COMPANY RESEARCH AND ANALYSIS REPORT

RIZAP Group, Inc.

2928

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Summary

Fully-fledged business development in the two major growth markets of “sports” and “food” Making major progress in M&A also

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. Made strong progress in FY3/18 Q3

In FY3/18 Q3, the Company achieved higher revenue and profits, with revenue of ¥99,129mn (up 50.8% year-on year (YoY)) and operating income of ¥8,114mn (up 1.4%). At first glance, the progress rates toward the full fiscal year forecasts seem low, but at FISCO, we think that the progress is in line with the forecasts for both revenue and profits. By segment, in the beauty and health business segment, which includes the mainstay body shaper business, both revenue and operating income steadily increased and drove the results for the Company as a whole. It also conducted upfront investment in the current Q3, and the nine-months cumulative upfront investment total reached ¥7bn. Looking at this in another way, it signifies that the current cumulative Q3 gross operating income exceeded ¥15bn, which is a result that confirms that the Company’s profitability is steadily growing.

2. Announced its intention to fully enter into the two major markets of “sports” and “food”

Toward accelerating the growth of the RIZAP-related businesses, the Company has announced that it will newly fully enter into the sports and food markets. Up to the present time, it has achieved growth for sports through businesses such as body shaper, golf, and sports apparel. But it is aiming to seize the opportunity provided by the rapid expansion of the sports industry market, initiated by the government, to achieve further growth. For food also, it has a track record of managing the diets of its close to 100,000 members, and in addition, it has been accumulating the results of joint research with universities and research into a low-carbohydrate diet. It can be said to have embarked on the full-scale monetization of the expertise and findings that it has acquired through these efforts.

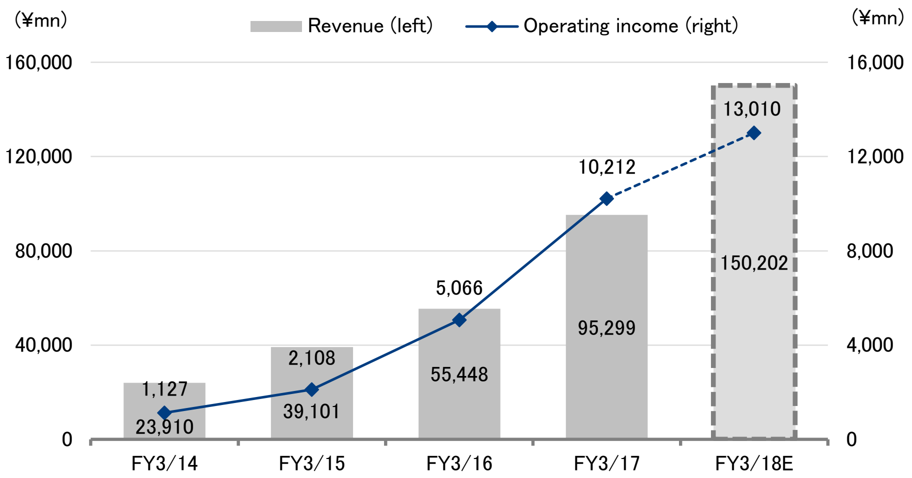
3. Expected to achieve FY3/18 results forecasts. Revenue and profits are forecast to continue to increase greatly in the next fiscal year also from the contribution of M&A

The Company is expected to achieve its results forecasts for FY3/18, of revenue of ¥150,202mn and operating income of ¥13,010mn, without any problems. When back-calculating from the rates of progress up to Q3, in Q4 it will need to accumulate operating income of approximately ¥5bn. Considering the results in Q3 on a single period basis and also the seasonal profit factors at the Group subsidiaries, their levels are not necessarily that high of a hurdle and we expect the Company to achieve the forecasts. As for FY3/19, the Company has in sight revenue of ¥250bn with the effects of the recent M&A also appearing. In profits, at FISCO we think one target is an operating margin of 10%. If it were to realize these figures in FY3/19, it would achieve the targets in its medium-term management plan, COMMIT 2020, ahead of schedule so another task will be considering the results targets for the period after that.

Key Points

- The high rate of growth is continuing in the body shaper business from the rise in LTV on the introduction of BMP and the improved productivity of trainers
- The RIZAP-related businesses of GOLF and ENGLISH have entered phases of fully-fledged expansion
- Announced that it will make Wonder Corporation a subsidiary. Has the potential to instantly accelerate business development through various synergies.

Results trends



Note: Transitioned to IFRS from FY3/17
Source: Prepared by FISCO from the Company's financial results

Results trends

Absorbed the upfront investment of ¥7bn and achieved higher revenue and profits

1. Overview of the FY3/18 Q3 results

In FY3/18 Q3 results, the Company posted higher revenue and profits, with revenue of ¥99,129mn (up 50.8% YoY), operating income of ¥8,114mn (up 1.4%), income before income taxes of ¥7,113mn (down 5.9%), and net income attributable to owners of the parent company of ¥5,233mn (up 3.0%), posting all-time highs both in revenue and operating income.

There were no prior forecasts for Q3, so it is not possible to evaluate the results compared to the forecasts. But at FISCO, we evaluate that the Company made strong progress for both revenue and profits.

Overview of FY3/18 Q3 results

(¥mn)

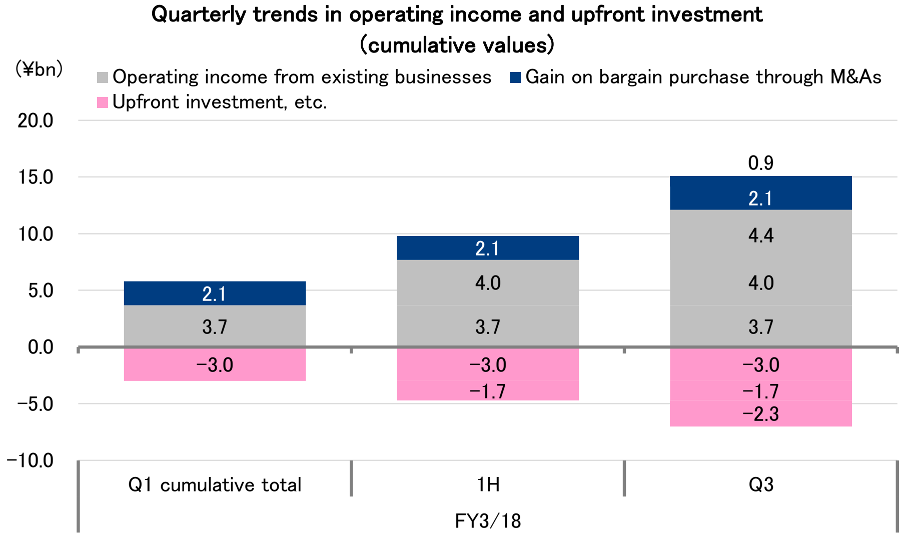
	FY3/17		FY3/18			
	Q3 cumulative total	Full year	Q3 cumulative total	Growth rate	Progress rate vs. full-year forecast	Full-year forecast E
Revenue	65,726	95,299	99,129	50.8%	66.0%	150,202
Operating income	8,001	10,212	8,114	1.4%	62.4%	13,010
Operating margin	12.2%	10.7%	8.2%	-	-	8.7%
Income before income taxes	7,557	9,604	7,113	-5.9%	59.4%	11,983
Net income attributable to owners of the parent company	5,081	7,678	5,233	3.0%	65.4%	8,007

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

The fact that the increase rate of operating income was small and that income before income taxes declined might give the impression that the Company's growth is slowing. But at FISCO, we think that this would not be a correct understanding.

As described in the previous report (at the time of the 1H results), in the current fiscal year the Company has been actively conducting upfront investment to achieve growth. The scale of this investment had reached a cumulative total of approximately ¥4.7bn by the end of 1H, and on entering Q3 also, it conducted upfront investment of around ¥2.3bn. As a result, the cumulative upfront investment total at the end of Q3 exceeded ¥7bn. The important point here is that this upfront investment was completely under the Company's control. We have explained in past reports that the Company manages its business while maintaining a balance between the aspects of profit levels at the time and what should be done now to lay the foundations for future growth. It continued to adhere to this approach in the current Q3 also.

Since the operating income amount on the financial statements is the net value after the deduction of upfront investment and other such amounts, it is difficult to understand the Company's actual profitability. To make it easier to understand, the graph (next page) shows the quarterly trend in the Company's gross operating income and upfront investment amount. We see that in the current Q3 cumulative period, total gross operating income increased to approximately ¥15.1bn; approximately ¥12.1bn from its existing businesses and ¥3bn from a gain on a bargain purchase (negative goodwill) following M&As. On the other hand, the Company actively conducted upfront investments for future growth which totaled approximately ¥7bn. These resulted in, as previously stated, operating income of approximately ¥8.1bn.



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

By segment, in the Q3 cumulative period in the beauty and health business segment, revenue increased 83.4% YoY and operating income grew significantly, by 24.4%, and this segment drove the Company's overall revenue and profits. It is noteworthy that in Q3 as a single period, operating income increased rapidly, by around 3.6 times to ¥4,002mn. Breaking it down, as explained below, revenue in the body shaper business continued to grow, while the results at the subsidiary Maruko Corporation <9980> improved greatly. The profit-loss conditions in the RIZAP-related businesses, including golf, also improved significantly in Q3 and contributed to the higher profits.

FY3/18 Q3 business breakdown by segment

(¥mn)

		FY3/17			FY3/18				
		Q3 cumulative total	Q3	Full year	Q3 cumulative total	YoY Growth rate	YoY Change	Q3	YoY growth rate
Revenue	Beauty and health	27,164	9,772	38,225	49,823	83.4%	22,659	18,464	89.0%
	Apparel	8,941	3,497	13,042	20,732	131.9%	11,790	8,421	140.8%
	Housing and lifestyle	21,306	8,139	33,253	21,266	-0.2%	-39	7,152	-12.1%
	Entertainment	8,929	3,156	12,044	9,022	1.0%	92	3,112	-1.4%
	Subtotal	66,341	24,564	96,566	100,844	52.0%	34,503	37,151	51.2%
	Adjustment	-615	-346	-1,266	-1,715	-	-1,099	-603	-
	Total	65,726	24,218	95,299	99,129	50.8%	33,403	36,548	50.9%
Operating income	Beauty and health	5,808	1,108	6,920	7,225	24.4%	1,416	4,002	261.0%
	Apparel	220	170	1,743	2,084	844.9%	1,863	-152	-
	Housing and lifestyle	979	336	1,150	890	-9.1%	-88	117	-65.2%
	Entertainment	1,853	240	1,783	41	-97.8%	-1,812	124	-48.3%
	Subtotal	8,862	1,855	11,598	10,241	15.6%	1,379	4,091	120.5%
	Adjustment	-861	-247	-1,385	-2,127	-	-1,266	-979	-
	Total	8,001	1,607	10,212	8,114	1.4%	113	3,111	93.5%

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

The body shaper business is continuing to grow from the rise in LTV on the introduction of BMP and the improved productivity of trainers

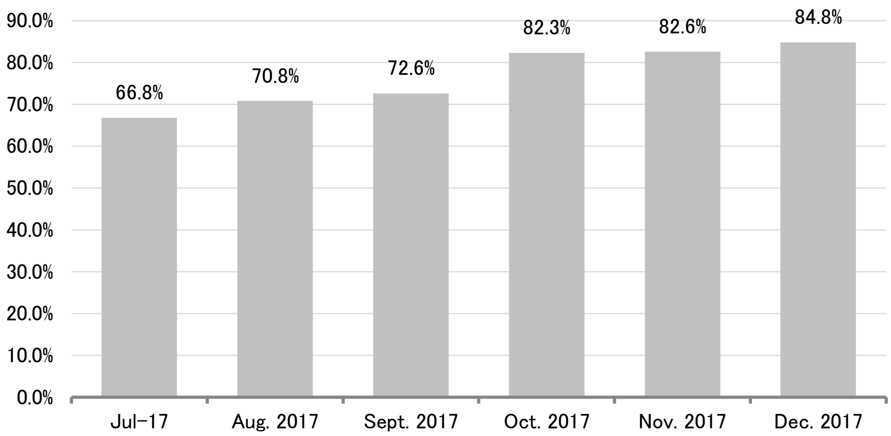
2. Trend in the RIZAP body shaper business

The body shaper business is not simply performing well, it is continuing to grow. As described in the previous report of January 9, 2018, the Company is aiming to convert the profit structure of the body shaper business to a recurring-revenue business model and toward this, it has introduced the Body Management Program (BMP).

The point for BMP is that for members who have completed the standard program (normally for two months), for a fee of ¥29,800 a month they can receive benefits such as the free use of facilities, diet guidance, and the provision of rebound insurance and other services. It can be said to be a service for which lifetime value (LTV) is expected to increase in the future, which is something the Company has been aiming for since the past. In trial calculations for 1,000 new members under certain assumptions, revenue on the introduction of BMP is about 3.4 times that on the completion of the normal program (please refer to the previous report or to the Company's financial results briefing materials.)

This BMP registration rate has trended steadily upward every month since its launch in July 2017, and by December 2017, it had reached 84.8%.

Trend in the Body Management Program (BMP) registration rate



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

One more key point for the source of growth of the body shaper business is the improved productivity. Improving productivity has also been an issue that the Company has continuously been addressing since the past, and the sustained pace in improving this figure is leading to the growth in profits in this business. The representative key performance indicator (KPI) for productivity improvement is revenue per trainer. In December 2017, it had risen to 1.3 times the figure in the same month in the previous fiscal year. This is also reflected in the revenue per gym, for which the value in December 2017 was 1.2 times the same month in the previous year.

On the other hand, the Company is actively working to increase the number of RIZAP stores (includes schools and gyms), and the number of stores in the RIZAP-related businesses increased by 40, from 108 at the end of December 2016 to 148 in December 2017. This includes the rise in the number of schools for golf and English, but it was mainly from the increase in gyms in the body shaper business. For gyms that initially opened in a satellite (small gym) business format, the Company responded to the growth in demand and increased the number of booths and expanded to larger-size gyms. So the current situation in the body shaper business is that the increase in the revenue per gym (vertical axis) and in the number of gyms (horizontal axis) is leading to the growth of revenue (the area).

In the previous report, we introduced the development of the "1-to-n (numerous)" business model based on the "RIZAP Declaration to Bring Health and Fitness to Ten Million People" as one of the measures that we should be paying attention to in the body shaper business. Specifically, the Company is working on services for corporations and collaborations with local governments, and these efforts seem to be resulting in the steady increase in the number of customers. Revenue to corporations in the October to December 2017 period increased by 1.6 times compared to the April to June 2017 period. It is also expected to grow further in the future, and at FISCO we think that there will be an announcement on the details of the progress made once a certain scale is reached.

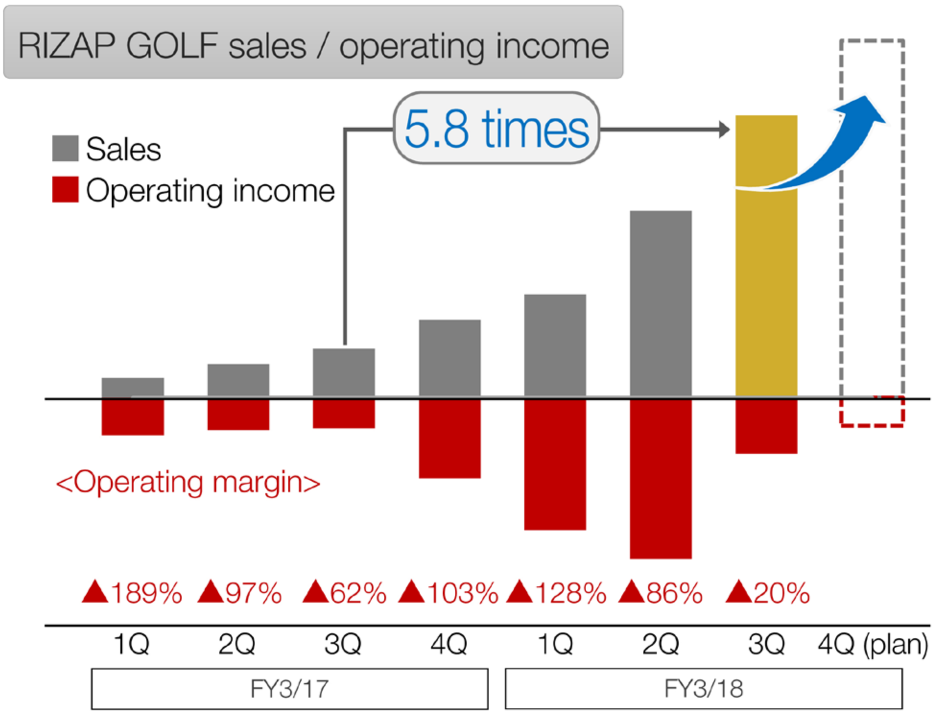
Full-scale expansion of the networks of multiple GOLF and ENGLISH schools. Profitability is also in sight from the growth in revenue.

3. Trend in the RIZAP-related business

The Company is developing businesses such as RIZAP GOLF and RIZAP ENGLISH as the RIZAP-related businesses, and entered fully fledged growth periods in FY3/18.

As of November 2017, there were 13 RIZAP GOLF schools, but by January 2018, the network had further expanded to 15 schools. The number of trainers, which in actuality determines the capacity, was 160 as of January 2018, which was an increase of 20 from 3 months before. The increase in the number of trainers resulted in the revenue per gym also increasing and combined with the rise in the number of schools, revenue in the RIZAP GOLF business is rapidly growing. Also, profitability can be seen to be sharply improving alongside the increase in revenue, and profitability is in sight during FY3/19. Whether the Company actually achieves profitability will be determined by its plan for expanding its school network, but if it stops or keeps down new investment and upfront investment, at FISCO we think it is fully capable of achieving profitability.

Trends in RIZAP GOLF sales / operating income



Source: Company's results briefing materials

The conditions in RIZAP ENGLISH are similar to those in RIZAP GOLF. At the end of FY3/18 Q3, it had four RIZAP ENGLISH schools with the opening of the Ginza and Shinjuku Gyoen schools at the end of September and December, 2017, respectively. Productivity improved from enhancing trainers' education and introducing new programs, and in the current Q3 (October to December 2017), revenue per trainer had doubled compared to the same period in the previous fiscal year. The improved productivity combined with the increase in the number of sessions resulted in an increase of 3.7 times in revenue per school YoY. In terms of profitability (operating income), the same as RIZAP GOLF, it is currently at the upfront investment stage (operating loss). But as a result of the steady growth in revenue, it fully has in sight achieving operating income in the next fiscal year.

Profits continue to improve at the listed subsidiaries. They achieved an improvement in excess of ¥2.6bn in the Q3 cumulative period

4. Earnings at Group companies

The Company's Group includes more than 20 listed and unlisted subsidiaries. Looking at the 8 listed subsidiaries that disclose their results, in the current Q3, they made strong progress in terms of improving profits.

In the Q3 cumulative period, total operating income was ¥997mn, which is an improvement of ¥2,662mn from the operating loss of ¥1,665mn in the same period in the previous fiscal year. On the same basis, the total improvement amount for the 8 companies in the current 1H was ¥2,116mn. So as a single fiscal year, the total improvement by the 8 companies in the current Q3 (October to December 2017) was ¥546mn.

Looking at the individual companies, the FY3/18 full year forecasts for Jeans Mate Corporation and SD Entertainment, Inc. were downwardly revised. The extents of their improvement up to the current Q3 were also below the initial forecasts, but this was covered by the results of the other 6 companies. For these 2 companies whose forecasts were recently downwardly revised, the plan is for them to recover profitability from the next period of FY3/19 (Jeans Mate to achieve operating income).

Results at the listed subsidiaries

Company name	Code	FY3/16 Q3 cumulative total		FY3/16 Q3 cumulative total			FY3/17 full year E	
		Revenue	Operating income	Revenue	Operating income	Operating income YoY	Revenue	Operating income
IDEA INTERNATIONAL CO., LTD.	3140	3,315	88	4,077	222	134	9,000	500
SD ENTERTAINMENT, Inc.	4650	5,646	35	5,834	-122	-157	8,050	70
DREAM VISION CO., LTD.	3185	2,262	-123	3,918	641	765	5,283	780
PASSPORT Co., Ltd.	7577	7,286	-453	6,766	243	696	10,000	300
Maruko Corporation	9980	9,277	-617	10,528	393	1,010	15,000	1,200
Jeans Mate Corporation	7448	6,711	-441	6,388	-447	-6	9,500	-550
Pado Corporation	4833	5,099	-322	5,098	-23	299	7,400	230
Marusho hotta Co., Ltd.	8105	5,570	91	5,878	90	-0	7,500	111
Total for the 8 companies		45,166	-1,665	48,487	997	2,739	71,823	2,641

Note: As Idea International's fiscal year ends in June, for FY17, the figures for 1H are listed in the Q3 cumulative column, as FY6/18.
Jeans Mate will change its fiscal year, so for both years the values shown are for February 21 to November 20.
Source: Prepared by FISCO from each company's financial results and results briefing materials

Progress made in medium to long-term growth strategy

Announced its fully fledged entry into the two major markets of "sports" and "food"

1. The progress and developments in Q3

In its medium-term management plan COMMIT 2020, the Company is targeting revenue of ¥300bn and operating income of ¥3.5bn in FY3/21. In the reports up to this time, we have repeatedly introduced the various measures that are to realize these targets. For the current Q3 also, it has announced new developments.

The Company announced that in the current Q3 it will make fully fledged entries into the two major growth fields of the sports and food markets. Both sports and foods are fields that are closely related to its business domain, and it feels like it is moving in the direction of "What more shall we do now?" At FISCO, our understanding is that the keyword for the new measures is "monetization." Up to the present time also, the Company has been involved in the sports and foods domains and been constantly aware of their "contributions to profits." At FISCO, we think that the fact that the Company is currently once again focusing on these two markets shows its willingness to participate in them with a desire to earn profits and a sense of scale that is much larger than in the past.

At FISCO, we think that at the present time only the broad framework has been decided and that the specific developments will gradually be clarified from now on. We shall be waiting with anticipation for specific measures to be announced by the Company, which has a track record of numerous M&A and collaborations.

Toward the integration of sports and technologies, it has announced a collaboration with Sony in the field of golf lessons. It is also conducting M&A, such as for Pro Shops.

2. Developments for “SPORTS”

The Japanese government has indicated its goal of expanding the scale of the sports industry market, which was worth ¥5.5 trillion in 2015, through government-led initiatives to ¥10 trillion in 2020 and ¥15 trillion in 2025 (the “Japan Revitalization Strategy” announced on June 2, 2016). Regardless of whether the market expands in accordance with the government’s targets, it is a fact that the “government-led initiatives” will provide a boost to the sports market, and the Company intends not to miss this opportunity and to rapidly expand its sports-related businesses.

The Company has already developed related businesses, such as the RIZAP body shaper, RIZAP GOLF, and sports apparel businesses, and it is closely related to the sports industry market. In the current Q3 also, it is progressing several new initiatives, including M&As.

(1) Collaboration with Sony

On February 8, 2018, the Company announced that it was introducing into RIZAP GOLF the “Smart Golf Lesson TM” provided by Sony Corporation <6758>, and from April 1, it will launch the RIZAP GOLF LESSON System. This system installs Sony’s “Smart Golf Sensor” into the golf club, and then the data obtained from it is used in combination with RIZAP GOLF toward realizing higher scores among its customers.

This collaboration with Sony is one specific example of the “Sports × Technology” (the integration of sports and technology) that the Company is aiming for.

(2) Making a subsidiary of a sports-related company

On December 28, 2017, the Company made a subsidiary of B&D Co., Ltd, which operates the Sports Pro Shops in the Tokyo metropolitan area. The Pro Shops cover customers from beginners through to athletes and experts, mainly for soccer and running, from 27 stores in the Tokyo metropolitan area and also e-commerce. In its most recent results in FY8/17, it recorded net sales of ¥7,262mn and an operating loss of ¥292mn.

On the same day, the Company also made a subsidiary of D&M Co., Ltd. D&M is a company engaged in the manufacture and sale of bandage supports for sports, and it provides supports, taping, icing, fitness supplies, and other goods under the D&M brand.

Steadily taking steps to capture demand in the enormous food market

3. Developments for "FOOD"

Food can also be said to be a field in which the Company is deeply involved. This is because the basis of its core body shaper business consists of two parts, gym work and diet management. Up to the present time, it has managed its members' diets as an important element of the body shaper business. In addition, it is conducting joint research with universities on food and exercise, developing and selling low-carbohydrate foods, publishing recipe books, and deploying the RIZAP COOK business.

Currently, the Company has announced several measures to take more direct steps into the food domain. These measures can be said to be an important move toward capturing demand in the enormous food market.

(1) Entering-into the boxed meal delivery market

On January 30, 2018, the Company made a subsidiary of Fanders Japan, Inc., which conducts a boxed meal delivery business. It would seem that the decisive factors behind this decision were that Fanders has distribution channels, food factories, and home-delivery expertise, and it is able to build complementary relations, such as with the Company's findings on low-carbohydrate foods.

The so-called ready-meal market, which includes boxed meal deliveries, constitutes ¥9.5tn of the total food market (¥67.2tn). In terms of market scale, it is small compared to the eating-at-home market (¥32.5 trillion), and the eating-out market (¥25.1 trillion), but its growth rate is the highest among these 3 markets (with 2006 as 100%, in 2015 it was 122.6%. The source of all of the figures is the Fiscal 2017 Ready-made Meal White Paper by the Ready-made Meal Association). As with the market scale, at FISCO we think it is possible that in the future, social needs will further increase for services involving "boxed meals" and "delivery."

(2) Business collaboration with Tiger Corporation

On February 14, 2018, the Company announced an agreement with the Tiger Corporation for sales of "Torahime," which is a rice grain processed food developed by Tiger Corporation, and also for a dedicated cooker for it, through the Company's "The RIZAP Low Carbohydrate Rice Program (provisional name)". This is the first phase of the business collaboration between the two companies.

"Torahime" is a rice grain processed food made from ingredients including tapioca and konnyaku whose characteristics include that it has a 47% reduction in carbohydrate content compared to white rice. A dedicated cooker is required in order to cook it, but from the end of March, the plan is to release a Torahime and dedicated cooker set via the RIZAP stores and the RIZAP Group's sales channels (the only other sales channel is the official online store of Tiger Corporation).

At FISCO, we think that the Company's business model and the food domain are highly related and have great affinity, and we shall be watching with great interest in its fully fledged entry into the food market. Within the current measures, we are focusing on the acquisition of the boxed meal delivery company. Fanders, which it recently acquired, is a small-scale company, but it has a complete infrastructure for and expertise in the boxed meal delivery business, and we think that the Company will obtain major benefits from it. It is planning to launch the "Healthy lunch reform for business people" project from the spring of 2018, and for this also, expertise in boxed meal is required. In addition, food is an important issue even in the seniors market, in which the Company has been working since the past, and it has enormous potential. The current acquisition and business collaboration are still at that introductory stage, so we shall be watching to see to in what form the two companies deepen and develop the collaboration in the future.

Announced that it will make Wonder Corporation a subsidiary., and various synergies are expected

4. New M&A: strategic capital and business alliance with Wonder Corporation

On February 19, 2018, the Company announced that it had entered-into a strategic capital and business alliance with Wonder Corporation <3344> (hereafter, Wonder), which is listed on the Tokyo Stock Exchange (TSE) JASDAQ, and that it will acquire the shares of Wonder through a public offering (TOB) and underwrite a capital increase from a thirty-party allocation. Through a series of share acquisitions, Wonder is scheduled to become the Company's consolidated subsidiary on March 29, 2018.

In the TOB, the Company has already concluded a subscription agreement with Wonder's leading shareholder, KASUMI CO., LTD., to acquire the shares it holds (approximately 2.4 million shares, ownership ratio, 43.11%) at ¥980 per share. While no upper limit has been set on the number of shares scheduled to be acquired, based on the results up to the present time, it is estimated that there are many shareholders who expect the results of Wonder to be improved on it joining the RIZAP Group, so at FISCO, we think the subscriptions from general shareholders will be limited. The cost of acquiring the approximately 2.4 million shares (43.11%) relating to the subscription agreement will be ¥2,356mn.

The capital increase from a third-party allocation will be implemented as a condition of the establishment of the TOB, so the Company will underwrite 1.98 million of Wonder's shares at ¥835 per share. When combined with the approximately 2.4 million shares relating to the TOB subscription agreement, the Company will acquire around 4.38 million shares and is expected to have a share ownership ratio of 58.02%. It will pay ¥1,653mn for the capital increase from a third-party allocation, so the total amount together with the TOB acquisition amount will be around ¥4bn.

At FISCO, we anticipate various synergy scenarios from the capital and business alliance with Wonder, and we evaluate that it is a deal with extremely large potential. Some examples of this have been introduced in the release materials, and one typical example is the business strategy in which the Company will utilize the network of 300 stores that Wonder owns (as of the end of January 2018) to instantaneously accelerate the speed of the development of the RIZAP-related businesses, which are its core businesses. Specifically, the Company has expressed its intention to open 20 RIZAP-related business stores in the next fiscal year within Wonder's WonderGOO stores. In the current fiscal year, revenue in the RIZAP-related businesses is set to be around ¥32bn and the Company plans to increase this by 50% in the next fiscal year. Wonder is also developing the WonderREX business (reuse business), and it seems that the Company may pursue synergies with this business also, including through its body shaper business and apparel business.

Looking from the Wonder side, it can be expected to realize profit growth through the strengthening of its product capabilities (including the introduction of PB products), a new store strategy (such as the opening of hybrid stores), and other benefits. Also, by utilizing the Global SPA framework, which the RIZAP Group is working on below the surface to strengthen its business foundations, it could reduce costs, such as for inventory management and distribution, and to improve profitability.

In terms of business results, the outlook is for the Company to continue growing significantly in FY3/19. Revenue in FY17, as the simple total for both companies, is expected to greatly exceed ¥220bn. In profits, Wonder's FY2/18 operating income forecast is ¥300mn, and although its impact appears small, as previously described, there are multiple measures to pursue synergies that will be effective immediately. Therefore, it is possible that when combining its direct and indirect impacts, the extent of the contribution to profits will expand above expectations. Wonder's results are expected to be incorporated into the housing and lifestyle business segment.

Business outlook

Outlook is for FY3/18 forecasts to be steadily achieved

1. FY3/18 forecast

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

Overview of FY3/18 forecast

(¥mn)

	FY3/17		FY3/18				
	Q4	Full year	Q4 E	Growth rate	Full year E	YoY	
						Growth rate	Value
Revenue	29,573	95,299	51,072	72.7%	150,202	57.6%	54,903
Operating income	2,211	10,212	4,895	121.4%	13,010	27.4%	2,798
Operating margin	7.5%	10.7%	9.6%	-	8.7%	-	-
Income before income taxes	2,046	9,604	4,870	138.0%	11,983	24.8%	2,379
Net income attributable to owners of the parent company	2,596	7,678	2,773	6.8%	8,007	4.3%	329

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

In order to achieve the operating income target for the FY3/18 full year, the Company will need profits of around ¥5bn in Q4 as a single period. On this point, at FISCO we think that on considering the results up to Q3, the current business conditions, and also the seasonality of profits, it is highly likely to achieve this forecast.

A level of operating income of ¥5bn for a quarter (3 months) may seem a high hurdle when looking at the results of the recent quarters. However, among the Company's subsidiaries, there are several companies whose results grow greatly in Q4 due to the seasonality of profits. Representative of these companies are Maruko and Pado Corporation <4833>. Also, the profits of RIZAP GOLF and RIZAP ENGLISH are rapidly improving, and their operating losses are expected to improve greatly in Q4. From the effects of these factors, we think it is fully possible it will achieve operating income of ¥5bn in Q4.

At FISCO, we are not concerned about the possibility that upfront investment will place downward pressure on profits in Q4. As previously explained, when the Company conducts upfront investment, in many cases it decides on its scale within a framework with some room to spare, while paying attention to results at that time. In other words, it carries out upfront investment that is completely under its control. In Q4, we think that gross operating income will exceed ¥5bn, but we expect that the Company will determine the scale of the upfront investment while considering the various important elements, including the extent to which it exceeds it and the expected return on the upfront investment, while placing the greatest importance on achieving the results targets.

Following Wonder becoming a subsidiary, the major increases in revenue and profits are likely to continue in the next fiscal year

2. Towards FY3/19

The outlook for FY3/19 is for revenue to continue to increase significantly due to Wonder being made a subsidiary. The total revenue amount for both companies for FY17 is expected to greatly exceed ¥220bn. In the next fiscal year, the organic growth part will be added to this, so at FISCO we think the target will be ¥250bn.

In profits, in addition to the effects of the M&A, the level of the forecast profit changes depending on how the upfront investment amount is viewed. Fundamentally, the same as in FY3/18, it would seem that the Company will shape profits in a situation in which it controls upfront investment and other costs. One approach toward obtaining an image of the profit level is looking at the operating margin. The FY3/18 forecast operating margin is 8.7%, while the target operating margin in the final fiscal year of COMMIT 2020 is 11.7%. So in terms of the process to arrive at this figure, at FISCO we consider that one target for the operating margin in FY3/19 is 10%.

Supposing that in the next fiscal year, revenue is ¥250bn and operating income is ¥25bn (operating margin of 10%), then it would seem possible that the targets in COMMIT 2020 will be upwardly revised or will be achieved ahead of schedule, and that there will be an awareness for considering the results targets for the period after COMMIT 2020.

Statements of income

(¥mn)

	FY3/16 full year	FY3/17 full year	FY3/18		
			Q3 cumulative total	Q4 E	Full year E
Revenue	53,937	95,299	99,129	51,072	150,202
YoY	-	76.7%	50.8%	72.7%	57.6%
Gross profit	32,513	46,034	48,986	-	-
YoY	-	41.6%	46.7%	-	-
Gross margin	60.3%	48.3%	49.4%	-	-
SG&A expenses	28,635	41,738	44,348	-	-
YoY	-	45.8%	48.7%	-	-
SG&A expenses ratio (to sales)	53.1%	43.8%	44.7%	-	-
Other income	227	6,687	4,167	-	-
Other expenses	947	770	691	-	-
Operating income	3,159	10,212	8,114	4,895	13,010
YoY	-	223.3%	1.4%	121.4%	27.4%
Operating income margin	5.8%	10.7%	8.2%	9.6%	8.7%
Income before income taxes	2,806	9,604	7,113	4,870	11,983
YoY	-	242.2%	-5.9%	138.0%	24.8%
Net income attributable to owners of the parent company	1,587	7,678	5,233	2,773	8,007
YoY	-	383.7%	3.0%	6.8%	4.3%
EPS after the stock split (¥)	6.26	30.13	20.53	10.89	31.42
Dividend after the stock split (¥)	-	6.05	-	-	6.29

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

Balance sheet

(¥mn)

	Transition date (Apr. 1, 2015)	End-FY3/16	End-FY3/17	End-FY3/18 Q3
Current assets	22,724	32,522	62,086	84,787
Cash, deposits and equivalents	8,366	10,483	24,643	30,705
Trade and other receivables	8,974	12,062	20,544	28,184
Other	5,383	9,976	16,897	25,897
Non-current assets	16,400	21,255	33,562	42,248
Property, plant and equipment	9,647	11,331	17,616	22,141
Goodwill	2,473	4,675	6,291	7,655
Intangible assets	846	689	1,013	1,489
Investment, other	3,432	4,559	8,640	10,962
Total assets	39,125	53,777	95,648	127,036
Current liabilities	19,898	27,296	43,636	52,057
Trade payables	10,766	13,756	24,326	28,251
Interest-bearing debt	7,820	10,914	15,996	19,767
Other	1,311	2,625	3,314	4,038
Non-current liabilities	12,286	15,344	30,557	39,610
Interest-bearing debt	10,371	12,853	25,204	33,877
Other	1,914	2,490	5,352	5,732
Total equity attributable to owners of the parent company	6,077	10,226	17,018	24,344
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	17,383
Other capital composition items	23	25	228	240
Non-controlling interests	863	910	4,436	11,023
Total equity	6,940	11,137	21,454	35,368
Total liabilities and capital	39,125	53,777	95,648	127,036

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

Cash flow statement

(¥mn)

	End-FY3/16	End-FY3/17	End-FY3/18 Q3
Cash flow from operating activities	868	175	-2,658
Cash flow from investing activities	-3,973	2,914	-6,720
Cash flow from financing activities	5,137	11,088	15,732
Cash, deposits and equivalents conversion difference	-27	-18	3
Change in cash, deposits and equivalents	2,004	14,160	6,356
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	30,705

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

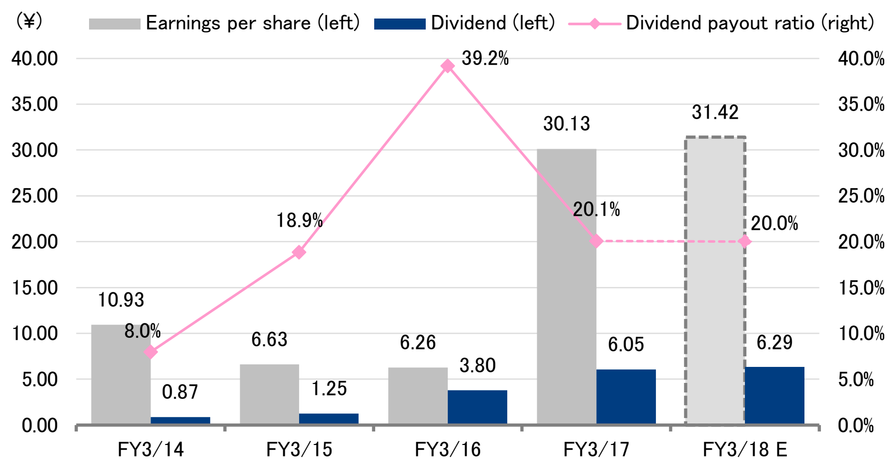
Shareholder returns

There has been no change to its approach of prioritizing shareholders. 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 stock split on October 1, 2017. Based on the situation after the stock 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 still have been no substantive changes to the values of the initial forecasts after the announcement of FY3/18 Q3 results.

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 announced its 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 was the highest classification. 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

Responds 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.

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