

An operator of 'TOMAS' one-on-one private lessons for students preparing for higher education

Recommendation rating (May 2)

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

Overweight

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER (E)
835yen (5/2)	100Shares	434.8Bil yen (5/2)	948yen (18/1/4)	725yen (18/3/26)	27.4 (5/2)

Riso delivers solid performance on upward enrollments; but shares remain undervalued

Record high earnings for FY2017, driven by successful 'satellite cram school strategy'

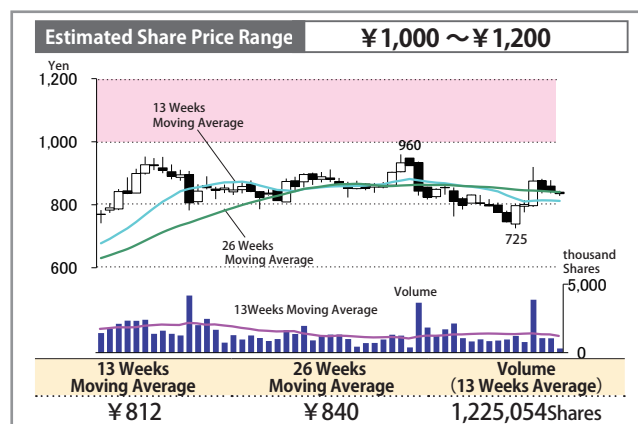
Riso Kyoiku Co., Ltd. reported its earnings for the year ended February 2018 (fiscal 2017), with revenue coming in at 22,584 million yen, up 8.7% compared with the previous year, while operating income grew by 5.2% to 2,158 million yen and net income up 8.3% to 1,381 million yen. In fiscal 2017, both revenue and profit grew on the year-on-year basis and achieved a record high. Meanwhile, its operating income margin for the year stood at 9.5%, falling moderately short of the company's and Morningstar's expectations. This underperforming margin was the result of a 72 million yen loss from its new business segment School TOMAS (an operator of in-school tutorial cram schools; the segment posted a profit of 169 million yen in the previous fiscal year). The loss was blamed on larger than expected amount of up-front investment in its online English conversation operation set up in the Cebu IT Park (Cebu, the Philippines). However, the investment project for the new operation was completed; therefore, the segment is expected to swing back to profitability from this year ending February 2019.

The mainstay Tomas segment (cram school business) steadily increased the number of 'satellite cram schools in the Tokyo metropolitan area', a growth strategy in which the company continued to place importance since the previous fiscal year. During this year it opened 8 new schools and resumed operations of 3 schools (renovated) at new locations. As a result, the segment increased revenue at a solid growth rate of 9.1% y-o-y to 11,556 million yen, while marking a high pace of net income growth rate at 18.4% to 1,029 million yen. **The TOMAS segment continued to fortify its high-profit structure despite proactive spending on new school openings. We are impressed that the segment operating margin rose to 8.9% from 8.2% in the same period last year.**

Benefitting from university entrance examination reforms and revolutionary change in human resource building

As a part of its initiative to promote "revolutionary changes in human resource building", the Japanese government is expected to take drastic measures in the national education scheme. These include a wider scope of free education and an increase in education-related spending, along with the incorporation of English communication ability assessments into the package of university admissions tests. We believe Riso should benefit from this increasingly favorable environment on the back of the government-led education reforms.

The company forecasts that both revenue and profit for fiscal 2018 ending February 2019 will achieve year-on-year growth and reach record-highs, with consolidated revenue and operating income for the year coming to 24,200 million yen (up 7.2% y-o-y) and 2,510 yen (up 16.3%), respectively. However, we think its forecasts are conservative. Although early in the current fiscal year, we believe there is upside potential for its forecast earnings. As it has been, the main driver for success in the achievement of these forecasts will be its mainstay cram school business. The company plans to open about 10 new schools



each year; since the beginning of this year, it has already opened 6. To date, the location of newly opened satellite cram schools has been focused around railway terminals (i.e.... busiest stations) but outlying medium-sized stations around these busiest stations are to be added to its new school location plan going forward. Due to the size of available properties, 'satellite cram schools' typically teach around 150 students. Exceptionally, some schools with more students have made relatively larger contributions to overall earnings. These include Kichijoji school (Tokyo) that opened this April. The school provides lessons to 250 ~ 300 students and it is in a favorable location with potential to attract many more enrollments. With regard to existing schools, Riso plans to expand or renovate them with an eye to acquiring more enrollments.

We also take notice of the growing in-school tutorial cram school segment. Revenue growth for FY2017 in this segment showed a remarkably high rate of 5.1% y-o-y. We predict that growth speed will accelerate in FY2018. Based in the IT Park in Cebu, Philippines, the segment runs in-class or after-school online English conversation systems targeting academic institutions. The number of academic institutions that have adopted its online English conversation system or in-school tutorials combined, will be 41 by the end of this fiscal year. These institutions include Japan's prestigious schools such as "Nishiyamato Gakuen Junior High School and High School" (Nara). With the continued decrease in the number of children, schools are striving to generate higher added value to their services in an effort to survive. Against this background, there is a growing demand for in-school one-on-one tutorials. In response to this opportunity, Riso Kyoiku aims to enhance its marketing force aggressively to acquire more enrollments.

Riso's share price rose in reaction to the release of its bullish earnings forecast and dividend increase expectations for the year ending February 2019, but we continue to see it undervalued. We leave our valuation of the company's shares unchanged with an 'Overweight' rating but slightly raise the upper limit of the estimated share price

Revenue and Earnings Trend (As of May 2)

		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	▲10.7	25.1
2018-2	Past Results	22,584	8.7	2,158	5.2	2,139	5.3	1,381	8.3	28.1
2019-2	Company est.	24,200	7.2	2,510	16.3	2,500	16.9	1,500	8.6	30.5
	MS est.	26,000	15.1	2,800	29.7	2,800	30.9	1,680	21.7	32.3
2020-2	MS est.	32,000	23.1	3,500	25.0	3,500	25.0	2,100	25.0	40.3

range to 1,200 yen (from the previous 1,150 yen). Following the recent meeting with the company management, we have updated our five-year earnings forecasts through to the year ending February 2023 (FY2022). The revised share price range was calculated based on the updated five-year earnings forecasts, using the DCF (discount cash flow) method.

The company continues to commit a 100% total shareholder return for the current fiscal year. This makes the full-year dividend per share for FY2018 likely to reach 30.0 yen (compared with 28.0 yen the previous year) and the payout ratio for the same year to stand at 3.6% (based on the closing price on May 2).
(Hiroyuki Miyamoto)

Company Overview

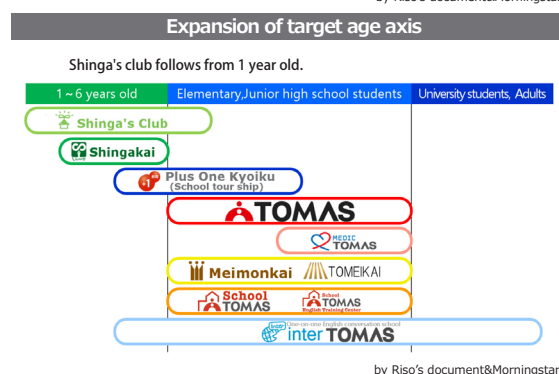
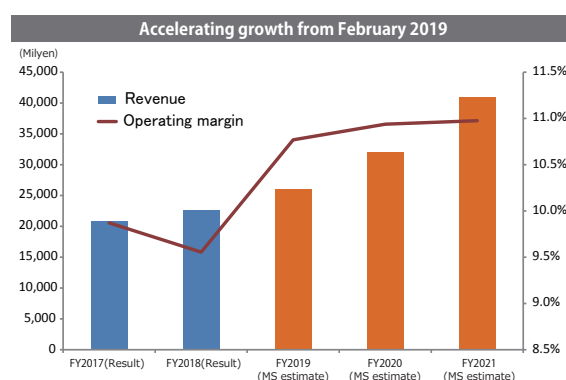
Riso Kyoiku Co., Ltd. is an operator of 'TOMAS', private tutorial-based cram schools primarily in the Tokyo Metropolitan area, for children preparing for higher education. Traditionally, tutorial lessons were largely seen as an opportunity to receive supplementary education. However, Riso, for the first 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 2018, Riso were operating 79 TOMAS schools. They had fewer classrooms compared with competitors, suggesting that there is plenty of room for the company to open new classrooms. It plans to open about 10 schools each year, boosting the number of total schools to around 120. In addition to TOMAS, other major businesses include Meimonkai, an operator of tutoring centers that specialize in dispatching professional tutors) and the Shingakai which the company acquired (M&A) in 2013. Its new business, in-school one-on-one tutorials, has also demonstrated significant growth.

Business Environment and Outlook

Riso operates in favorable business conditions. As a part of his grand design to initiate 'revolutionary changes in human resource building', Japanese prime minister Shinzo Abe and his government announced it would spend 2 trillion yen each year on its education reform project including free pre-school education and the reduction in high school education costs. The government plans to finance the project by the extra revenue from a rise in the consumption tax planned for October 2019. This development is expected to help the extension of the early childhood education market and boost investment into cram schools and other education-related facilities. Also, the reformed national academic achievement test for university admissions, to be commenced in 2020, will add an assessment of applicants' English 'conversation' and 'writing' proficiency to its examination subjects, providing another new business opportunity for the education industry.

In light of growing importance of English conversation learning, Riso has established an office in the Cebu IT Park (Cebu city, Philippines) with the aim of capitalizing on the need for English conversation lessons. The number of client schools adopting Riso's 'Hello e-Sensei' conducted in the school building (an English conversation program deploying the company's strength within that field) and other in-school one-on-one tutorials has surged recently. More client schools have begun to incorporate Riso's programs into their full-time curricula in addition to traditional after-school lessons. The in-house one-on-one tutorials business is conducted within clients' building, which allows the company to save property



expenses, thus enjoying a 25% ~ 30% higher rate of profitability. This business also helps client schools add value to their services. In times of lower birth rates, this provides advantages in the competition for survival.

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 2)

Dividends

		Dividend Per Share				
		1Q	2Q	3Q	4Q	Annual
2017-2	Past Results	¥0	¥12	¥6	¥7	¥25
2018-2	Past Results	¥7	¥7	¥7	¥7	¥28
2019-2	Company est.	¥7.5	¥7.5	¥7.5	¥7.5	¥30

Shareholder Special Benefits

None

Competitor Comparison (If the number is better than rivals, it's highlighted by red character) (As of May 2)

	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	¥ 835	¥ 1,245	¥ 1,220	
Basic Point	Unit of Investment	100Shares	100Shares	100Shares
	Minimum Investment Amount	¥ 83,500	¥ 124,500	¥ 122,000
	Fiscal Year End	February	August	February
Share Price Indicator	PER (E)	27.4	27.8	37.0
	PBR	6.6	2.3	7.7
	Dividend Yield (E)	3.6%	3.4%	2.1%
Growth	Revenue Growth Rate (E)	7.2%	5.3%	3.3%
	Operating Profit Growth Rate (E)	16.3%	▲23.1%	2.5%
	EPS Growth Rate (E)	8.5%	▲41.7%	2.5%
Profitability	Operating Margin (E)	10.4%	9.9%	13.6%
	ROE	22.0%	14.8%	20.7%
	ROA (Ordinary income/Total assets)	18.6%	15.5%	24.0%
Financial Health	Equity ratio	53.5%	74.5%	75.2%
	Debt-Equity Ratio	0.0%	0.5%	0.0%
	Current Ratio	176.4%	250.3%	316.7%

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 resistance to prevailing lower birthrates. We therefore expect the company to achieve steady growth even in difficult business conditions. The company forecasts that both revenue and profit for the current year ending February 2019 will achieve year-on-year growth and reach record-highs, with consolidated revenue and operating income for the year coming to 24,200 million yen (up 7.2%) and 2,500 million yen (up 16.8%), respectively. As a long-term target, by fiscal 2021 ending February 2022, it aims to post revenue of 40,000 million yen or more and ordinary income of 5,000 ~ 6,000 million yen or more, doubling the amounts of its projected revenue and operating income for fiscal 2016. We predict that the company is likely to maintain a high-level and double-digit rate of profit growth, as it rolls out profitable in-school one-on-one tutorials and other new business operations. From fiscal 2018 ending February 2019, when the effect of the new TOMAS school openings begins to kick in and contributions to its earnings from new businesses are set to gain momentum, the company's bottom lines are expected to exhibit full-scale growth.

■ Profitability

Riso Kyoiku management attaches importance to ROE (return on equity). ROE for fiscal 2017 rose further from 18.1% for fiscal 2016 to 22.0%, exceeding that of its competitors. Going forward, its ROE is likely to increase, supported by solid contributions from an expanding online English conversation operation run by the School TOMAS segment and highly profitable new businesses such as the growing in-school one-on-one tutorials. The company is committed to a policy of giving weight to returning 100% of net profits to shareholders and employees; profit growth is highly likely to lead to a dividend increase among other returns.

■ Financial Position

Riso's equity ratio at the end of fiscal 2017 stood at a reasonable level of 53.5%. 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. In fiscal 2017, it suffered an expense related to the up-front investment in the online English conversation operation established in the Cebu IT Park (Cebu city, Philippines) but the establishment completed in the year and it seems no other investment projects on the cards. In light of these factors, together with its liquidity ratio of well over 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.