COMPANY RESEARCH AND ANALYSIS REPORT

RIZAP Group, Inc.

2928

Sapporo Securities Exchange Ambitious

9-Jan.-2018

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Summary

Preparing a solid foundation for medium- to long-term earnings growth through new measures, including collaborating with local governments and strengthening the business infrastructure platform

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

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

In FY3/18 1H, revenue increased but profits declined, with revenue of ¥62,581mn (up 50.8% year-on-year (YoY)) and operating income of ¥5,003mn (down 21.7%). Compared to the initial forecasts, profits were above forecast, and at FISCO we evaluate these results to be extremely positive. The expansion of the RIZAP-related businesses that includes the body shaper business, and the improvements in the results of the listed subsidiaries, both progressed as planned or at a pace that was better than expected. There are no causes for concerns in the 2H also, and we think that the Company will achieve its results forecasts for FY3/18 full fiscal year.

2. In the body shaper business, the major progress points are the spread in the use of the BMP and the collaborations with local governments

There are two points to pay attention to for the body shaper business, which is the Company’s core business. The first is the fact that the Body Management Program (BMP) has quickly gotten on track and the Company has made major progress in converting this business to the recurring-revenue business model which the Company had aimed for. The second is the progress made in the collaborations with local governments based on the RIZAP Declaration to Bring Health and Fitness to Ten Million People. Although this is an extremely modest and steady initiative, for example there are no TV commercials for it, the Company is tackling head-on the challenge facing Japan of reducing medical costs. For this, the Company is adopting a framework of performance-based compensation, and the impact on the results of this business model, and when it achieves a certain level of success, are expected to be greatly different to those from the existing businesses.

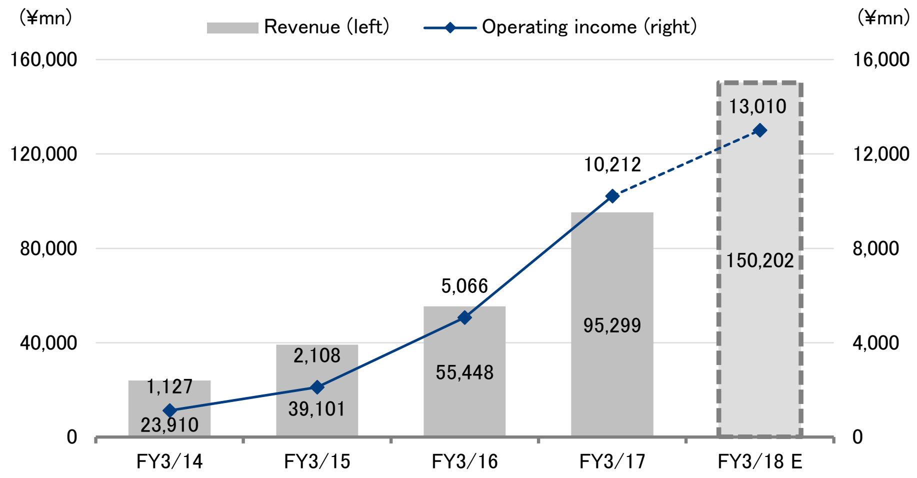
3. Started to strengthen the business infrastructure platform toward medium- to long-term growth

As its new growth strategy from the FY3/18, the Company has started to strengthen its business infrastructure platform. The content of this strengthening covers three areas; technologies, global SPA, and the customer base, marketing, etc., to support the RIZAP economic zone. The growth strategy up to the present time focused on expanding topline growth, but from FY3/18, its focus will be on “solidifying footholds,” which at FISCO, we read as the Company’s self-confidence in its growth. Together with the previously mentioned RIZAP Declaration, we think that in the coming years, it is possible that FY3/18 will be evaluated as “the turning point” for the Company.

Key Points

- The contract renewal rate rose rapidly to 82% on the introduction of the BMP. Made major progress in converting to a recurring-revenue business model
- Has so far collaborated with three local governments. The business model may be transformed with the increase in the collaborations with local governments
- By solidifying the footholds in the business infrastructure, the Company aims to achieve the targets in COMMIT 2020 and secure sustainable growth in the future

Results trends



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

Results trends

Achieved a major increase in revenue for the sixth consecutive fiscal year. Profits exceeded the initial forecasts

1. Overview of the FY3/18 1H results

In FY3/18 1H results, the Company posted higher revenue but a decline in income, with revenue of ¥62,581mn (up 50.8% YoY), operating income of ¥5,003mn (down 21.7%), profit before income taxes of ¥4,394mn (down 27.5%), and profit attributable to owners of parent of ¥2,948mn (down 30.8%).

Compared to the initial forecasts, revenue was 9.3% below the forecast, but operating income and profit attributable to owners of parent were 23.4% and 30.0%, respectively, above their initial forecasts.

Overview of FY3/18 1H results

(¥mn)

	IFRS						
	FY3/17		FY3/18				
	1H	Full year	1H (E)	1H	Growth rate	Growth rate vs. initial forecast	Progress rate vs. full-year forecast
Revenue	41,507	95,299	68,986	62,581	50.8%	-9.3%	41.7%
Operating income	6,393	10,212	4,053	5,003	-21.7%	23.4%	38.5%
Operating margin	15.4%	10.7%	5.9%	8.0%	-	-	-
Profit before income taxes	6,064	9,604	3,560	4,394	-27.5%	23.4%	36.7%
Profit attributable to owners of parent	4,262	7,678	2,268	2,948	-30.8%	30.0%	36.8%

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

Revenue increased 50.8% YoY, for the sixth consecutive fiscal year of higher revenue (on a 1H basis). In the core beauty and health business segment, it rose 80.3%, while in the apparel business segment, it grew by 126.1%, with these two segments driving the higher revenue for the Company as a whole. The segments other than these two also retained their revenue increases YoY. The reason why the result was below the forecast was that in the apparel business, the Company did not open stores unnecessarily, prioritizing improvement of the profitability of stores, and also that the timing of an M&A was pushed-back slightly. Therefore, at FISCO we do not think that this result is a cause for concern.

In profits, the points to be aware for the FY3/18 1H results include the two factors that kept profits down, that 1) gains from bargain purchases of business entities of approximately ¥4.1bn (negative goodwill) recorded in FY3/17 1H was reduced by half in FY3/18 1H, and that 2) in the 1H period, the Company spent a total of ¥4.57bn on upfront investment. Due to these factors, profits were forecast to decline YoY from the start. Conversely, steady progress was made in each business, of the RIZAP-related businesses including the body shaper business, the apparel business conducted by a subsidiary, and housing and lifestyle business, and therefore the results exceeded the forecasts. As a result, in FY3/18 1H on an effective basis after excluding the negative goodwill, operating income was a record high for a 1H.

Looking at the effects of negative goodwill by segment, it was generated in the beauty and health segment and the entertainment segment in FY3/17 1H, so profits decreased YoY in these segments for FY3/18 1H due to the absence of it. Conversely, in the apparel segment, negative goodwill was generated in FY3/18 1H and profits greatly increased.

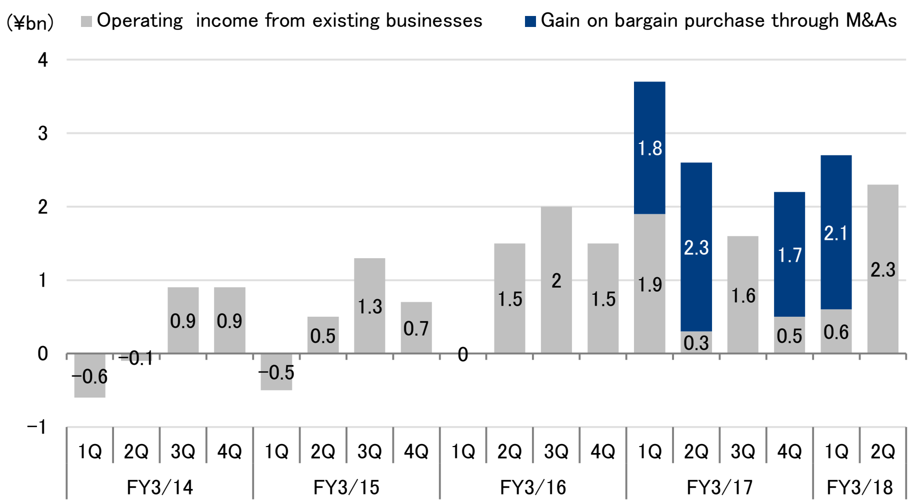
FY3/18 1H business breakdown by segment

(¥mn)

		FY3/17			FY3/18				
								YoY	
		Q1	Q2	1H	Q1	Q2	1H	Growth rate	Value
Revenue	Beauty and health	7,614	9,778	17,392	14,394	16,965	31,359	80.3%	13,966
	Apparel	2,512	2,931	5,444	5,355	6,954	12,310	126.1%	6,865
	Housing and lifestyle	7,110	6,056	13,167	6,760	7,353	14,113	7.2%	946
	Entertainment	2,751	3,020	5,772	2,940	2,968	5,909	2.4%	136
	Subtotal	19,989	21,787	41,776	29,451	34,241	63,692	52.5%	21,916
	Adjustment	-155	-113	-269	-798	-313	-1,111	-	-842
	Total	19,834	21,673	41,507	28,652	33,928	62,581	50.8%	21,073
Operating income	Beauty and health	1,414	3,285	4,700	764	2,459	3,223	-31.4%	-1,476
	Apparel	136	-86	50	2,329	-93	2,236	4330.0%	2,186
	Housing and lifestyle	847	-204	642	168	604	773	20.3%	130
	Entertainment	1,606	7	1,613	-53	-29	-82	-	-1,695
	Subtotal	4,004	3,001	7,006	3,209	2,941	6,150	-12.2%	-855
	Adjustment	-278	-334	-613	-507	-640	-1,147	-	-533
	Total	3,725	2,667	6,393	2,701	2,301	5,003	-21.7%	-1,389

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

Quarterly trend in operating income



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

The contract renewal rate rose rapidly to 82% on the introduction of the BMP. Made major progress in converting to a recurring-revenue business model

2. Progress of the RIZAP body shaper business

In the body shaper business, the numbers of members and gyms are continuing to steadily increase, but what is clear from FY3/18 1H results is the major progress made in the rapid and high-level spread in the use of the BMP. Significant progress was also made in deploying the overseas business.

(1) Body Management Program (BMP)

For the body shaper business, the Company is working to “Shift to a recurring-revenue business model that increases customer value over extended periods.” Together with the RIZAP Declaration to Bring Health and Fitness to Ten Million People described below, it can be said to form the core of the new growth strategy for the body shaper business.

Since the past, the Company had incorporated the client retention rate after one year and the contract renewal rate as the KPI (Key Performance Indicators) for body shaper business and worked to increase Lifetime Value (LTV). Then from 2016, it introduced the Life Support Program (LSP) in order to fully convert to a recurring-revenue business model. This program enables members to maintain their body shape and health through receiving twice monthly sessions from trainers for ¥19,600.

It then launched the BMP in July 2017 as advanced LSP. Compared to the monthly fee for LSP, the BMP fee for ¥29,800 is 50% more expensive, but it provides various additional services, including unlimited use of the training machines, complementary fallback option, and dietary advice from registered dieticians on a dedicated app. The contract period is one year, which is renewed automatically each year.

The BMP registration rate continues to be extremely high, of 82% up to November following its introduction in July. This registration rate is approximately twice as high as that for LSP, of about 40%. The body shaper business’ earnings model is expected to be dramatically transformed by the realization of a high contract renewal rate from the introduction of the BMP.

On comparing the estimated revenue between the completion of the regular two-month program and the introduction of the BMP in the case of 1,000 new members, the difference between the two programs is obvious. In the case of the regular program, the revenue is ¥298,000 x 1,000 people = ¥298mn (excluding the entrance fee). On the other hand, in the case of BMP, based on the actual registration rate up to the present time of 82% and assuming that the number of renewals in the renewal period decreases by a fixed amount each year, it is calculated to be ¥1,009mn a year over 5 years. In other words, revenue increases by more than three times compared to the completion of the regular program. As sales of goods and other revenue can also be expected during the ongoing contract period, it is anticipated that the actual difference will be even greater.

In addition to the BMP, the Company is preparing multiple other programs on its contract renewal menu. Among the 18% of people who do not apply for the BMP, around half of them apply for another program on the contract renewal menu, so more than 90% of members are continuing their contract in some form after they complete the regular program. From this, at FISCO we think the body shaper business may be evaluated as having converted to a recurring-revenue business model.

(2) The state of overseas business deployment

The Company has also been deploying the body shaper business overseas from an early stage, and it has currently opened a total of five gyms in Shanghai, Hong Kong, Taiwan, and Singapore. At the end of FY3/17, total operating loss for the overseas gyms reached ¥106mn, but on entering FY3/18, their profitability rapidly improved, and in September 2017 the Hong Kong gym become profitable on a single month basis and profitably was achieved as the total for all of the gyms. As a result, in Q2 (July to September) the four gyms' total operating income was ¥3mn and they had become profitable. The overseas business is also expected to be profitable for FY3/18 full fiscal year.

Based on the improvements in the results of the overseas gyms and the accumulation of management expertise, from the next fiscal year onwards, the Company plans to once again accelerate the deployment of its overseas business. During FY3/19, it intends to open one gym in each of Taiwan and Singapore, where the markets are favorable, to establish a network of 6 overseas gyms, and it is aiming to increase this to 30 gyms by the end of FY3/21.

At FISCO, we think that the deployment of the overseas business has an extremely important significance for the medium- to long-term. This is because of the attempt to reduce medical costs that the Company is working on in collaboration with local governments. The increasing financial burden from social security expenses (medical expenses, long-term care expenses, etc.) led by aging population is a problem facing not just Japan, but all advanced countries. As is explained below, in Japan the Company is steadily increasing its collaborations with local governments and they are expected to become a major source of earnings in the future. Our opinion is that the sequence of events, of a global development of collaborations following their success in Japan, can naturally be expected, and from the viewpoint of building bases and foundations for that time, the Company's current overseas business deployment is extremely important.

RIZAP GOLF established its capacity for fully-fledged expansion. The new business formats of "RE zap" and "zapDELI" are to be launched

3. Progress in the RIZAP-related businesses

The Company is deploying various businesses as the RIZAP-related businesses, including schools for golf, English, and cooking lessons, and sales of highly functional apparel. It is sequentially opening golf, English, and cooking schools, and at the current time, the golf business has the greatest momentum. The Company has also announced the launch of "REzap" and "zapDELI" as new business formats in the RIZAP series.

(1) RIZAP GOLF's situation

Currently, it seems that RIZAP GOLF is approaching the same stage of rapid expansion as that previously experienced by the body shaper business. The potential demand for RIZAP GOLF has been clear since the beginning, but the situation has been that it was unable to take a dramatic leap forward due to a lack of capacity at schools and a shortage of trainers. But this situation greatly improved in FY3/18 H1.

The number of schools more than doubled, from 6 schools at the end of March 2017 to 13 schools at the end of November 2017. The number of trainers also increased by 2.8 times during the same period, from 50 to 140 trainers.

In addition to the fact that a structure for receiving customers is now in place, demand has been further stimulated by the favorable reception to the commercials featuring the actor Katsunori Takahashi. This has led to a dramatic increase in revenue, and monthly revenue from August onwards was double the level in the April to June period. There continues to be a waiting list for reservations for RIZAP GOLF, going forward the Company's policy is to continue to steadily open schools and recruit trainers.

(2) The new business formats of "REzap" and "zapDELI"

The Company announced (in a press release on September 13, 2017) that it was to launch the new RIZAP-related business formats of "REzap," which are comprehensive healthcare partner stores covering "mono (tangible products), koto (intangible services), and food," and "zapDELI," for sales of prepared meals bases on RIZAP nutrition.

For "REzap," the plan is to comprehensively handle RIZAP apparel products, which are mainly highly functional apparel such as compression ware, and the "zapDELI" meals. The RIZAP apparel business currently has a network of 2 stores and the plan is to expand this quickly to a network of 70 stores by FY3/20 1H. "REzap" will be responsible for expanding the store network.

There have been no announcements from the Company on the business scales of REzap or RIZAP apparel, but at FISCO, we think that, based on their results of the test marketing for RIZAP apparel and other factors up to the present time, if the network of 70 stores gets on track, it is possible that they will become businesses with annual revenue scale of ¥10bn.

The total operating income of the 8 listed subsidiaries in FY3/18 1H was ¥979mn, an improvement of more than ¥2bn YoY

4. Improvement in earnings at Group companies

The Company has 8 listed subsidiaries and more than 10 non-listed subsidiaries. Looking at those listed subsidiaries that disclose their financial information, continuing on from Q1, in the 1H their results improved significantly YoY.

The total operating income from the 8 listed subsidiaries in 1H FY3/18 (Q1 results for IDEA INTERNATIONAL <3140> as its fiscal year ends in June) was ¥979mn. In the same period in the previous fiscal year, this was an operating loss of ¥1,137mn, meaning that the result improved by more than ¥2bn compared to a year ago.

Earnings are expected to improve continuously from Q3 onward also. For the FY2018 full year, the total operating income from the 8 companies are projected to reach ¥3,871mn. In the previous fiscal year, their total operating loss was ¥1,255mn.

Results at the listed subsidiaries

(¥mn)

Company name	Code	Listed market	FY2017 1H		FY2017 full year		FY2018 Q1		FY2018 1H		FY2018 full year E	
			Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income	Revenue	Operating income
IDEA INTERNATIONAL CO., LTD.	3140	TSE JASDAQ	1,493	-19	6,160	182	1,493	-19	3,315	88	7,205	401
SD ENTERTAINMENT, Inc.	4650	TSE JASDAQ	3,793	50	8,281	188	1,887	-68	3,891	-76	8,600	450
DREAM VISION CO., LTD.	3185	TSE Mothers	1,340	-157	3,107	-154	1,293	756	2,476	666	5,283	780
PASSPORT Co., Ltd.	7577	TSE JASDAQ	5,145	-355	10,215	-552	2,026	14	4,017	23	10,000	300
Maruko Corporation	9980	TSE-2	6,566	-242	13,401	135	3,398	42	7,311	514	15,000	1,200
Jeans Mate Corporation	7448	TSE-1	4,573	-245	9,195	-829	2,010	-218	4,300	-272	11,550	300
Pado Corporation	4833	TSE JASDAQ Growth	3,415	-174	6,997	-311	1,622	-113	3,418	6	7,400	230
Marusho hotta Co., Ltd.	8105	TSE-2	3,450	5	7,488	86	1,696	-8	3,781	27	7,500	111
Total for the 8 companies			29,775	-1,137	64,844	-1,255	15,688	496	30,950	979	74,333	3,871

Note: As IDEA INTERNATIONAL's fiscal year ends in June, the FY2018 result represents that for the year ended June 2017. PASSPORT's FY2017 (FY3/17) results were for an irregular fiscal year of 13 months following the change to the fiscal year. Jeans Mate's FY2017 (FY3/18) results are for an irregular fiscal year of 13 months 11 days following the change to the fiscal year.
Source: Prepared by FISCO from each company's financial results

The listed subsidiaries have been highly evaluated for their various efforts, including the progress made in improving earnings and in strengthening returns to shareholders, and overall, their share prices have been trending strongly. Based on the stock prices as of November 24, 2017, the valuation gain from the listed subsidiaries has reached approximately ¥67.5bn.

Valuation gains / losses from the listed subsidiaries

Company name	Code	Listed market	Ownership stake at the time of the acquisition	Acquisition price (¥)	Number of shares acquired (shares)	Acquisition amount (¥mn)	As of Nov. 24, 2017		Share acquisition method
							Share price (¥)	Valuation gain / loss (¥mn)	
IDEA INTERNATIONAL	3140	TSE JASDAQ	66.25%	104.3	7,118,400	742	1,128	7,287	Private-placement capital expansion
SD ENTERTAINMENT	4650	TSE JASDAQ	72.03%	89	5,340,000	475	986	4,790	TOB from GEO
DREAM VISION	3185	TSE Mothers	78.50%	192	3,900,000	749	1,385	4,653	Private-placement capital expansion
PASSPORT	7577	TSE JASDAQ	65.83%	117	9,730,000	1,138	559	4,301	Private-placement capital expansion
Maruko	9980	TSE-2	63.18%	50	55,000,000	2,750	420	20,350	Private-placement capital expansion
Jeans Mate	7448	TSE-1	63.99%	160	5,748,753	920	765	3,478	TOB
				187	3,450,000	645	765	1,994	Private-placement capital expansion
Pado	4833	TSE JASDAQ Growth	71.11%	74	13,513,515	1,000	565	6,635	Private-placement capital expansion
Marusho hotta	8105	TSE-2	62.27%	55	35,000,000	1,925	456	14,035	Private-placement capital expansion
Total						10,345		67,523	

Prepared by FISCO from various materials, news releases, etc.

Medium to long-term growth strategy and the progress made

Launched new measures for COMMIT 2020

1. Evolution of the growth strategy

The Company is working to achieve the targets set in COMMIT 2020, its medium-term management plan, of revenue of ¥300bn and operating income of ¥35bn in FY2021 (FY3/21).

Toward achieving these targets, in the last few years the Company has been expanding its business areas through strategic M&A, mainly for the RIZAP-related business, such as body shaper, golf, English, and cooking businesses, with the aim of realizing topline growth through leveraging Group synergies. As previously mentioned, in the body shaper business, it has succeeded in converting to a recurring-revenue business model. RIZAP GOLF is following the same growth path as the body shaper business and is growing to become the Company's second business pillar. Up to the present time, 8 listed companies have been added to the Group through M&A, and their earnings have been improved remarkably.

The Company started multiple new measures in FY3/18. Within them, the measures of particular note are the RIZAP Declaration to Bring Health and Fitness to Ten Million People and to strengthen the business infrastructure platform as the new growth strategy. At FISCO, we think that these measures are not only meaningful toward steadily achieving the targets in COMMIT 2020, they are also extremely meaningful for realizing sustainable growth after that also.

Has so far collaborated with three local governments. The business model may be transformed with the increase in the collaborations with local governments

2. The progress made in the RIZAP Declaration to Bring Health and Fitness to Ten Million People

When announcing the FY3/18 Q1 results in August 2017, the Company also announced the RIZAP Declaration to Bring Health and Fitness to Ten Million People as RIZAP's new commitment. It means that by FY2021, it wants 10 million people or more to have experienced the RIZAP method and support their healthy, vibrant lives. This will be achieved in the form of providing "one-to-n (where "n" stands for numerous)" of the body shaper service, which utilizes the RIZAP method, the most typical service within the RIZAP-related services provided by the Company, in the hope of connecting the service to many people's health improvement.

The provision of a "one-to-n" service is extremely meaningful. Essentially, RIZAP is a "one-to-one," service, but there are limits to it depending on the capacity of the facilities and the number of trainers. There are no such limits for the "one-to-n" service, which will transform the RIZAP business model. It will also eliminate the concerns about RIZAP being copied.

In terms of the specific measures, they include 1) collaborations with universities and medical institutions, 2) collaborations with local governments, and 3) a corporate program. Within them, at FISCO we are particularly focusing on the measures for collaborations with local governments.

The Company's first collaboration with a local government was with Makinohara City in Shizuoka Prefecture, which it announced in March 2017. This was to implement a health promotion program developed by RIZAP over three months (session once per week) for the senior citizens of Makinohara City. The average age of the participants was 68, while their average physical-fitness age at the start of the program was 86.6. After the implementation of the program, their average physical-fitness age was down to 73.0 (an improvement of 13.6 years), and clearly showed improvements to their fitness level.

Supported by this success, on November 8, 2017, the Company announced that it would launch a performance-based compensation health promotion program with Ina City in Nagano Prefecture. The same as the Makinohara City collaboration, it provided a health promotion program to senior citizens with a compensation framework of working out the cost by applying whichever amount was higher after calculating; 1) the number of people whose physical-fitness age was reduced by 10 years or more x ¥50,000, and 2) half of the amount of the reduction in medical costs for the program participants.

Moreover, the Company announced that, continuing on from Ina City, it would collaborate with Kawakami Village in Nagano Prefecture to provide a health promotion program for 20 male successors in this village aged in their twenties and thirties.

The reason why at FISCO we are focusing on the collaborations with local governments is the strength of the potential demand and the size of the market on top of the Company's capability in promptly implementing the abovementioned measures. It would seem unnecessary to explain that Japan is on the verge of becoming an aged society that is unprecedented anywhere in the world. Regional local governments (municipalities and special wards) manage the national health insurance and long-term care insurance systems as the insurers, and the increase in social security benefits alongside the aging of society has become a major problem.

The Company's measures with local governments have only just started, but after its announcement of collaborations with Makinohara City and Ina City, it seems that inquiries increased from local governments nationwide. Japan has 1,741 municipalities (the total of municipalities and the special wards in Tokyo's 23 wards), and going forward, it is considered fully possible that the Company's collaborations with local governments will greatly increase.

At FISCO, we think that the performance-based compensation that the Company introduced in its collaboration with Ina City is attractive to both sides. The local government side does not incur costs if there are no results, such as a reduction in medical expenses. But even if it does incur costs, it is still advantageous to the local government, as it does not have to allocate a budget for these costs from its own financial resources, as it can pay for them from within the amount it saves. Conversely for the Company, the business has the potential of growing into a business with a high profit margin and a business providing a large source of revenue.

By solidifying the footholds in the business infrastructure, the Company aims to achieve the targets in COMMIT 2020 and secure sustainable growth in the future

3. The new growth strategy: strengthening the business infrastructure platform

The Company has been changing its growth strategy from FY3/18, and its measures from this year have been to strengthen the business infrastructure platform. There has been no change to its basic approach of increasing profits through topline growth, but this development seems to be the result of a judgment that rather than aiming to haphazardly increase profits, first it is necessary to establish a framework for accelerating earnings growth that will ultimately increase the speed of growth in the future.

There are three specific strengthening points; 1) technologies, 2) global SPA, and 3) the customer base, marketing, etc., to support the RIZAP economic zone

(1) Technologies

Going forward, the Company's policy is to utilize its technologies in every business area, from RIZAP-related koto intangible services, to mono tangible services, such as for apparel, in order to increase the efficiency of its businesses and to accelerate the pursuit of synergies.

The first entry point for this is to accumulate every type of data on the customers of the entire RIZAP Group as big data. The sequence of events will be then to utilize it for specific customer services and internal management by using dedicated apps according to each individual objective. Also, for customers receiving RIZAP services in the body shaper business, the Company will support their self-realization through providing them with information on the other services provided by the Group, such as apparel and the cooking schools, and it will also aim to connect this to synergies between the businesses.

(2) Global SPA

Global SPA can be said to be a measure aimed at improving efficiency for mono tangible services including apparel and interior goods. Among its subsidiaries, the Company has many subsidiaries handling apparel and lifestyle goods, and these companies procure products that are produced overseas, mainly in China and other Asian countries. It also handles many overseas-produced products through its mail-order business.

Within this sequence of events, of overseas production and domestic sales, the main content of the Company's construction of a global SPA model include its objectives of building a shared supply chain toward integrating logistics and conducting appropriate inventory control, improving cost competitiveness through joint procurement that utilizes scale merits, and strengthening the development capabilities of private brand products, particularly of high value added products.

The effects from global SPA will appear in a variety of areas, but it seems to be in logistics where it is easiest to get a specific image of them. The Company intends to introduce a shared supply chain. Currently, each subsidiary arrange their own respective logistics and import products that are produced overseas into Japan. By conducting these logistics operations jointly for all subsidiaries, the vacant spaces will be eliminated in each process, such as the containers, logistic centers, and trucks, and lead to cost reductions. It seems that the Company has already been discussing the specific management methods and other aspects with major logistics companies.

(3) The customer base, marketing, etc., to support the RIZAP economic zone

The RIZAP economic zone envisages the construction of a network in which the majority of people's lives are covered by the products and services provided by the RIZAP Group, or in other words, it is the ultimate form that the Company is aiming to become. It is essential to utilize its technology and implement the global SPA for realizing the RIZAP economic zone.

However, this alone will be insufficient, so collaborations with external partners are essential. During their daily lives, people require a large number of services and products that are not provided by the Company's Group, such as convenience stores, supermarkets, (local) government services, hospitals, and schools. It is considered that through this measure, the Company is aiming to become more deeply involved in people's lives through collaborations with corporations, institutions, and others in these areas.

However, it would seem that a reasonable amount of time will be required to realize this. Also, at FISCO, we think that to guide this measure to success, the prerequisites will be the establishment of the above-described measures, including to utilize technologies and implement the global SPA.

Business outlook

It is expected that the Company will achieve FY3/18 target with some room to spare. However, it has numerous investment projects for growth, so profits are not expected to greatly exceed the forecasts.

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

Overview of FY3/18 forecast

(¥mn)

	1H	2H	Full year	1H	1H (E)	YoY growth rate	Full year (E)	YoY
Revenue	41,507	53,792	95,299	62,581	87,620	62.9%	150,202	57.6%
Operating income	6,393	3,819	10,212	5,003	8,006	109.6%	13,010	27.4%
Operating income margin	15.4%	7.1%	10.7%	8.0%	9.1%	-	8.7%	-
Profit before income taxes	6,064	3,539	9,604	4,394	7,588	114.4%	11,983	24.8%
Profit attributable to owners of parent	4,262	3,416	7,678	2,948	5,058	48.1%	8,007	4.3%

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

On the full-year basis, revenue is forecast to increase ¥54,903mn YoY. Regarding the detailed breakdown, we estimate it to be as follows; ¥13,000mn to ¥15,000mn from the RIZAP-related businesses, approximately ¥30,000mn from the listed subsidiaries, and ¥10,000mn as the total from other subsidiaries and M&A. On the end of H1, there do not seem to be any particularly reasons to change this perspective.

Trend in the RIZAP-related business revenue

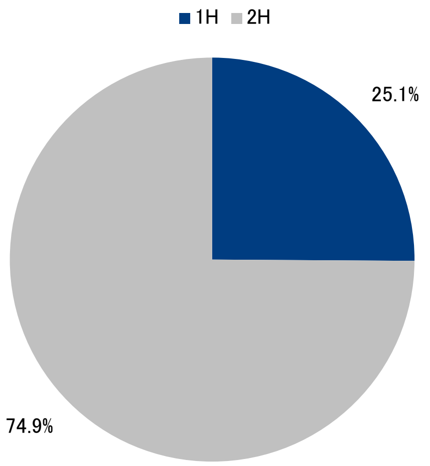
Business brand	Type of business/ business format	No. of stores		Revenue	
		End-FY3/17	End-FY3/18 (E)	FY3/17	FY3/18 (E)
RIZAP	Body shaping	120	120-130	Approx. ¥23,000mn	Approx. ¥28,000mn
RIZAP GOLF	Golf lessons	6	25	Several hundred million yen	Approx. ¥4,000mn to ¥5,000mn
RIZAP ENGLISH	English conversation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

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

The reason why revenue in FY3/18 1H did not reach its forecast was that in the apparel business, the Company is not rushing to open stores and instead is prioritizing improving profitability. Due to the steady progress made in improving profitability up to FY3/18 1H, it seems it will accelerate store openings from 2H. Therefore, at FISCO we think that it is fully possible that the Company will achieve its full fiscal year forecast for revenue.

For profits, we do not think there will be any major issues for the Company to achieve its forecasts. Its basic business model is to conduct upfront investment in Q1 and Q2 and to recover this investment in Q3 and Q4. Therefore, the results over the past 4 years have had a structure in which one quarter of profits are from the 1H and three quarters from the 2H. The rate of progress for the full fiscal year operating income forecast up to FY3/18 1H was 38.5%, which has greatly lowered the profit hurdle that must be cleared in the 2H order to achieve this forecast.

Percentages of operating income on a half-year basis
(FY3/14 to FY3/17 cumulative totals)



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

The high rate of progress up to FY3/18 1H will have increased expectations that operating income may greatly exceed its forecast for FY3/18 full fiscal year. But at FISCO, we think that the likelihood of this is low, because it is highly possible that the Company will allocate funds to upfront investment for FY3/19 and beyond. As previously mentioned, the Company is changing its growth strategy to one with a longer-term perspective, and from FY3/18, it is focusing on solidifying footholds in the business infrastructure. At FISCO, we think that the Company will invest funds in advance for future growth considering the backlog of investing projects beyond COMMIT 2020.

Simplified statements of income

(¥mn)

IFRS					
	FY3/16 full year	FY3/17 full year	FY3/18		
			1H	2H (revised E)	Full year (E)
Revenue	53,937	95,299	62,581	87,620	150,202
YoY	-	76.7%	50.8%	62.9%	57.6%
Gross profit	32,513	46,034	30,815	-	-
YoY	-	41.6%	45.4%	-	-
Gross margin	60.3%	48.3%	49.2%	-	-
SG&A expenses	28,635	41,738	28,466	-	-
YoY	-	45.8%	48.0%	-	-
SG&A expenses ratio (to sales)	53.1%	43.8%	45.5%	-	-
Other income	227	6,687	3,086	-	-
Other expenses	947	770	432	-	-
Operating income	3,159	10,212	5,003	8,006	13,010
YoY	-	223.3%	-21.7%	109.6%	27.4%
Operating income margin	5.8%	10.7%	8.0%	9.1%	8.7%
Profit before income taxes	2,806	9,604	4,394	7,588	11,983
YoY	-	242.2%	-27.5%	114.4%	24.8%
Profit attributable to owners of parent	1,587	7,678	2,948	5,058	8,007
YoY	-	455.5%	-30.8%	48.1%	4.3%
EPS after the stock split (¥)	6.26	30.13	11.57	19.85	31.42
Dividend after the stock split (¥)	-	6.05	-	-	6.29

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

Simplified balance sheet

(¥mn)

IFRS				
	Transition date (Apr. 1, 2015)	End-FY3/16	End-FY3/17	End-FY3/18 1H
Current assets	22,724	32,522	62,086	77,793
Cash, deposits and equivalents	8,366	10,483	24,643	31,163
Trade and other receivables	8,974	12,062	20,544	23,979
Non-current assets	16,400	21,255	33,562	40,302
Property, plant and equipment	9,647	11,331	17,616	21,371
Goodwill	2,473	4,675	6,291	7,355
Intangible assets	846	689	1,013	1,370
Total assets	39,125	53,777	95,648	118,095
Current liabilities	19,898	27,296	43,636	48,104
Trade and other payables	10,766	13,756	24,326	28,058
Interest-bearing debt	7,820	10,914	15,996	15,718
Non-current liabilities	12,286	15,344	30,557	36,951
Interest-bearing debt	10,371	12,853	25,204	31,832
Total equity attributable to owners of parent	6,077	10,226	17,018	22,032
Capital stock	132	1,400	1,400	1,400
Capital surplus	200	1,799	1,692	5,320
Retained earnings	5,720	7,001	13,696	15,101
Other capital composition items	23	25	228	209
Non-controlling interests	863	910	4,436	11,007
Total equity	6,940	11,137	21,454	33,039
Total liabilities and capital	39,125	53,777	95,648	118,095

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

Cash flow statement

(¥mn)

IFRS			
	End-FY3/16	End-FY3/17	End-FY3/18 1H
Cash flow from operating activities	868	175	1,028
Cash flow from investing activities	-3,973	2,914	-5,370
Cash flow from financing activities	5,137	11,088	11,173
Cash, deposits and equivalents conversion difference	-27	-18	-15
Change in cash, deposits and equivalents	2,004	14,160	6,815
Cash, deposits and equivalents at the start of the period	8,478	10,483	24,643
Cash, deposits and equivalents at the end of the period	10,483	24,643	31,163

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

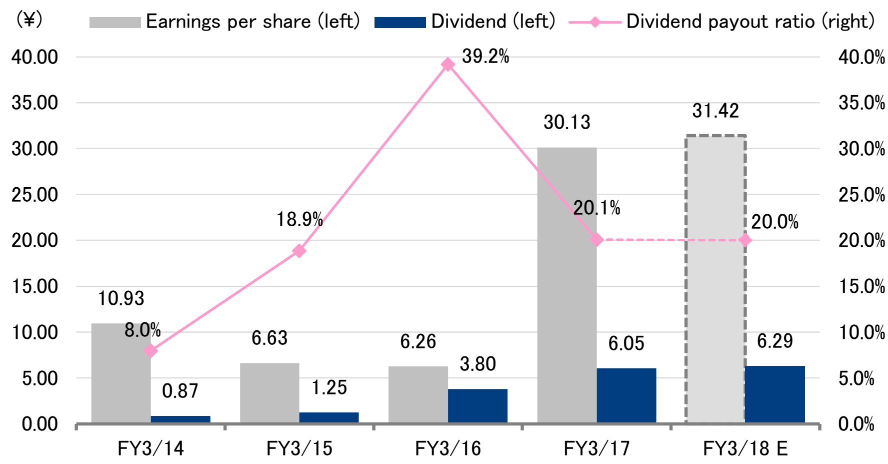
Shareholder returns

The basic policy is to pay dividends targeting a dividend payout ratio of 20%. In FY3/18, it implemented a share split and enhanced the shareholders' benefits program.

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

The Company conducted a 2 for 1 share split on October 1, 2017. Based on the situation after the share split, the FY3/18 forecast for dividend earnings per share is ¥31.42, and corresponding to 20% of this, it has announced a dividend forecast of ¥6.29. There have been no substantive changes to the values of the initial forecasts.

Earnings per share, dividend, and dividend payout ratio



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

In the shareholder benefits program, shareholders listed in the register of shareholders at the end of the fiscal year (March 31) can choose a RIZAP Group product according to the number of shares that they hold. The Company also made changes during FY3/18 that further enhance the appeal of is shareholder benefit program. The first change is that it has increased the number of products from which shareholders may choose. The number of companies in the Group has risen through M&A. Reflecting this, it plans to increase the number of products in the shareholder benefits program from 157 at the end of FY3/17 to more than 300 by the end of FY3/18. The second change is the increase in the value of the benefit for large shareholders. Previously, shareholders holding 2,000 or more shares (prior to the share split) could choose a product with a maximum value of ¥36,000. But now, it has newly established a "premium class," in which shareholders who hold 4,000 or more shares or 8,000 or more shares (both after the share split) can receive a Group product with values of ¥72,000 or ¥144,000, respectively.

Information security

Responded to information security risks by establishing dedicated department and investing in systems. Also actively utilizes evaluation and advice from external organizations

As a B-to-C enterprise, the Company has many members of the general public as its customers, while the number of RIZAP members has increased to around 100,000. Based on this situation, the Company is highly aware of the importance of information security. As its specific responses, the Company has already established a dedicated department for information security and investing in systems in order to improve security as required. It also incorporates the evaluations and opinions of external experts and third-party organizations, and in such ways, it is continually striving to improve information security.

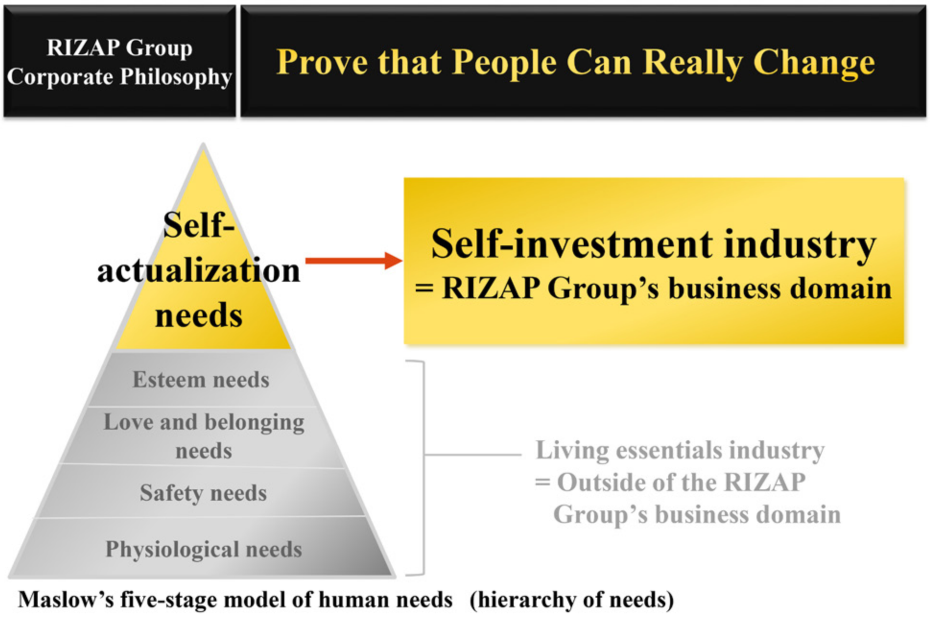
History and business domain

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

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 operating company through a company split, and it became a pure holding company. At the same time, it changed its company name to RIZAP Group Inc. It is currently developing four businesses; beauty and health, apparel, housing and lifestyle, and entertainment.

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

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



Source: Company's results briefing materials

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