and ordinary profits in a 6th consecutive fiscal year that set all-time highs at ¥26,704mn in net sales (+9.0% YoY), ¥2,716mn in operating profit (+7.4%), ¥2,749mn in ordinary profit (+8.2%), and ¥1,953mn in profit attributable to owners of parent (+23.9%). Sales increases in all segments and healthy expansion of student volumes fueled sales and profit growth. The Company added three TOMAS schools, five Meimonkai schools, two Shingakai Club schools (after-school care), one TOMAS GYMNASTICS SCHOOL, and one school for the new spec. TOMAS brand that opened in February 2020. It sustained operating margin at a roughly flat level of 10.2% (-0.1ppt YoY) through active rollout of new schools. Furthermore, the Company substantially raised the number of client schools in School TOMAS business from 36 schools at end-FY2/19 to 55 schools and reached a profit for in-school one-on-one instruction business that puts it in a phase of recouping investments.

FY2/20 consolidated results

	FY2/19		Period-start plan	FY2/20			
	Results	Ratio to sales		Results	Ratio to sales	YoY	Versus plan values
Net sales	24,496	-	27,000	26,704	-	+9.0%	-1.1%
Gross profit	7,113	29.0%	-	7,707	28.9%	+8.3%	-
SG&A expenses	4,583	18.7%	-	4,990	18.7%	+8.9%	-
Operating profit	2,529	10.3%	3,010	2,716	10.2%	+7.4%	-9.7%
Ordinary profit	2,540	10.4%	3,000	2,749	10.3%	+8.2%	-8.4%
Extraordinary income	-44	-	-	-103	-	-	-
Profit attributable to owners of parent	1,576	6.4%	1,800	1,953	7.3%	+23.9%	+8.5%

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

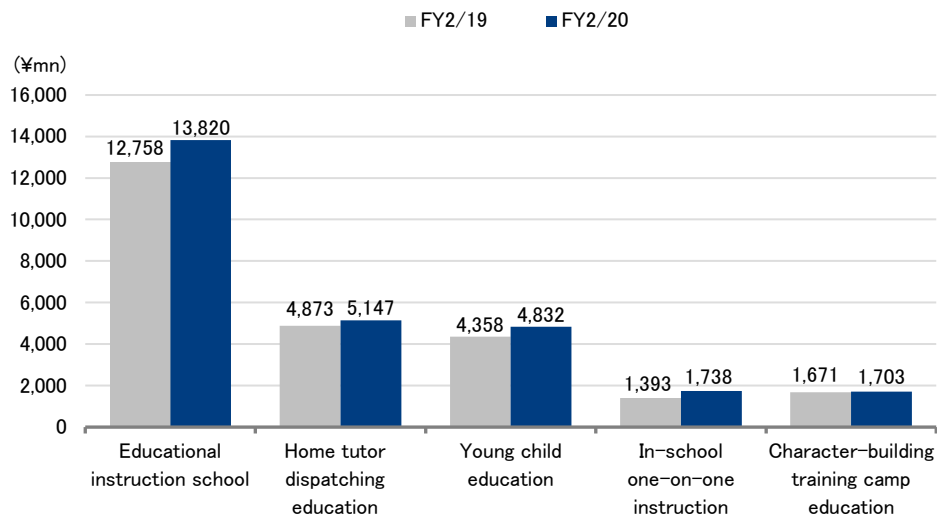
The Company missed guidance by 1.1% in net sales and 9.7% in operating profit because of a roughly ¥200mn sales shortfall in young child education business with the impact of closing all Shingakai schools during the major typhoon event in October 2019 and a profit setback of just over ¥100mn from curriculum costs, advertising & promotional expenses, and other costs related to opening the spec. TOMAS school that was not factored into guidance. The 8.5% upside in profit attributable to owners of parent, meanwhile, reflected decline in the effective tax rate through adjustment of carryover losses and other values related to the Company's absorption of consolidated subsidiaries Inter TOMAS (English school business) and TOMAS Kikaku (student recruitment business) in December 2019 aimed at improving management efficiency.

Results trends

Attained sales increases in all businesses and reached a profit in School TOMAS

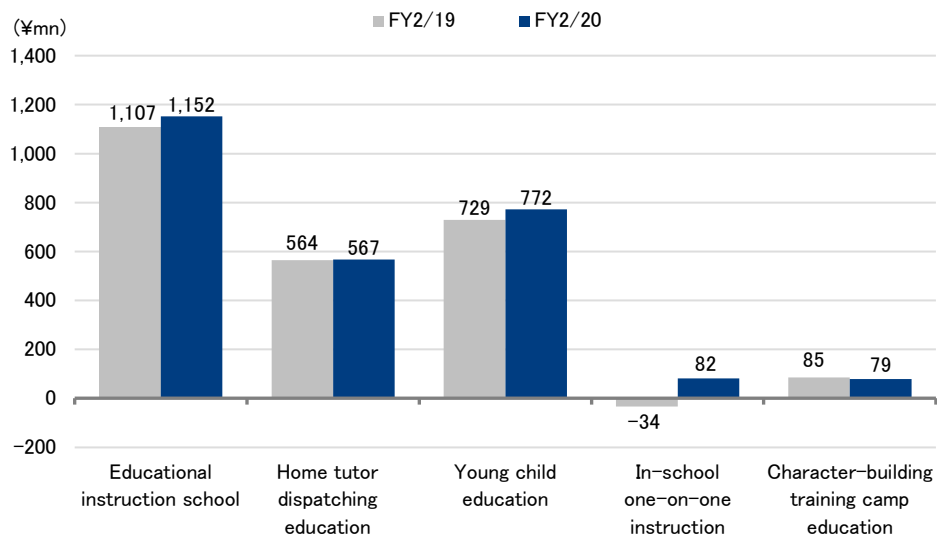
2. Segment trends

Net sales by business segment



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

Operating profit by business segment



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

Results trends

(1) Educational instruction school business

This segment reported ¥13,820mn in net sales including internal transactions (+8.3%; same below) and ¥1,152mn in operating profit (+4.1%). Period-end student volume increased 10.2% YoY, a healthy gain, with a rise in students at existing TOMAS schools and student acquisitions at three new schools opened under its satellite strategy in the Tokyo metropolitan area promoted since FY2/18 (Gakugei Daigaku School (May), Tama Center School (June), and Miyazakidai School (September)). Another addition is the spec. TOMAS school, a new format, in Jiyugaoka (February 2020) under subsidiary Sundai TOMAS.

While operating margin dropped from 8.7% to 8.3%, this occurred on investment of just over ¥100mn in spec. TOMAS launch costs, and margin improved excluding this factor. In addition, spec. TOMAS is a provider of one-to-one instruction that specializes in entrance exams for the most difficult schools and has its own entry test. The Jiyugaoka school teaches 3rd–6th year elementary students and has recruited about 50 students as planned.

(2) Home tutor dispatching education business

This segment reported higher sales and profits again in FY2/20 with ¥5,147mn in net sales (+5.6% YoY) and ¥567mn in operating profit (+0.6%). Combined student volume for Meimonkai and TOMEIKAI at end-FY2/20 expanded by a healthy 3.9% YoY. Meimonkai opened five new schools (Okayama Satellite School in March, Utsunomiya School in May, Mito Ekimae School and Takasaki Ekimae School in August, and Tsukuba Ekimae School in September). Operating margin slightly declined from 11.6% in FY2/19 to 11.0% mainly because of new school launch costs.

(3) Young child education business

This segment booked higher sales and profits in a 5th consecutive fiscal year and set new highs again in FY2/20 with ¥4,832mn in net sales (+10.9% YoY) and ¥772mn in operating profit (+5.8%). Combined student volume for Shingakai and Shinga's Club at end-FY2/20 rose by an upbeat 10.8% YoY. Shinga's Club, in particular, continued double-digit growth against a backdrop of vibrant demand. The Company added two Shinga's Club (after-school care) locations in FY2/20 (Ikebukuro Higashiguchi in April and Gakugei Daigaku in June).

Even though operating margin fell from 16.7% in FY2/19 to 16.0% because of launch costs for new schools and impact from closures accompanying the major typhoon in October 2019, this segment continues to deliver the highest profitability in the group.

(4) In-school one-on-one instruction business

This segment realized a profit for the first time in three years in FY2/20 with ¥1,738mn in net sales (+24.8% YoY) and ¥82mn in operating profit (vs. a ¥34mn loss in FY2/19). The main sales driver was expansion of the number of schools offering School TOMAS service from 36 schools at end-FY2/19* to 55 schools (65 schools on a contract basis). The Company rapidly increased deployments from 2H considering that it had 39 locations at end-1H. Profit margin improved on higher sales in the School TOMAS business and decline in investments in the Philippines for Hello eSensei online English conversation business.

* School TOMAS and Hello eSensei use the same business model of selling service through schools. The number of schools offering its service includes schools with contracts only for Hello eSensei service.

(5) Character-building training camp education business

This segment reported ¥1,703mn in net sales (+1.9% YoY) and ¥79mn in operating profit (-7.0%) in FY2/20. Sales growth slowed, though continued at a solid pace, due to backlash from robust momentum in FY2/19. Profit dropped because of launch costs related to opening the TOMAS GYMNASTICS Azabu school in July.

Results trends

Healthy financial standing with debt-free operations, ROE and ROA continue to trend upward

3. Financial conditions

Looking at financial conditions at end-FY2/20, total asset value increased by ¥703mn YoY to ¥13,214mn. Main changes were increases of ¥120mn in cash and deposits and ¥209mn in operating accounts receivable under current assets and increases of ¥180mn in property, plant and equipment and ¥180mn in deposits and guarantees on progress with new school openings under non-current assets.

Total liabilities increased by ¥809mn YoY to ¥7,056mn. Main changes were increases of ¥382mn in advances received that convert to future sales and ¥122mn in unpaid corporate taxes under current liabilities and ¥116mn in liabilities related to retirement benefits under non-current liabilities. Net asset value dropped by ¥106mn YoY to ¥6,157mn. The Company paid ¥1,838mn in dividends and spent ¥326mn on share buybacks in accordance with its active shareholder return policy. Since profit attributable to owners of parent was ¥1,953mn, the total shareholder payout ratio exceeded 100%.

In management indicators, even though the capital ratio fell to 45.9% on active implementation of dividends, share buybacks, and other shareholder return from FY2/17, we think the Company offers sound financial content in the absence of interest-bearing debt and with over ¥4bn in cash and deposits and a steady upward trend. Operating margin was flat YoY at 10.2%. Nevertheless, ROE moved into the 30% range at 31.7% with support from the increase in profit and ROA continued to trend upward at 21.4%. With steady improvements in profitability and capital efficiency, we believe the Company is strengthening its income structure.

Consolidated balance sheet

	(¥mn)				
	FY2/17	FY2/18	FY2/19	FY2/20	Change (value)
Current assets	5,598	6,052	6,318	6,644	326
(Cash and deposits)	3,866	4,171	4,716	4,837	120
Non-current assets	5,577	5,602	6,138	6,531	393
Total assets	11,250	11,724	12,510	13,214	703
Current liabilities	3,162	3,430	3,861	4,498	637
Non-current liabilities	1,786	2,019	2,385	2,557	172
Liabilities	4,949	5,450	6,247	7,056	809
(Interest-bearing debt)	-	-	-	-	-
Net assets	6,301	6,273	6,263	6,157	-106
Management indicators					
Capital ratio	56.0%	53.5%	49.9%	45.9%	-4.0pt
Operating margin	9.9%	9.6%	10.3%	10.2%	-0.1pt
ROE	18.1%	22.0%	25.2%	31.7%	6.5pt
ROA	17.1%	18.6%	21.0%	21.4%	0.4pt

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

■ Outlook

TOMAS and Meimonkai partially resumed operations with rigorous measures to prevent COVID-19 infections

1. COVID-19 measures and impact on results

Japan issued a state of emergency declaration on April 8 in response to the COVID-19 outbreak. Following this action, the Company suspended operations of all TOMAS and Shingakai schools, and Meimonkai schools in the Tokyo metropolitan area, Keihanshin, Nara, and Fukuoka (excluding home tutor dispatching). Since School TOMAS provides in-school instruction, school closures suspended services from March. Shinga's Club (childcare and after-school care), meanwhile, continued operating with limited coverage and revised hours and content based on requests from local society.

TOMAS and Meimonkai announced the restart of one-on-one instruction with thorough measures to prevent infections for interested people on April 22 due to requests from students and guardians to resume classes. As measures to prevent infections, these schools required surgical masks and use of alcohol-based sanitizer. The Company also installed vinyl curtains and procured 20,000 medical-use masks that prevent droplets for free supply to teachers and students. It is conducting classes in a manner that ensures social distancing too.

Measures for dealing with COVID-19 in main businesses

	April 8–21	From April 22
TOMAS	Suspended operations at all schools	Resumed operations with rigorous measures to prevent COVID-19 infections for interested people
Meimonkai	Stay home restrictions did not apply to home tutor dispatching service. The Company hence continued normal operation of this business with measures to prevent infections, such as wearing face shields. It suspended classroom instruction at schools only in the Tokyo metropolitan area, Keihanshin area, Nara, and Fukuoka.	The Company subsequently resumed classroom instruction at suspended schools utilizing measures similar to TOMAS.
Shingakai	Suspended all schools from April 8 to May 6	
Shinga's Club		
(Childcare)	Offered services with revised hours and content only for children from households in which both parents work from April 13 to May 6	
(After-school care)	Offered services with revised hours and content for guardians with jobs that required going to work from April 8 to May 6	

Source: Prepared by FISCO from the websites of each business

Looking at COVID-19 impacts, during March, sales increased 20% YoY at TOMAS and Meimonkai on a rise in students attending classes in the morning following blanket school suspensions. New TOMAS students rose by a healthy 10% YoY in March. While the Company closed TOMAS and Meimonkai schools in April, it resumed classes for interested people on April 22. The Company intends to revise schedules after re-openings to make up for missed classes during the shutdown once the state of emergency situations end and operations normalize. We believe adverse impact on income results should be mild in both businesses as long as the government does not extend the state of emergency period.

Outlook

We think temporary negative impact on Shingakai is unavoidable because it halted all schools for roughly a month. Nevertheless, 2Q and 3Q are the main demand periods and we think damages should be limited if Japan lifts the state of emergency by May. We expect difficult 1Q results in School TOMAS business because ordinary school closures in March and April eliminated sales during this period. Furthermore, while the School Tour Ship program run by Plus One Kyoiku has halted all events at this point and is facing negative impact, implications in consolidated total results are minor.

The Company did not disclose FY2/21 guidance because of the difficulty of preparing reasonable estimates of COVID-19 impact on results. Although it depends on the extent of infection spread, we think it should be possible to assess impacts once operations normalize in the Company's various businesses. Management might be capable of disclosing full-year guidance as soon as 1Q announcement timing.

New schools (including planned ones) in FY2/21 are one Inter TOMAS school (Sakura Shinmachi School in March) and one TOMEIKAI school (Nagoya Gokiso School in May) and three TOMAS school renewals in a larger space (Omiya School, Sakura Shinmachi School, and Sangenjaya School in March). While timing has not been finalized yet, the Company hopes to open a spec. TOMAS school in Kichijoji that broadens scope to elementary, middle, and high school students. The Company currently targets deployment of School TOMAS at 100 schools during FY2/21. However, attainment of this level might slip to FY2/22 if school closures are prolonged.

Pursuing sustainable growth in all businesses driven by increases in student and school volumes

2. Medium-term management plan and growth strategy

(1) Overview of the medium-term management plan

The Company started a three-year medium-term management plan in FY2/20 that aims for sustainable growth by not only further expanding existing core businesses TOMAS, Meimonkai, and Shingakai, but also proactively developing School TOMAS, Shinga's Club, Inter TOMAS, spec. TOMAS, Plus One Kyoiku, and other businesses.

In the medium-term management plan announced in April 2019, the Company aims to reach ¥33,000mn in net sales, ¥3,810mn in operating profit, and 11.5% operating margin in final-year FY2/22. Even though it slightly missed net sales and operating profit targets in the first year and is facing uncertain conditions about how the COVID-19 outbreak might affect results in FY2/21, the second year, as explained above, the Company retains its fundamental growth strategy and intends to expand income in the various business areas via increases in school and student volumes. Teacher recruitment is an issue in efforts to expand the number of schools, and the Company plans to establish a joint venture with Surugadai Gakuen Educational Institute, a capital and business alliance partner, for recruiting, training, and dispatching teachers in the near future. It wants to bolster teacher hiring by utilizing a network that includes Sundai Preparatory School and others and thereby accelerate expansion of TOMAS business as well as TOMEIKAI, the school brand deployed outside of the Tokyo metropolitan area, and School TOMAS. However, the Company intends to proceed cautiously on decisions to open new schools in FY2/21 in light of COVID-19 impact and other factors.

Outlook

Medium-term management plan covering FY2/20 to FY2/22 (values announced in April 2019)

	FY2/20		FY2/21		FY2/22	
	Plan	Results	Plan	YoY	Plan	YoY
Net sales	27,000	26,704	30,000	12.3%	33,000	10.0%
Operating profit	3,010	2,716	3,410	25.6%	3,810	11.7%
Operating profit margin	11.1%	10.2%	11.4%	-	11.5%	-
Ordinary profit	3,000	2,749	3,400	23.7%	3,800	11.8%
Extraordinary income						
Profit attributable to owners of parent	1,800	1,953	2,000	2.4%	2,300	15.0%

(¥mn)

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

(2) Growth strategy in the educational instruction school business

Educational instruction school business consists of one-on-one instruction school TOMAS, English conversation school Inter TOMAS, and medical school exam one-on-one instruction and preparatory school MEDIC TOMAS. In February 2020, it added spec. TOMAS as a provider of one-to-one instruction that specializes in entrance exams for the most difficult schools. The medium-term plan calls for sales growth at a roughly 10% annual rate driven by increases in school and student volumes.

The Company intends to continue promoting a “strategy of satellite schools in the Tokyo metropolitan area,” which it has been implementing since FY2/18, as the TOMAS school initiative. While it previously deployed schools at terminal train stations with about 495–661m² floor space that accommodate 200–400 students, the satellite strategy deploys schools at mid-sized train stations around terminal sites with about 165–198m² floor space that accommodate 100–150 students. This business had a school count of 84 schools at end-FY2/20. It plans to continue opening new satellite schools at a pace of about 5–10 schools a year with the aim of establishing operations with 120 schools as a milestone for the time being. While the Company needs to proceed cautiously with investments due to the importance of carefully assessing COVID-19 impact as explained above, we expect it to switch to an active stance once the external environment normalizes. The Company will also move existing schools that have become crowded with rising student volumes to larger spaces.

The spec. TOMAS business, which the Company has launched as a new brand, plans to open a second school in Kichijoji in FY2/21 and will be looking at other additions in the Tokyo metropolitan area. Student volume per school is somewhat smaller than TOMAS in the range of 150–200 students, including the impact of having its own entrance exam. A key characteristic is guiding students interested in the most difficult schools to achieve admission to their desired school by integrating knowhow accumulated by Surugadai Gakuen Educational Institute and the Company to create original curriculum and provide genuine one-on-one instruction with professional adult teachers. We expect large synergies from the alliance with Surugadai Gakuen Educational Institute by utilizing its teacher personnel and enhancing the quality of original materials in production and publishing. Since admission results are the main barometer for student recruitment at academic advancement schools, the Company hopes to solidify spec. TOMAS as the brand for one-on-one instruction that specializes in entrance exams for the most difficult schools by building a track record of admission results.

(3) Growth strategy in the home tutor dispatching education business

Subsidiary Meimonkai handles home tutor dispatching education business. The Company launched this business in 1989. Meimonkai stands out by dispatching 100% professional adult instructors and being the only firm in the home tutor industry with full disclosure of academic advancement results. These are important differentiating points with peers.

Outlook

Home tutors deliver one-on-one instruction, but the class location is different. The Company segments group business into focus on expanding TOMAS service in Tokyo and three surrounding prefectures and one-on-one instruction by Meimonkai home tutors in areas outside of TOMAS coverage. This approach leads to regional sales breakdown in Meimonkai business of 31% in the Tokyo metropolitan area and 69% in other areas. Growth strategy at Meimonkai involves expansion of sites in the existing home tutor dispatching service business and development of the TOMEIKAI one-on-one instruction school business as a new area.

The Company primarily developed Meimonkai business in the Tokyo metropolitan area and Osaka, Nagoya, and other large cities, but plans to actively deploy sites in core regional cities too. In fact, it newly opened four schools in the Kita-Kanto area and a satellite school in Okayama in FY2/20.

TOMEIKAI business is opening schools in core cities outside of the Tokyo metropolitan area. Currently, it only has eight schools nationwide including four schools in the Kyushu area, three schools in the Tokai area, and one school in the Koshinetsu area, but is likely to accelerate school openings once it has established a platform for hiring part-time teachers. The Company is working on formation of a joint venture to hire, train, and dispatch teachers with Surugadai Gakuen Educational Institute in the near term and intends to launch schools in Osaka, Nagoya, Fukuoka, and other major cities. We see TOMEIKAI business potential as opening 80–90 sites nationwide with an average of two schools per prefecture.

Risks, meanwhile, are decline in regional population and weakening of local economies at faster paces than expected. From this perspective, it might be safer to estimate the above-mentioned potential market size at about half that size, or around 50 schools. The Company is aiming for solid growth in Meimonkai sales at a 5–10% annual rate over the medium term.

(4) Growth strategy in the young child education business

Shingakai, the main unit in young childcare business, has a longstanding presence in the market with a history of 64 years since its founding and was the pioneer and offers the No.1 entrance results in the “entrance exam” industry for well-known kindergartens and elementary schools. It also has dominant name recognition. This segment is expanding Shinga’s Club as a growth initiative.

The elementary school entrance exam market for well-known kindergartens and elementary schools is highly unique, and this makes it difficult to achieve horizontal development (regional expansion) of the Shingakai business that handles it. This business is limited to the Tokyo metropolitan area and Keihanshin area. The Company hence is aiming for vertical development (age segment expansion) as the growth strategy with Shinga’s Club (childcare and after-school care) as the specific platform.

While preparation for elementary school entrance exams begin at the age of about four years old, this strategy seeks to engage at an even younger age and also ensure that Shingakai graduates (first-year to third-year elementary students) continue in TOMAS service for junior-high school entrance exams (exam studies typically start with fourth-year elementary students). Specific services are Shinga’s Club childcare and after-school care businesses.

Outlook

Childcare business covers children aged 1–5 years old and recruits a group that is one stage before entrance exam instruction provided by Shingakai. Key service points are 1) entrance exam-oriented extended-hours childcare and 2) provision of entrance exam-oriented solutions to households in which both parents work (traditionally it is believed that children from homes without a stay-at-home mother have trouble passing entrance exams). The Company currently operates six schools in the Tokyo metropolitan area (as of end-February 2020), but these sites have already filled up. It intends to open new schools once it arranges school staff, real estate locations, and other details.

After-school care covers first-year to third-year elementary school students. General after-school care receives subsidies from the government based on the Child Welfare Act. It is also one of the few growth markets, and educational instruction school operators and other private-sector companies have been entering the market. The Company entered this market by distinguishing itself as “extended-hours after-school care with academic advancement instruction (as preparation for junior-high school entrance exams). The Company currently has 15 schools in the Tokyo metropolitan area, and all of the sites are doing well in terms of student volume. Just as with childcare, it plans to open new schools once it arranges school staff, real estate locations, and other details.

We think the Company has leeway to roughly triple the number of Shinga’s Club classrooms over the medium term and hence could expand to about 60 classrooms. If the Company is positioning Shinga’s Club as a way of broadening the age scope of existing Shingakai business, it might open childcare and after-school care sites at the 20 Shingakai schools in the Tokyo metropolitan area. We believe 60 schools is a realistic target assuming 40 schools based on two classrooms x 20 sites and openings at other terminal train stations and core stations. Rather than market potential, main hurdles for realization are securing real estate locations and recruiting instructors. Personnel recruitment, in particular, is an issue, because skills for childcare and after-school care differ entirely with those used at educational instruction schools.

The Company, meanwhile, remains cautious in its stance toward expanding the number of Shingakai classrooms. We attribute this approach to management’s conclusion that it has limited opening room geographically for the niche business of “entrance exams” at well-known kindergartens and elementary schools with the existing 20 schools in the Tokyo metropolitan area and three schools in the Keihanshin area and ability to accommodate increases in student volume by adding floor space at existing classrooms. While Shingakai is likely to have more moderate growth than the Company’s other businesses as a result, it serves as a cash-cow business with high profitability and the prospect of steady demand each year.

(5) Growth strategy in the in-school one-on-one instruction business

The in-school one-on-one instruction business operated by School TOMAS consists of two services - School TOMAS for one-on-one instruction service at schools and Hello eSensei for online English conversation service.

School TOMAS provides one-on-one instruction at schools for interested people and stands out in class content that focuses on entrance exam preparation rather than supplementing coursework. Schools adopting this service aim to improve their academic advancement results. Many private schools use academic advancement results as a sales point to recruit students. We think this service has very strong potential demand because client schools are capable of increasing the number of people who want to attend if the addition of School TOMAS to the school’s ordinary classes raises exam passing rates. A key advantage for the Company is elimination of real estate costs and advertising and promotional costs to recruit students. Management estimates that School TOMAS could theoretically achieve 15–20% operating margin.

Outlook

The Company accelerated service rollout to 55 schools at end-FY2/20 (65 schools on a contract basis), an increase of 19 schools YoY, thanks to progress bolstering operations, including instructor recruitment. It concluded a business consignment contract with the Tokyo Metropolitan Board of Education for an “academic advancement assistance school” program in April 2019. This means School TOMAS service might make inroads at metropolitan high schools. The initiative involves deployment of School TOMAS service for students at metropolitan high schools in order to enhance academic capabilities for advancement to universities and improve academic advancement results. Service is currently available at two schools on a trial basis. Since the service is taking place for first year students, it is likely to require some time to confirm deployment results (academic advancement). We intend to closely monitor developments because evidence of positive results would boost expectations for deployment at metropolitan high schools. Separately, the Company is conducting negotiations with Surugadai Gakuen Educational Institute on utilization of Sundai Preparatory School’s video class contents at School TOMAS in areas with a shortage of part-time instructors.

The Company is targeting 100 schools with School TOMAS service in the near term, but believes it has room to deploy service at 300 schools as potential size. It aims to achieve strong double-digit growth over the medium term by raising awareness of the service through steady realization of “academic advancement” results.

Hello eSensei service provides in-school man-to-man personalized English conversation instruction and utilizes the same B-to-B-to-C business model as School TOMAS in which the contract counterpart is a school corporation and offers significant synergies. Hello eSensei service instructs students in English conversation with a native speaker as the teacher. Meanwhile, since it is difficult to secure native English conversation teachers in Japan including from a cost perspective, the Company established the TOMAS English Training Center in Cebu (Philippines) for local instructors and developed a model of conducting online English conversation classes at Japanese high schools with these instructors in 2017. It had been booking losses for the past few years due to initial investments, including system development costs, but exhausted depreciation costs and realized a profit for the first time, similar to School TOMAS, in FY2/20. This business is positioned now to contribute favorably. The main issue is growing price competition due to increase in participating companies with growth in the online English conversation market. Whether the business grows or not depends on the extent to which the Company can differentiate its service.

Shareholder returns

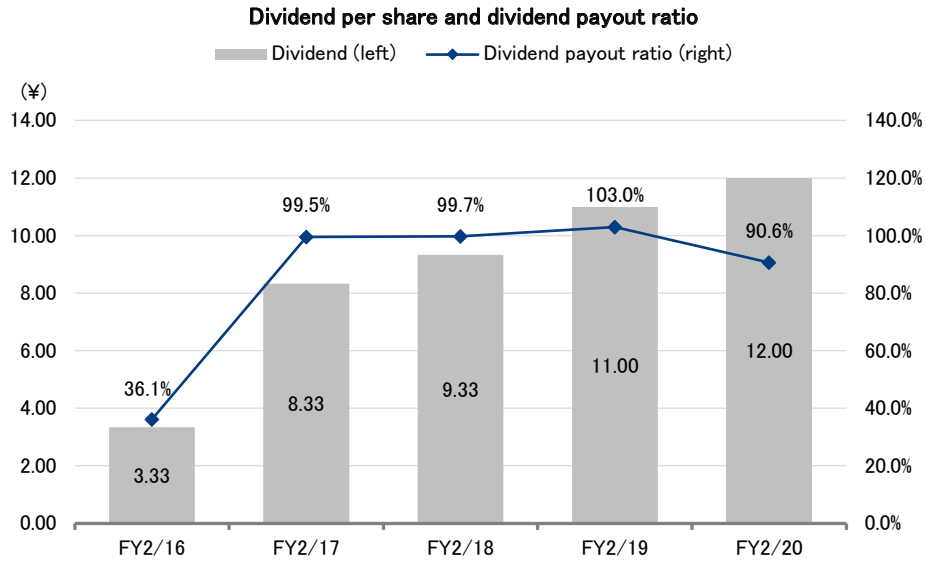
Plans to decide future dividend policy considering retained profits for risk management, etc.

The Company positions returning profits to shareholders as an important management theme and has paid dividends with a target of 100% dividend payout since FY2/17 under a basic policy of paying dividends based on earnings with consolidated payout as the indicator. In FY2/20, it paid a ¥12.0/share dividend. The Company pays dividends four times a year at the end of each quarter.

For FY2/21, the Company has not decided the dividend yet, similar to guidance, because of uncertainty about COVID-19 impact on results. It intends to make a decision on future dividend policy through comprehensive consideration of retained profits for risk management and other points. We do not expect non-payment of a dividend and think the Company is likely to pay a certain amount in accordance with the earnings situation.

Shareholder returns

The Company announced share buybacks in February 2020 with upper limits of 4mn shares or ¥1.2bn in purchase costs. The buyback program lasted through May 11, 2020.



Note: Implemented a three-for-one stock split on December 1, 2018
 Retroactively revised dividend values
 Source: Prepared by FISCO from the Company's financial results



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