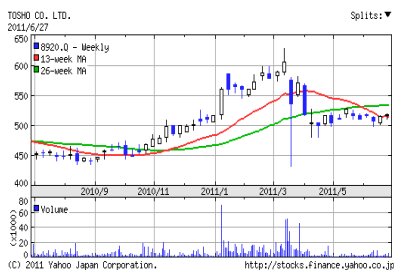


Grown with a highly profitable sports club business at the core; Restore double-digit growth in FY3/12

Market Cap: ¥9.06 billion Operates its own facilities at low costs aiming for an annual sales of ¥17.5 billion in FY3/15

Stock price: ¥527 (June 27)
Target stock price range: ¥500 - ¥900
High after the recent stock split
¥770/low ¥436



Shares outstanding 17,592,351
Treasury stock 1,889
Consolidated EPS (FY3/11) ¥60.9
Consolidated EPS (est.) (FY3/12) ¥69.3
PER (est.) (FY3/12) 7.4x
BPS (FY3/11) ¥419.9
PBR (actual) (FY3/11) ¥1.22x

Cash flow (FY3/11)

Operating CF 2,411 (¥ million)
Investing CF -1,224 (¥ million)
Free CF 1,187 (¥ million)
Financing CF -1,298 (¥ million)
Depreciation cost 1,264 (¥ million)
Gross margin 30.1%

Corporate profile

Established: March 1979
Listed: February 2004
Shareholders: 4,994 (end of Mar. 2011)
Employees: 200 (Apr. 1, 2011 consolidated)
Avg. age: 25.8 years old (26.4 years old in 2010)
CEO: Toshihiro Kutsuna

Executive Summary

The starting point of the development of the Tosho's business was when Towa Construction, which was established in March 1979, started a sports club business in Mikawa-Anjo in May 1996. Today, Tosho operates 43 sports clubs (as of May 1) nationwide for adults over 16 years old under the "Holiday Sports Club" brand. Tosho owns most of its facilities and operates them at low costs. Tosho plans to raise its performance by developing a new "No Swimming Pool 2000" model on about 3,306 square meter site without a swimming pool in urban areas from this fiscal year in addition to a "Comprehensive 2000" model which runs multi-location operations on about 4,959 square meter site assuming 2,000 members while investing approximately ¥350 million including opening expenses. As a result, Tosho expects to open eight sports clubs in FY3/12 from the 5 sports clubs in FY3/11 making a total of 50 clubs. Tosho is also engaged in hotel business and lease business but at present, the sports club business accounts for approximately 80% of sales. Tosho's business model is to realize a low-cost operation that does not incur rent expense by building its own properties on a lease land based on borrowing from a bank. This business model creates cash flow while steadily increasing the number of sports clubs and expanding the scale of operation. Compared with peer companies, Tosho's ordinary income margin is about 19% which is overwhelmingly high. This is because Tosho is able to cut investment costs by half compared with peer companies. Tosho opened two to five sports clubs in the past three fiscal years at a moderate pace but the company plans to open eight sports clubs from FY3/12. With this, interest-bearing debt is likely to increase in the short run but fixed cost will decrease due to the expiration of the equipment lease terms of eight sports clubs opened five years ago. Therefore, Tosho expects its profit to increase. In FY3/11, Tosho experienced a decline in performance caused by increase in SG&A expenses including opening expenses due to increased number of sports clubs but expects increases in sales and earnings in FY3/12. Moreover, Tosho formed a midterm management plan and plans to actively develop its business aiming for annual sales of ¥17.5 billion, and an ordinary income of ¥4.4 billion in FY3/15.

Valuation

After its listing on the JASDAQ market in February 2004, Tosho's stock price was low at about ¥600 for about a year. However, Tosho's performance improved rapidly by actively opening sports clubs. Meanwhile, stock price increased steadily from 2005 to 2007. Following the Lehman shock, Tosho stock is underperforming once again. There was a six-for-one stock split after the listing. Tosho's shares outstanding is 2.1x. Therefore, market cap based on the current stock price is ¥9 billion, double that of when trading started. However, the earnings level is about 3x which shows that investors' evaluations are very low. Although Tosho's FY3/11 performance remained flat including drop in earnings for the first time since its IPO, the company's performance from FY3/12 is expected to be on a growth path once again given that the company currently plans to launch new sports club operations and improves its earnings model. There is room for financial improvement, ie: interest-bearing debt exceeds ¥10 billion, but the forward PER for FY3/12 is only 7.4x and the current stock price is extremely undervalued compared with the average index in the stock market and peer companies. Over the next year, the target stock price range will be set at ¥500 to ¥900 in comparison to peer companies.

(Million yen)	Net sales	YOY	Operating income	YOY	Ordinary income	YOY	Net income	YOY	EPS
FY3/09	10,901	0.9%	2,238	18.2%	1,954	21.9%	1,087	22.8%	65.8
FY3/10	10,597	-2.8%	2,335	4.3%	2,087	6.8%	1,106	1.7%	65.4
FY3/11	10,803	1.9%	2,198	-5.9%	2,000	-4.2%	1,071	-3.2%	60.9
FY3/12 (est.)	11,900	10.2%	2,520	14.6%	2,300	15.0%	1,220	13.9%	69.3

Started out as a construction business

Tosho, which started a sports club business in Mikawa-Anjo 15 years ago, was established in March 1979. Originally, Towa Construction was established aimed at civil engineering business. Originating as Towa Construction, Tosho's core business is the "Holiday" brand sports club business for adults. Only seven years after Tosho's establishment, the company started the condominium sales business and rental business which led to the current company-owned rental condominium A City series business. Because Tosho also launched a real estate business, the company's industry sector when listed in 2004 is real estate. However, Tosho's sports club business, which was launched in Mikawa-Anjo in 1996, achieved success, and today the company operates sports clubs nationwide with annual sales of more than ¥10 billion. As a result, Tosho's industry sector has been changed to service sector in 2006 and changed its business to a highly-value added facilities service business aiming for further growth.

The secret of high profitability

Cost reduction is the key!!

1. Lease Location strategy
2. Construction cost Own properties
3. Operation Use of personnel
4. Machine Use of 5-year lease

With the profitability of peer companies including Konami Sports, Central Sports and Megalos, which operate relatively large sports clubs mainly in urban areas declining, the business of Tosho which has been operating sports clubs mainly in the region is growing steadily since its listing. The determining factor of the profitability of sports club business is how you can reduce costs including investment and operation. The costs of sports clubs consist construction cost including land cost and operating cost or machinery and equipment cost, and this is not limited to Tosho. Tosho's business model is to lease premises from land owners and build buildings using funds procured and operate facilities using its employees.

Interested in the 2nd best location

As far as peer companies are concerned, there are many cases in which landowners or developers prepare lands and buildings for them and they only run operations or landowners build buildings for them and they pay rents, but because Tosho was originally engaged in construction and real estate businesses, it is understandable that the company is able to control two out of three major expenses so far. Tosho is particularly interested in the second best location rather than the best location which is expensive. Tosho also succeeded in reducing investment costs by using its ingenuity in building a swimming pool. The reason why Tosho secures high profitability is partly because the company rents sites for sports club facilities and builds its own buildings using funds procured at low interest rates and run multi-location operations.

Use of almighty employees

Tosho is also devising ways of using its personnel. Employees and part-time staffs seem to demonstrate their abilities including machine maintenance. Tosho uses their own staffs for advertisements instead of using models. Also, while 70% of instructors at peer companies work as freelance, 70% of Tosho's instructors are its employees and part-time staffs and this is leading to attracting more customers. Tosho opened a "Holiday College", which is a human resources development organization, this May to enrich employee training toward a 100 sports club system. Tosho has been providing training at each sports clubs but from this year, 45 new graduates will receive unified training at the college. Opening the college is important for performing operations from the customers' standpoint.

No. of clubs at the end of FY3/11 was 42

[No. of clubs after listing]

FY	No. of clubs	Sales
	Clubs	¥ billion
FY3/04	7	18.9
FY3/05	11	27.6
FY3/06	17	43.7
FY3/07	25	63.4
FY3/08	32	75.5
FY3/09	35	81.5
FY3/10	37	83.0
FY3/11	42	85.8
FY3/12est.	50	97.0
FY3/15est.	74	153.0

Tosho opened its first sports club "Holiday Sports Club Mikawa-Anjo" in 1996. For the first four years, Tosho only operated one sports club but the company opened one sports club each over three years from 2000, and has continued to show steady growth. Before its listing, Tosho's lease business sales accounted for the majority of sales that lease business accounted for ¥3.7 billion of the company's FY3/03 sales of ¥5.23 billion and sales of hotel business were ¥400 million, total sales of four sports clubs were only ¥1.12 billion. Since its listing, Tosho began multi-location operations. Including the opening of eight sports clubs in FY3/07, Tosho aggressively opened sports clubs which led to a sharp increase in sports club business sales and in FY3/11, sales of 42 clubs amounted to about ¥8.6 billion. In the 5-year midterm plan which started in the previous fiscal year, Tosho will open 8 clubs every year from this fiscal year and 74 clubs in FY3/15 aiming for sales of ¥15.3 billion. Tosho covers areas from Hokkaido to Kyushu but opening sports clubs has no direct effect on the company's operations as there are no sports clubs in East Japan earthquake-affected areas (Iwate, Miyagi, Fukushima, Ibaraki, Chiba). However, Tosho may be affected by shortage of construction materials, price increase, concerns of planned outages, rising cost of fuel and downturn in consumer confidence.

**114,700 members in FY3/11
Aging members**

[Pct. of members by age]	FY3/11	FY3/06
No. of members	115,000	56,000
No. of clubs	42	17
16 to 29 years old	17%	27%
30s	21	27
40s	20	18
50s	19	15
60s or older	23	12

Develop No Swimming Pool 2000

[Sports club model]

①Comprehensive 2500 Investment ¥400mn
Assumed members More than 2500 members

②Comprehensive 2000 Investment ¥350mn
Location...Region & urban area
Site area...About 4,959 square meters
Total floor space...About 1,700 square meters
Swimming pool...Yes
Trade area population...5km radius 100 thousand people
Assumed members...More than 2,000 members

↓ ↓ ↓
③No swimming pool 2000 Investment ¥250mn
Location...Urban area
Site area...About 3,306 square meters
Total floor space...About 1,300 square meters
Swimming pool...No
Trade area population...3km radius 100 thousand people
Assumed members...More than 2,000 members

**Actively open eight clubs
a year**

**Expect annual sales of
¥17.5 billion**

Number of members continues to grow with increasing sports clubs. The assumed membership per club is set at more than 2,000 people. In FY3/11, there were 114,700 members, an increase of about 60,000 members from 56,000 members in FY3/06. Membership increased by about 10,000 from 105,000 members in FY3/10 as Tosho opened five sports clubs in FY3/11. Membership per club calculated on the basis of 42 clubs at the end of year was 2,730 members. The ratio of male members to female members is 49 to 48 (the rest is corporate members), which is almost equal but as men accounted for 44% and women accounted for 56% in 2006, the ratio of male members is increasing. The key characteristic of Tosho is that its sports club facilities are for adults aged 16 years old and above and not for children. Percentage in 60s is 23% which is the highest and users are shifting from younger age group to older age group. As with peer companies including Curves, aging of the population and declining birthrate is expected to raise the number of members mainly in their 60s. Tosho's slogan is "A reputation as a partner in leading a healthy life." Expectations for the performance of Tosho which offers health and beauty has increased with the advent of the aging society.

Initially, Tosho's Comprehensive 2500 model targeting more than 2,500 members and a trade area population of 150 thousand people was its mainstream. Then, Tosho introduced a "Comprehensive 2000" model which has a total floor space of more than 1,700 square meter swimming pool on an area of 4,959 square meters of land some distance away from a prime location in regional city. In FY3/12, Tosho will start operating a "No swimming pool 2000" model (targeting 10 thousand people within a 3 km radius in 178 regions), which has a total floor space of more than 1,300 square meters, on an area of 3,306 square meters of land in an urban area. Based on these business models, Tosho plans to accelerate the expansion of its sports clubs. The amount of investment per sports club for the "Comprehensive 2000" is ¥350 million but "No swimming pool 2000" equipped with gym and studio has no swimming pool. Therefore, Tosho can reduce its initial investment as the investment amount will only be ¥250 million. "Comprehensive 2000" costs an average of ¥7,000 a month and "No swimming pool" costs ¥6,000 a month but ordinary income margin is expected to be about 33%. It is expected that Tosho will further promote multi-location operations as it is possible to have operations in Tokyo, Kanagawa, Chiba and other urban areas.

Tosho's facilities include easy-to-use training machines and offer studio programs in which even beginners can participate. Tosho has a wide variety of training machines and also installs Italian Technogym's training machines which are used for Olympics. Tosho has a five-year lease on the training machines and after five years, increase in profit is assumed along with reduced burden of depreciation on buildings as fixed cost will drop. Meanwhile, Tosho will remodel its facilities every 10 years that are likely to cost between ¥50 million to ¥80 million per sports club. Tosho is making efforts to reduce withdrawal through these investments.

In the past three fiscal years, Tosho only opened 10 sports clubs but for four fiscal years from FY3/12, the company plans to open eight sports clubs (investment of ¥2 billion) every year including "No swimming pool 2000." Tosho's operating cash flow is about ¥2.4 billion a year. Tosho will make investments in its facilities within this amount and use the rest for interest-bearing debt repayment aiming to reduce the current interest-bearing debt of ¥13 billion to ¥10.9 billion in 2015. Increased investments in sports clubs are anticipated and thereby the sports club business borrowing will continue to increase but hotel and rental condominium businesses borrowings are expected to decrease. Tosho shows a positive attitude amid the sluggish economic situation following the earthquake disaster. We would like to positively evaluate Tosho's strategy to become more health conscious while maintaining the advantages of its earnings model relative to peer companies.

Sales for FY3/15, which is the final year of the five-year midterm plan, are expected to be ¥17.5 billion, ordinary income ¥4.4 billion, EPS ¥140 and ordinary income margin 25%, up 5.3 percentage points from FY3/10. Hotel business and rental condominium sales are likely to remain flat as there are no new investments but Tosho intends to move forward depending on properties. In Tosho's core sports club business, the number of sports clubs is expected to increase to 74 and sales to ¥15.3 billion from ¥8.58 billion in FY3/11, up 78%.

Posted development cost of sports clubs in advance in FY3/11

Tosho accelerated the pace of opening sports clubs by opening six to seven sports clubs a year after its listing but opened only three sports clubs and two sports clubs in FY3/09 and FY3/10, respectively. In FY3/11, Tosho accelerated its pace once again by opening five sports clubs. Sales of existing sports clubs were 1.5% to 2.0% lower than Tosho's annual plan but its sports club business sales were up ¥280 million or 3.4% YoY. Operating income benefited from a 90 million yen decrease in machine leasing expenses due to the completion of leases. But SG&A expenses increased because of development expenses of 50 million yen each for five stores opened during the fiscal year and for a store to be opened in the next fiscal year, a total of 300 million yen. The result was a 2.8 percentage point decline in the operating margin to 22.6%. Sales and earnings were higher in the hotel business as the occupancy rate improved. In the leasing business, performance was stable, although sales and earnings decreased as there were no sales of rental condominiums. As a result, sales increased by 1.9% YoY, operating income decreased by 5.9% YoY and ordinary income decreased by 4.2% YoY. Tosho posted a decline in profit for the first time since its listing but maintained a high ordinary income margin of 18.5%.

Expect increases in sales and earnings in FY3/12

Five sports clubs opened in FY3/11 contributed to Tosho's performance in FY3/12. Tosho's sports club business sales are expected to increase by 10.2% YoY to ¥9,698 million. Hotel and lease businesses are expected to remain flat but will prop up earnings. Tosho expects an overall increase of 13.0% YoY. Tosho assumes a 2.5% decrease in sales of existing sports clubs but expects to open eight sports clubs (one "Comprehensive 2500", five "Comprehensive 2000" and two "No swimming pool 2000") in FY3/12 and opening expenses will be required. However, Tosho will make efforts such as by offsetting the expenses with contributions of sports clubs opened in FY3/11, reducing existing sports clubs' lease expenses, reducing depreciation, improving withdrawal and cutting overheads. As a result, a YoY increase of 16% in operating income is expected. In addition, Tosho expects a 19.3% increase in ordinary income margin in FY3/12, up 0.8 percentage point YoY. Tosho attaches the highest importance to this ordinary income margin and its goal is to raise this index to 30%. Tosho is not only working toward increasing its sales but also improving its stock value by employing profit-oriented strategy.

Compared with peer companies, Tosho is in an advantageous position in terms of profitability

Peer companies include Konami's consolidated subsidiary Konami Sports & Life, Central Sports, Megalos and Renaissance. Recently, Curves (Koshidaka), which develops small-scale fitness facilities, is making a strong showing but earnings of peer companies except Curves are pale in comparison to Tosho. Konami has an operating loss of about ¥2.5 billion on sales of ¥85.6 billion in FY3/11. Ordinary income margin of Central Sports in FY3/11 stood at 3.7%, Renaissance's ordinary income margin was 2.8% and Megalos' ordinary income margin was 2.3%, which were overwhelmingly low compared with Tosho's 18.5%. This is because many peer companies develop services targeting all age groups including children at facilities located in cities in front of a stations, mainly lease its buildings and because low-cost operations are difficult due to high labor costs and sales promotion expenses.

Payout ratio of 20%

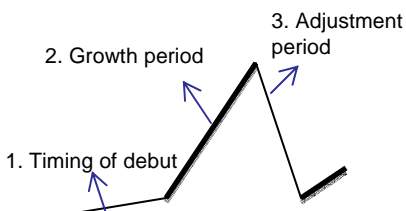
Because Tosho owns its own buildings, interest-bearing debt exceeded its sales size and the company's financial situation is pale in comparison to peer companies. However, Tosho's financial soundness is expected to improve by steadily opening sports clubs within its operating cash flow. Tosho plans to raise its performance by continuing multi-location operations in the medium run while maintaining a high-profit structure. It is highly possible that Tosho will rack up an annual growth rate of more than 20% from FY3/12. A sales increase of about ¥2 billion is expected every fiscal year on the assumption that existing sports club sales remain flat. Tosho plans an ordinary income of ¥2.3 billion in FY3/12, ¥3 billion in FY3/13, ¥3.6 billion in FY3/14 and ¥4.4 billion in FY3/15. Tosho projects an EPS of ¥140 in the final fiscal year. Therefore, with a payout ratio of 20% in mind, Tosho is expected to pay a dividend of ¥28 per share.

Stock appears to be extremely undervalued

Currently, Tosho's share price hovers at ¥500 but the forward PER for FY3/12 is 7x which is overwhelmingly low compared with peer companies. It is also very low in comparison to the JASDAQ market average of 14x. Tosho's current annual dividend per share is ¥12 but a stable dividend increase is expected given the development of its future business.

Expect an upward trend

[Stock price variation pattern after listing]



[Target stock price range]

Current price: ¥527

Stock price variation range from 2008

(Jan. 2008-May 31, 2011)

Low ¥432/High ¥750

Avg. monthly closing price: ¥ 549

Target stock price range ¥500-¥900

Recent one-month stock price variation range

¥510-¥529

【 Target market cap】

【 Risk factors】

Tosho's stock price after its listing was formed in three stages (1. Moderate period immediately after the debut 2. Growth period due to multi-location operations 3. Adjustment period following the Lehman shock). The present situation is believed to be the stage before forming the fourth stage but from a long-term standpoint, it is considered that new investment opportunities taking Tosho's future growth into account are opening up. So far, the effect of the earthquake disaster on Tosho is limited but opaque factors including downturn in the mood to save energy and consumer confidence and increase in construction costs are preventing the rise in its stock price. Tosho's stock price is remarkably low compared with peer companies and since 2008, the stock has remained in a trading range of ¥400 to ¥700. However, Tosho has a strong desire for midterm growth and its financial soundness is likely to improve by reducing interest-bearing debt. Therefore, Tosho is expected to raise its performance and be on an upward trend once again.

Currently, there are four publicly-owned pure-play fitness companies including Tosho. Six companies are listed including Konami and Koshidaka that are developing fitness business as business units. Peer companies include Central Sports (4801), Renaissance (2378) and Megalos (2165), and this time, we also included Koshidaka (2157) which franchises its operation of Curves, to perform comparisons. Excluding Megalos that used a somewhat irregular valuation method, the average market capitalization multiple for the three companies is 6.8 x based on the ordinary income forecasts. This raises expectations for an increase in Tosho's valuation. Using the average market cap/ordinary income forecast multiple of 6.8 x for the three companies results in a target market cap of ¥15.64 billion (stock price of ¥889) one year from now based on Tosho's ordinary income forecast of ¥2.3 billion. Consequently, a comparison with the stocks of peer companies indicates the stock of Tosho has the potential of increasing about 70% from its current level. Therefore, the target stock price range over the next year is set at ¥500 to ¥900.

Company (code)	Stock price ¥	Market cap (A) ¥ billion	Projected ordinary income (B) ¥ billion	A/B Times
C Sports (4801)	896	102.7	14.2	7.2
Renaissance (2378)	300	64.1	7.5	8.5
Koshidaka (2157)	621,000	149.0	31.6	4.7
Megalos (2165)	1010	38.7	1.8	21.5
4-company avg.		88.6	13.8	10.5
3-company avg. excluding Megalos		105.3	17.8	6.8
Tosho (8920)	515	90.6	23.0	3.9

*Stock price as of June 1th.

**¥2.3bn × 6.8x (3-company avg. market cap/ordinary income)=¥15.64bn
(stock price of ¥889)**

Interest-bearing debt has exceeded sales and there is a risk resulting from rising interest rates. The earthquake seemed to have no direct effect on Tosho but there is a possibility of having an indirect effect on the company. Rise in construction material prices and a downturn in consumer confidence will also constitute risk factors.

<Disclaimer and precautions concerning this report>

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