

An operator of 'TOMAS' private classes for students preparing for higher education

Recommendation rating (May 15)

Riso Kyoiku Co., Ltd. (4714 Tokyo 1st)**Overweight**

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER (E)
804yen (5/15)	100Shares	418.6Bil yen (5/15)	843yen (17/4/27)	570yen (17/1/18)	28.3 (5/15)

Riso Kyoiku moves into an expansion phase, raises estimated share price range

FY 2016 saw growth in revenue and profit, in line with expectation

Riso Kyoiku Co., Ltd. reported its consolidated results for the fiscal year ended February 2017 (fiscal 2016), with revenue coming in at 20,777 million yen, up 5.8% compared with the previous year, while operating income was up 8.5% year-over-year to 2,051 million yen. Both revenue and operating income were largely in line with the company's projections. Net income fell by 10.7% compared with the previous year to 1,275 million yen. The double-digit decline on the year was expected as an inevitable response to an inflated net income in the previous year, during which the company posed extraordinary gains.

In this year, Riso's core business segment TOMAS (a private cram school operator) resumed its new school opening plan. TOMAS Yotsuya and TOMAS Tamachi (both in Tokyo) were newly opened, while TOMAS Minami-Osawa (Tokyo), TOMAS Hon-Atsugi (Kanagawa) and TOMAS Akabane (Tokyo) were reopened at new locations. Revenue at the Cram School segment increased by 7.6% y-o-y to 10,480 million yen, achieving a faster growth rate than that registered in fiscal 2015 (2.6%). Revenue at the Early Childhood Education segment, the operator of 'Shingakai' and 'Shinga's Club', increased by 7.5% on the year. This revenue expansion rate exceeded that registered in fiscal 2015 (6.0%), underlining the segment's steady growth.

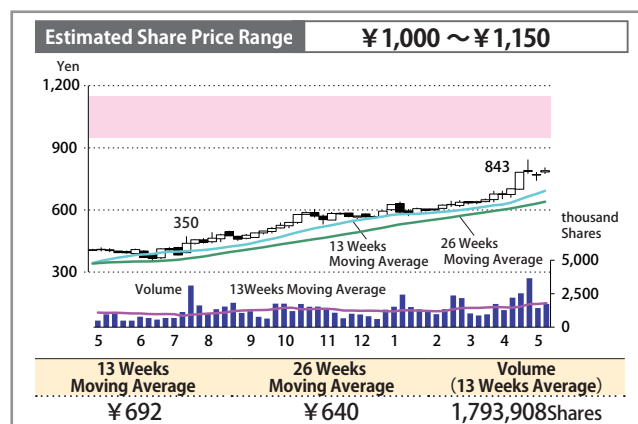
On the profit front, the core Cram School segment posted an operating margin of 8.3%, falling short of the 8.9% of the previous year as it resumed its new school opening plan. However, its operating margins for 3Q and 4Q far outstripped the previous year and we believe the new school opening initiative has had a limited impact on the company's profitability. Overall profitability increased, with an operating margin for the year reaching 9.9% from the previous year's 8.1%, driven by the marked improvement in operating margins of the Early Childhood Education and In-school Tutorials segments. **Riso Kyoiku has committed a 100% shareholder return for this fiscal year. The company sharply increased the full-year dividend per share for fiscal 2016 to 25.0 yen (compared with the previous year's 10.0 yen). This led to a dividend payout ratio for fiscal 2016 of 99.5%, demonstrating that the company fulfilled its promise by returning almost all the net profits generated in the year.**

Upgrades earnings forecast and raises estimated share price range

Riso Kyoiku's medium-term management plan, which ends in fiscal 2018 (ending February 2019), has set targets for the plan's final year on revenue and ordinary income at 23,800 million yen (up 7.2% from the previous fiscal year) and 2,800 million yen (up 16.7%), respectively. However, this plan does not incorporate the estimated contributions from new businesses. Morningstar's adjusted forecasts for revenue, operating income and operating margin for fiscal 2018 are 26,000 million yen (up 12.6% from fiscal 2017 target), 3,100 million yen (up 24.0%) and 11.9%, respectively.

Revenue and Earnings Trend (As of May 15)

		Revenue (Yen Mil)	YoY (%)	Operating Profit (Yen Mil)	YoY (%)	Ordinary Profit (Yen Mil)	YoY (%)	Net Profit (Yen Mil)	YoY (%)	EPS (Yen)
2017-2	Past Results	20,777	5.8	2,051	8.5	2,032	9.4	1,275	-	25.1
2018-2	Company est.	23,100	11.2	2,420	18.0	2,400	18.1	1,400	9.8	28.5
	MS est.	23,100	11.2	2,500	21.9	2,500	23.0	1,460	28.5	29.7
2019-2	MS est.	26,000	12.6	3,100	24.0	3,100	24.0	1,800	23.3	36.6



The success in the achievement of these targets relies in large part on the performance of its mainstay cram school business. Currently, the TOMAS business operates tutorials at a total of 71 schoolrooms in Tokyo and another three prefectures; the number of schoolrooms is far lower than that operated by its competitors. This shows that there is substantial scope for Riso to open further cramming classes in the Tokyo metropolitan area. Riso Kyoiku has embarked on a 'satellite cram school strategy', in which it will open schoolrooms relatively smaller than conventional sized ones in convenient locations such as near a train station. Through this strategy, it plans to double the number of schoolrooms to approximately 120 over the next five years. The company is expected to fully implement the satellite cram school strategy from fiscal 2017, planning to extend the number of schools at a rate of about 10 new schools each year. Meanwhile, with the aim of developing non-Tokyo metropolitan areas, in which the TOMAS school does not have a presence, the company has launched a plan to deploy the Meimonkai business model in those areas, with emphasis on ordinance-designated cities across Japan. Going forward, the company plans to increase the number of TOMAS Meimonkai schools "TOMEIKAI" to around 150, by opening 2-3 schools in each prefecture.

The Shinga's Club, the burgeoning business having shown a solid performance over the recent quarters, comprises classes that provide early learning programs to nurture pre-school children aged one to three. There is mounting public concern about the long lists of pre-school children waiting to be admitted to nursery schools. Hence, the Shinga's Club is expected to be a solution to the problem. Its schools are in high demand, with a large number of applicants on a waiting list for next term's enrollment; therefore, the Club is rapidly establishing more new schools to cope with this situation. We now expect each of Riso Kyoiku's segments to speed up more new school openings in the coming years, entering a rapid growth phase.

We are raising our estimated share price range from the previous 700–800 yen to 1,000–1,150 yen. We estimated the share price range based on our adjusted five-year (setting fiscal 2021 as the final year) revenue forecast - company forecast plus new business contributions, using the DCF (discount cash flow) method. Our valuation of the company shares remains unchanged with an 'Overweight' rating. The dividend payout ratio for fiscal 2017, ending February 2018, would be 98.4%, with a per share dividend increasing to 28.0 yen (compared with 25.0 yen the previous year). The dividend yield for fiscal 2017 is expected to be at an attractively high-level of 3.3% (based on the closing price on April 27). We continue to look favorably on the management's policy to maintain high shareholder returns.

(Hiroyuki Miyamoto)

Company Overview

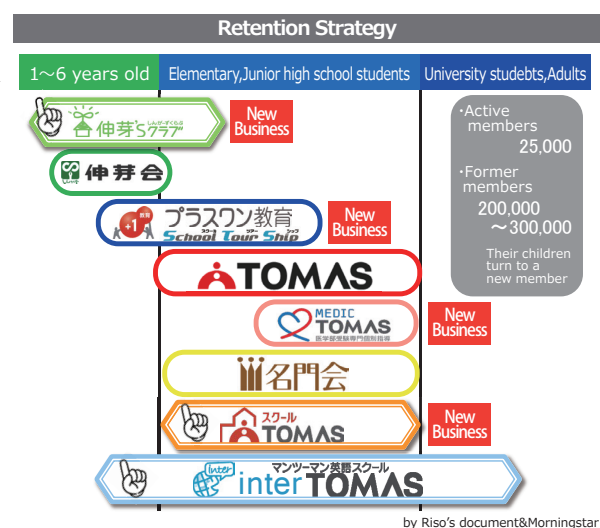
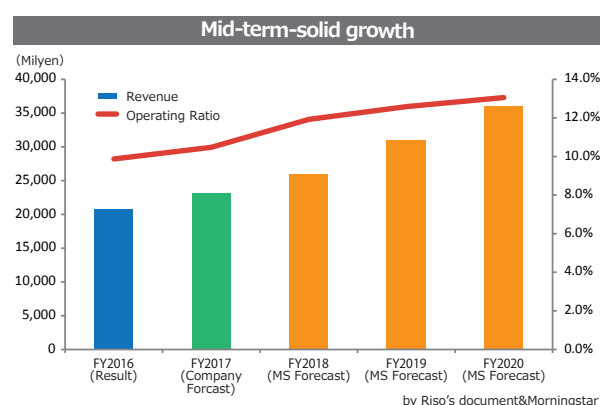
Riso Kyoiku Co., Ltd. is an operator of 'TOMAS', private tutorial-based cram schools primarily in the Tokyo Metropolitan area, for children preparing for higher education. Traditionally, tutorial lessons were largely seen as an opportunity to receive supplementary education. However, Riso, for the first time in the industry, targeted children aspiring to 'higher-level education'. Because of this, its schools have demonstrated high-level advancement rates. While tutorial lessons at cram schools operated by other companies often take the form of 'one tutor to a few students', Riso's lessons are strictly on a one tutor to one student basis. For this reason, its programs require relatively high monthly tuition fees. In return, its students can receive higher-quality education programs from proficient tutors who have completed the company's intensive training courses and choose lessons that meet their specific requirements from 'various curricula' among other distinctive services.

As of the end of March 2017, Riso were operating 71 TOMAS schools. They had fewer classrooms compared with competitors, but this suggests that there is plenty of room for the company to open new classrooms. Going forward, Riso increases 10 schools every year and reaches approximately 120 after 5 years. In addition to TOMAS, other major businesses include Meimonkai, tutoring centers that specialize in dispatching professional tutors and the Shingakai which the company acquired (M&A) in 2013. Riso also expands new business such as, "Hello e-sensei", provides private online English lessons within school buildings. Under its medium-term management plan, Riso focuses its management resources on the expansion of newly established businesses, including the Shinga's Club, a nursery chain aiming to develop the ability of pre-school children (aged 1+), School TOMAS, an operator of TOMAS classes within school buildings and Inter TOMAS that provides one-on-one English lessons not only for children but college students and business people as well. The company also promotes a strategy to 'retain customers' by extending its target demographic from one-year-old toddlers to adults.

Business Environment and Outlook

According to the Vital Population Statistics issued by Japan's Ministry of Health, Labour and Welfare, in 2016 there were approximately 980,000, which is the minimum number ever recorded. Meanwhile, the Family Income and Expenditure Survey of the country's Ministry of Internal Affairs and Communications showed that the monthly average education expense (more than 2 households) increased 1.3% indicating that education expenses per head were on an upward trend.

Riso's tutoring programs completely comprise lessons on a one tutor to one student basis. The company takes the view that the cram school



business belongs to the service sector not the education; therefore it makes thoroughgoing efforts to constantly improve its service quality. Although it charges relatively higher service prices, its one-on-one lessons provide significantly higher-quality service compared with group teaching and one-tutor for multi-student programs. There is a growing trend among cram school users to seek higher-level education services as such those offered by the company. Riso's tutors receive comparatively higher salaries than others. This has helped the company to recruit highly competent tutors. It also implements rigorous training programs for employees and tutors. Employees in the classroom are assigned to full-time tutoring jobs (including supporting for students and tutors), which allow them to concentrate on their lessons.

Risk Factors

The TOMAS segment, the operator of one-on-one private lesson cram schools for students aspiring to higher-level education, plans to extend classrooms by opening new schools as well as expanding or renovating existing schools in locations with a focus on the Tokyo metropolitan area. However, if the schoolroom expansion fails to progress according to plan due to difficulties in securing properties, this may adversely affect the company's performance.

Shareholder Return (As of May 15)

Dividends

		Dividend Per Share				
		1Q	2Q	3Q	4Q	Annual
2016-2	Past Results	¥0	¥0	¥0	¥10	¥10
2017-2	Past Results	¥0	¥12	¥6	¥7	¥25
2018-2	Company est.	¥7	¥7	¥7	¥7	¥28

Shareholder Special Benefits

None

Competitor Comparison (If the number is better than rivals, it's highlighted by red character) (As of May 15)

	Riso Kyoiku Co., Ltd. (4714•TSE 1st)	MEIKO NETWORK JAPAN CO.,LTD. (4668•TSE 1st)	Tokyo Individualized Educational Institute, INC. (4745•TSE 1st)
Stock Price	¥ 804	¥ 1,478	¥ 1,361
Basic Point	Unit of Investment	100Shares	100Shares
	Minimum Investment Amount	¥ 80,400	¥ 147,800
	Fiscal Year End	February	August
Share Price Indicator	PER (E)	28.3	20.8
	PBR	6.3	3.0
	Dividend Yield (E)	3.5%	2.7%
Growth	Revenue Growth Rate (E)	11.2%	7.3%
	Operating Profit Growth Rate (E)	18.0%	17.7%
	EPS Growth Rate (E)	13.3%	101.6%
Profitability	Operating Margin (E)	10.5%	12.8%
	ROE	18.1%	6.8%
	ROA (Ordinary income/Total assets)	17.1%	13.0%
Financial Health	Equity ratio	56.0%	77.4%
	Debt-Equity Ratio	0.0%	0.6%
	Current Ratio	177.0%	224.4%

Our chosen industry peers are MEIKO NEYWORK JAPAN (4668), an operator of "MEIKOGIJYUKU". We also pick up Tokyo Individualized Education Institute (4745), known as a group company of Benesse.

■ Growth

Riso Kyoiku provides high-quality education services that demonstrate resistant to prevailing lower birthrates; therefore the Company is expected to achieve steady growth.

Under its medium-term management plan, in fiscal 2018 ending February 2019 - the final year for the plan, Riso aims to achieve its goals for revenue of 23,800 million yen and ordinary income of 2,800 million yen (these goals do not incorporate the contributions from new businesses). As a long-term target, by fiscal 2021 ending February 2022, the company aims to post revenue of 40,000 million yen or more, double the amount of its projected revenue for fiscal 2016, and ordinary income of not less than 5,000 million – 6,000 million yen. Meanwhile, the company is likely to maintain a high-level and double-digit rate of profit growth, as it rolls out an expansion in profitable new business operations. From fiscal 2019 ending February 2020, when contributions to its earnings from new businesses are set to gain momentum, the company's bottom lines are expected to exhibit remarkable growth.

■ Profitability

Riso gives weight on ROE (returns on equity). The ROE for fiscal 2016 stood at 18.1%, which already outnumbered that of its competitors. Going forward, Riso's ROE is likely to increase, supported by solid contributions from the School TOMAS and other highly profitable new businesses.

Riso Kyoiku indicated its adoption of a policy of attaching importance to returning 100% of net profits to shareholders and employees; therefore profit growth is highly likely to lead to a dividend increase among other returns.

■ Financial Health

Riso's equity ratio at the end of fiscal 2016 was 56.0%. With no interest-bearing debts, the company essentially manages its operations without relying on borrowings. It uses all schoolrooms on lease and the nature of the industry in which it is involved does not require major capital expenditure. The School TOMAS business builds a classroom at its own expense if it is unable to locate to one within a school building; however this seems to be very exceptional. In light of these factors, together with its liquidity ratio exceeding 100%, there is little concern about the company's financial standing.

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How to Read Morningstar Equity Research Report

Our Uniqueness

(1) Emphasize Its Position as an Independent Evaluation Organization

Morningstar emphasizes its position as an independent evaluation organization and is committed to providing objective comparison and assessment in the Morningstar Equity Research Report. For all stocks covered by us, we determine investment decisions, estimated share price range and earnings forecasts based on expertise of an individual analyst as well as the stock assessment committee consisting of several analysts.

(2) Universe of Covered Stocks

The stock assessment committee selects covered stocks based on the following criteria.

[Stock Selection Criteria]

- Domestic emerging companies that are rarely covered by analysts
- Stocks that are popular among retail investors (refer to data from online security brokers)
- Size of market capitalization (over about 5 billion yen)
- Exclude stocks which are liquidated or trade control, or stocks with going concern and excessive debt

(3) Investment Decisions Classified into Three Groups

We determine investment decisions for covered stocks after consultation with the stock assessment committee based on research, interview and analysis by each Morningstar analyst.

Each stock is classified into either of three groups according to the following criteria.

Overweight : Forecasted to go beyond the current stock price level by 15% or more in the next 6 months.

Neutral : Forecasted to fall into the range of -15% ~+15% of the current stock price level in the next 6 months.

Underweight : Forecasted to go below the current stock price level by 15% or more in the next 6 months.

We flexibly respond to any changes of observations regarding earnings forecasts, financial situations and stock price trends, and change investment decisions accordingly. "Under Review" status may be applied if any new information comes out and extra time is needed to determine investment decisions. Also we don't change investment decisions during trading hours. "Suspension" status may be applied when an analyst leaves our company.

(4) Estimated Share Price Range in the Medium Term

It shows the price range for a stock price in the next 6 months. We determine upper and lower range of stock price based on fair value estimates from share price indicator, technical factors such as chart points, most recent high and low prices, trend line and moving average, trading volume in each price range and such.

Analysis Points

■ Analyst Comment

Each analyst reports and evaluates the most recent earnings trend and business environment. It shows the most important information for stock investment such as evidence for investment decisions, perspectives on earnings forecasts and business prospects. Also to make sure it is easy to comprehend, we write in 2-4 paragraphs and use bold to emphasize important texts.

■ Revenue and Earnings Trend

It reports earnings in past two fiscal years, company forecasts and our forecasts for the current and next fiscal year. We predict earnings based on research as well as past quarterly earnings trend and analysis by segments.

■ Company Overview

It explains in detail what businesses the company is engaged in and how revenue sources are defined. Also on the basis of our research, it discusses what businesses the company will focus on in years to come and how it carries out mid-term business plan.

■ Business Environment and Outlook

It discusses current circumstances and growth potential of the industry to which the company belongs. A comprehensive report on the industry from different perspectives is provided through research interviews to competitors. Specific figures of the industry data are also introduced.

■ Risk factors

It shows the company's risk factors and describes various aspects of risks such as business, earnings and financials. Typical stock market risks are also taken into consideration.