COMPANY RESEARCH AND ANALYSIS REPORT

USEN-NEXT HOLDINGS Co., Ltd.

9418

Tokyo Stock Exchange Prime Market

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Summary

Integration with “Paravi” and upturn of operating environment raises expectations for growth

1. Maintained growth to post record-high earnings despite tough operating environment

USEN-NEXT HOLDINGS Co., Ltd. <9418> (hereafter, also “the Company”) provides various equipment and solutions needed to operate stores and facilities and for DX (Digital Transformation), with music distribution as the main area, to commercial stores such as restaurants and retailers, and to facilities including hotels, hospitals, and offices. It also provides distribution services for individuals, such as for video and e-books. USEN Co., Ltd. and U-NEXT Co., Ltd. reintegrated in December 2017 and the Company was established. This has promoted growth by circulating funds from the cash cow music distribution to the growth businesses, including the content distribution business, while also creating synergies by cross-selling the mainstay products of the Group’s companies by utilizing their strengths and sales channels. As a result, the Company has maintained growth through tough business conditions during the novel coronavirus pandemic (COVID-19) and with-COVID-19 period and continues to post record-high earnings.

2. Five businesses share strengths such as deep customer base and sales capabilities cultivated through music distribution

The Company operates five businesses. The content distribution business distributes movies, e-books, and other digital content to individuals via the “U-NEXT” flat-rate distribution service. The store services business distributes music to commercial stores and retail facilities, manages music copyrights, and supplies all types of solution services related to store management, such as for store DX products and services. The communications business conducts sales and provides services for ICT for corporate customers and its own optical line service for commercial stores. The business systems business sells and maintains automated payment machines, front desk management systems, and other products and services to hotels and hospitals, among other users. The energy business sells electricity and gas as products supporting the store services business. Each respective business has its own strengths, while the strengths of the Group as a whole include its deep customer base and sales capabilities cultivated through music distribution.

3. Integration of “U-NEXT” and “Paravi” expected to contribute to earnings in the medium term and take the lead in content distribution business

The company integrated “U-NEXT” with “Paravi,” a video distribution service offering major broadcasting network content. “Paravi”’s extensive lineup of TV broadcasters’ content will likely further strengthen the substantial offerings of the content distribution business. Although the integration is expected to have a negative impact in the short term (due to factors such as “Paravi”’s earnings performance and work required for integration), the Company’s recent robust performance will likely compensate to some extent. We think “Paravi” will make a substantial earnings contribution in the medium term through positive integration effects, including expanded content offerings and user base, strengthened branding, creation of new services, and cost reduction from FY8/24 onward.

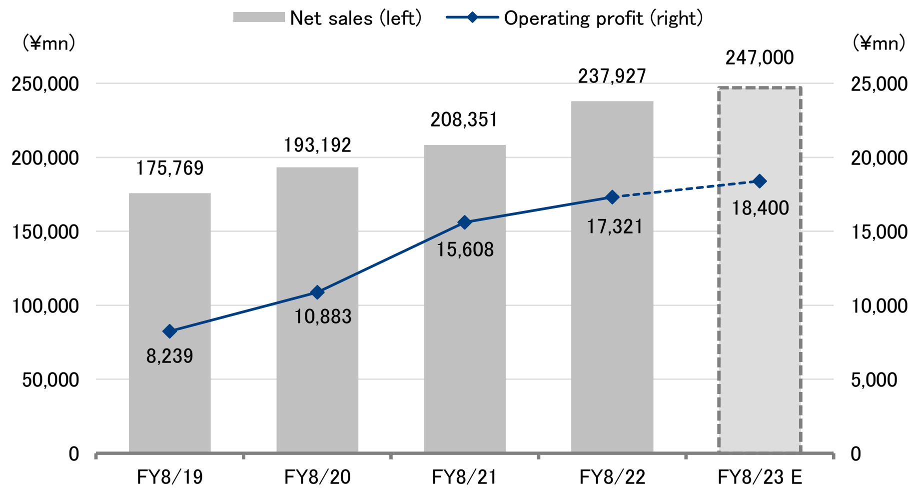
4. Earnings generally brisk; business systems business and "Paravi" to contribute to profit growth in FY8/24

In the 1H FY8/23 results, net sales were ¥133,732mn (up 17.3% year-on-year (YoY)) and operating profit was ¥9,544mn (up 7.9%). The Company made significant progress versus its full-year forecast, but the business systems business, whose operating environment was expected to improve in the with-COVID-19 period, was weaker than expected, due in part to customers holding back on purchases in anticipation of the issue of new paper currency in 2024. The Company's full-year FY8/23 forecast is net sales of ¥247,000mn (up 3.8% YoY) and operating profit of ¥18,400mn (up 6.2%). The Company likely left its initial forecast unchanged because of concerns about the business systems business and "Paravi" integration effect, but both of these businesses are forecast to contribute to profit growth in FY8/24. We therefore expect earnings to continue to track the upside case of the Company's medium-term management plan.

Key Points

- Maintained growth to post record-high earnings despite the tough operating environment of with-COVID-19 period
- "Paravi" expected to yield integration effect in the medium term in the content distribution business; combined market share second only to Netflix
- To sustain upside case of medium-term management plan

Results trends



Note: The Accounting Standard for Revenue Recognition, etc. has been applied from FY8/22.
Source: Prepared by FISCO from the Company's financial results

Company profile

"A 'Social DX' company" that promotes DX of stores and lifestyles

1. Company profile

Through the Group companies under its umbrella as the holding company, the Company provides devices, solutions and other products and services needed to operate stores and facilities and support for DX, centered on its founding business of music distribution, to restaurants, retailers, and other commercial stores, and to various facilities including hotels, hospitals, and offices. It also provides a service that distributes movies, e-books, and other digital content to individuals under a flat-rate-fee system. The Company has created synergies through cross-sales of the Group companies' products and services. This involves leveraging the respective strengths of each Group company, specifically a customer base consisting of over 0.8mn commercial stores and other such enterprises, nearly 3mn paid subscribers of its video distribution services, expertise in supporting commercial stores, a network infrastructure, and strong sales capabilities leveraging sales channels such as a direct sales platform, telemarketing, web marketing, and a network of agencies, a sales force of around 2,000 nationwide that underpins sales capabilities, and around 1,000 field engineers. It is progressing a dynamic growth strategy that actively incorporates IT technologies like IoT and AI. In this way, the Company is implementing its corporate slogan of "Brighten the future" as "a 'Social DX' company that makes the future closer."

Consistently worked to spread IT infrastructure since 2000

2. History

Mototada Uno founded USEN as a private business in 1961, which later became Osaka Yusen Broadcasting (now, USEN) and subsequently built a wired broadcast network nationwide. When Yasuhide Uno took over as President in 1998, he consistently worked to spread IT infrastructure, such as launching the world's first commercial optical fiber service as a private-sector company in 2001. He also expanded business to include store assistance services, broadband services, video distribution, and other content provision services based on the Company's existing customer base and infrastructure. U's Broad Communications (now, "U-NEXT"), a broadband service provider, took over the paid TV video distribution service and sales agent business for optical lines for individuals and other communication lines and spun off from USEN in December 2010. USEN and "U-NEXT" strategically reintegrated in December 2017 with the aim of leveraging respective customer bases and other management resources. The reintegration was an opportunity to concentrate shared Group functions while simultaneously expanding business through Group synergies. As a result, the Company formed a solid earnings base with strong growth potential in a tough operating environment during the COVID-19 pandemic. In the current with-COVID-19 period, the Company has started to reap the benefits of further progress of DX and an economy returning to normal.

Is developing content distribution for individuals stores and management support services for stores and facilities

3. Business contents

The five business segments are the content distribution business, the store services business, the communications business, the business systems business, and the energy business. The content distribution business involves the distribution of digital content, of movies and e-books, to individuals. The other four businesses mainly consist of pro- viding management support services for SME's business establishments and various facilities, such as commercial stores operated by corporations and individual business owners. The store services business provides the store management solution services, such as music distribution, store DX, and customer attraction support for stores to commercial stores including restaurants and retail stores, and various other facilities. The communications business provides services such as network security to offices and other users and engages in agency sales of Internet services. The business systems business sells equipment, such as automated payment machines and front desk work management systems, to hotels, hospitals, and other customers, and also provides maintenance services. The energy business sells high-voltage and low-voltage electricity and gas to the customers of the store services business and the communications business.

Business corporations are all consolidated subsidiaries of the Company, which is a holding company. "U-NEXT" and TACT Inc. engage in the content distribution business. USEN, CAN SYSTEM Co., Ltd., USEN Media Corporation, USEN FB Innovation Co., Ltd., USEN Techno-Service Co., Ltd., USEN-NEXT Design Co., Ltd., U'S Music Co., Ltd., and Virtual Restaurant Co., Ltd. engage in the store services business. USEN NETWORKS Co., Ltd., U-NEXT Co., Ltd., USEN ICT Solutions Corporation, USEN Smart Works Corporation, USEN-NEXT LIVING PARTNERS Inc., U-MX Co., Ltd., Next Innovation Co., Ltd., and Y.U-mobile Co., Ltd. engage in the communications business. ALMEX Inc. engages in the business systems business and USEN and U-POWER Co., Ltd. in the energy business.

(1) Content distribution business

"U-NEXT" is a content distribution service for individuals of video, of movies and TV, and e-books and music, which for a monthly fee users can access via the Internet on many types of devices, including TVs, PCs, and smartphones. The video distribution market expanded rapidly due to COVID-19, but it has been noted that this growth is slowing down in the shift in with-COVID-19 period. However, in Japan, the use of flat-rate-fee video distribution services has not progressed sufficiently compared to in the United States and other countries, so it seems that this market will still grow in the medium term. Japan's video distribution market is growing and can be said to be a growth market, but on the other hand it can also be said to be a fiercely competitive market, where many companies (including those affiliated with major broadcasters and smaller players) are struggling. "U-NEXT" has continued to grow in this tough environment by harnessing its unique strengths. Its market share in Japan is second only to Netflix, ahead of big foreign names like Amazon Prime Video and Disney Plus.

The overwhelming strength of the three major foreign companies is the contents they produce based on the enormous amounts that they spend on them. To compete with them, “U-NEXT” has a comprehensive lineup of content from Japan and overseas. In its “coverage strategy,” it provides an all-you-can-watch service for a library of more than 270,000 titles, including movies, dramas, and anime. Users can also watch more than 30,000 rental titles, including the latest titles that have only just been released and broadcast, and the number of titles in its lineup is said to be industry leading. It is quick to distribute new titles, and niche fields such as live music, live martial arts, and other areas. Moreover, as it packages together more than 910,000 e-books, including manga and books, and more than 170 magazines. It also packages music-distribution songs, allowing users a seamless entertainment experience across genres (view, read, and listen) with a single app. The monthly usage fee for the Company services seems relatively high at ¥2,189 (tax included), but every month users receive points worth ¥1,200 (points can be used to acquire coupons for live theater performances), so it is actually only ¥989 (tax included). Also, a single account can be viewed by up to four people, and when considering together all these benefits, its cost performance can be said to be rather high. The number of paid subscribers totaled 2.92mn as of February 2023.

The Company also differentiates itself through its content offerings. It is strengthening the number of exclusive content delivery titles with the “ONLY ON” strategy (new and popular titles, sports and music content available to watch live or on-demand from “U-NEXT” only). This has led to an increase in contracts with overseas content holders wishing to compete with Netflix and Amazon Prime Video. The Company is also making progress with unique live music distribution by harnessing deep relationships cultivated through its music distribution business. It recently strengthened its exclusive and comprehensive subscription video on demand (SVOD) partnership with Warner Brothers Discovery (WBD) of the US, increasing the number of episodes for exclusive distribution from 1,300 to 2,300. It also concluded new partnership agreements with SPOTV NOW, which livestreams the world’s best sports such as Premier League (UK) and Serie A (Italy) soccer and US Major League baseball games, and UFC (US), which runs the world’s top mixed martial arts (MMA) organizations’ events to begin livestreams of all events. In this way, the Company continues to build on its exclusive content offerings. It is also the only leading company in the business to distribute content for mature audiences. Titles for mature audiences clearly make a point of difference as demonstrated by TSUTAYA, which dominated major U.S. company competitor, Blockbuster LLC in the growth period of rental videos. Users continue to choose “U-NEXT” because of its strategy of differentiating itself from major foreign rivals. A growing number of users are signing up with multiple video distribution services since the COVID-19 pandemic, providing a favorable operating environment for “U-NEXT.”

In March 2023, the Company integrated “U-NEXT” with “Paravi,” one of the video distribution services that provide major broadcasting network content. This will likely further differentiate its content offerings from those of competitors. “Paravi” is a joint video streaming platform run by Premium Platform Japan (PPJ) with investment from TBS Holdings <9401>, Nikkei Inc., TV Tokyo Holdings <9413>, WOWOW Inc. <4839>, Dentsu Group Inc. <4324>, and Hakuhodo DY Media Partners Inc. Users can watch a broad range of content from Tokyo Broadcasting System (TBS), TV Tokyo, and WOWWOW for a monthly subscription of ¥1,017 (tax included). It boasts the largest archive of Japanese dramas and 850,000 paid subscribers. We think the Company decided to integrate “U-NEXT” with “Paravi” because of the heightened need to increase corporate value by leveraging integration synergies (complementary content and customer segments) and as a step toward aiming for the top spot among content distribution platforms.

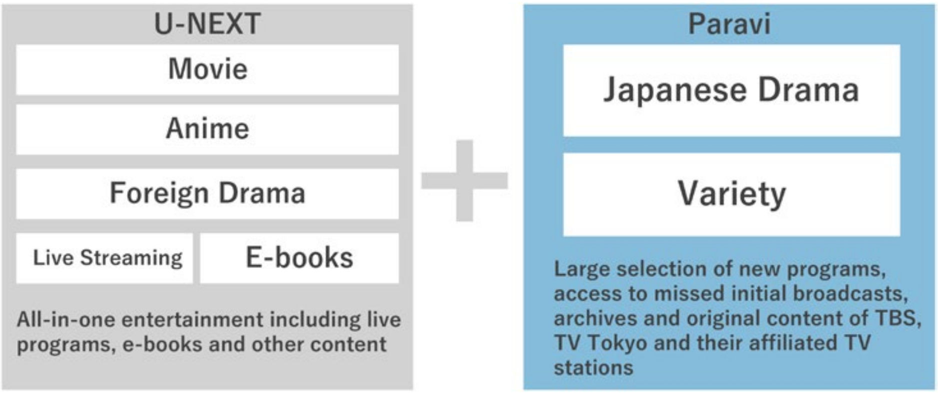
The integration process is as follows. PPJ (which runs "Paravi") will be integrated with "U-NEXT" on March 31, 2023. "Paravi" will operate as before through June 30, 2023. In July 2023, "Paravi" services will be transferred to "U-NEXT." "Paravi" users can view "Paravi" content as well as "U-NEXT" content (some genres excluded) under existing conditions. "U-NEXT" users can view "Paravi" content as well under current existing conditions. Business integration with PPJ will take the form of a share swap. PPJ shareholders can choose whether to hold PPJ shares or "U-NEXT" shares. The Company plans to disclose information regarding the impact of integration on FY8/23 earnings in Q3 onward because it takes time to estimate PPJ earnings, goodwill, and one-off integration expenses. Considering PPJ's recent earnings performance, integration is expected to have a negative impact in the short term, but the Company's recent robust performance will likely compensate to some extent. Goodwill looks likely to be less than the estimated ¥3.0bn based on a simple calculation.

Although integration may have a negative impact in the short term, the medium-term integration effect from FY8/24 onward is expected to be significant because synergy effects will expand the user base and content offerings, strengthen branding, create new services, and reduce costs. In terms of user base, "U-NEXT"'s 2.85mn paid subscribers plus "Paravi"'s 850,000 total 3.7mn*. Regarding content offerings, "U-NEXT"'s strengths in movies, anime, and foreign dramas (including Korean dramas) will combine with "Paravi"'s best-in-class lineup of Japanese drama and variety programs, which will likely boost user satisfaction. As well, "Paravi" streams a lot of original content by two major broadcasters. Streaming TV content before broadcast, live, and on-demand to catch up with missed episodes or from archives will also improve user satisfaction.

* Simple calculation that does not factor in users that subscribe to both services. User numbers as of November 30, 2022.

To strengthen branding, promotions that combine digital means such as Web promotions (listing ads and affiliate ads) at "U-NEXT," physical outlets (multiplex cinemas and mass electronics retailers) and mass promotions (broadcast) using TV ads, such as "Paravi"'s promotions on over-the-air television and online and features in infotainment programs become possible. This maximizes opportunities to attract users. Regarding the creation of new services, "U-NEXT"'s IT development capabilities in UI/UX and apps combined with "Paravi"'s creative and production capabilities have potential to create new cross-entertainment services, including development of original content and IP in a media mix of comics, books, movies, etc. That being said, we think the Company will not actively involve itself in content production because the risk is too great for a platform business, and will only make a small investment in any project in takes part in. Cost synergies will like materialize six to 15 months after integration, in FY8/24. Although still under detailed review, the Company is expecting synergies sufficient to absorb "Paravi"'s operating loss by integration and consolidation of duplicated content, integration of "U-NEXT" and "Paravi" infrastructure, and sharing promotions.

Enhanced content offerings from integration with "Paravi"



Source: Reference material from small meeting with institutional investors regarding integration of "U-NEXT" and "Paravi"

(2) Store services business

The store services business provides "USEN MUSIC," which is the cash cow music distribution service and the Company's founding business with a history of more than 60 years, and also a service to support store DX. It targets the approximately 3mn commercial stores and facilities nationwide, including restaurants, retail stores, beauty salons, medical facilities and offices, ranging widely from individually-run stores to community-based or nationwide chains. Of these, the Company provides a music distribution service to 700,000 stores and facilities throughout the country, as well as sales and installation of peripheral audio equipment and management of music copyright (its estimated share of the music distribution market for stores is approximately 90%), broadcasting music and various information for stores and facilities ranging from specialty channels, such as for J-POP and Western music, through to request channels. In this service, it has a library of around 10mn songs and can use AI to create playlists suited to any type of industry or business format. It also provides as standard 1,000 types of in-store announcements for customers, employees, and others.

Store DX has been conducting a business peripheral to the music distribution service. In recent years, needs for digital support aimed at personnel saving and labor saving have been rapidly increasing. It is a big challenge for SMEs to progress technology such as IoT and DX on their own, so the Company provides them with installation support as a one-stop service. Centered on the "USEN MUSIC" music distribution service, this is a store management service that integrates various products and services, including "USEN Regi," which is a POS cash register, "USEN AIR," which is business-use Wi-Fi, "USEN Camera," which is an AI camera that can analyze the attributes of customers visiting stores, and catering service robots. This one-stop solution for adoption of IoT to wirelessly connect DX products and services is called the "USEN IoT PLATFORM." Against the backdrop of the enhancements to this service, the Company has developed "USEN Marutto Store DX," which creates a package of store DX products and services, and it is progressing operations for new customers, including for new stores that have a high set contract completion rate. When adding music distribution, this business has a customer base on a scale of close to 1mn customers and can be said to be the Company's greatest management resource.

The strengths of this business are this customer base and also a strong support network consisting of around 150 Group bases nationwide, as well as a workforce of 1,200 sales and 900 field engineers. Along with providing services such as music distribution and store DX, the Company can provide support from a store opening through to its management, from installing equipment through to aftercare and also dealing with troublesome copyrights. Although music distribution has limited growth potential because the effect of new stores (new contracts) is cancelled out by store closures (contract cancellations), this business is a stable and highly profitable cash cow. Therefore, it is a business that financially supports the growth strategy of the Group as a whole. For store DX, alongside the decline in the working population, needs for personnel saving and labor saving are rapidly increasing, and in particular among the customers, many individually-run stores and small- and medium-sized stores have not progressed digitalization, so there remains plenty of room for installations and it can be said to be an extremely high growth business.

(3) Communications business

The communications business conducts sales agency operations for broadband internet lines, proposes and sells the building of office ICT (Information and Communication Technology) environments, provides the "y.u mobile" MVNO service for individuals, and provides and sells broadband internet lines for individuals. For the building of ICT environments, as a "multi service vender," it provides corporations with ICT products and solution services linked to SaaS, such as cloud services, mobile services and data center services from Google, Cybozu <4776>, and others. The strengths of the Company's corporate business, which has continued to stably grow despite the rapid changes in the ICT industry, include the wide breadth of its service lineup through a multi-vendor strategy and offering highly convenient direct sales through which it can respond to each customer's needs via a single customer contact point. The Company also makes proposals for improving the working environment that matches customer companies' needs, such as "Sound Design for OFFICE" and other background music services for office workers and a range of cloud (SaaS) services to support employees' work styles. Although increased competition is a risk, these services have considerable growth potential given the expanding need among offices and commercial stores for digitalization, business efficiency improvement, and security solutions.

Also, for broadband internet lines to offices, the Company is progressing the switch from agencies to its own highly profitable optical line service, while also strengthening sales of up-sales products to commercial stores.In addition, "y.u mobile" (MVNO service for individuals) has performed strongly since its rollout thanks to a simple pricing plan, while broadband internet lines for individuals are being used in an expanding range of new ways such as teleworking.The strengths of communications business include the synergies with the store services business and that sales promotions are conducted through a network of 250 agencies. Another strength is its network in the real estate industry, and it provides a one-stop communication line service for residents of major rental residential properties.

(4) Business systems business

The subsidiary ALMEX INC. is responsible for the business systems business. With "taking techno-hospitality (technology x hospitality) to the world" as its slogan, its goal is to deliver to customers and their end-users "the ultimate hospitality" with products and services that harness the latest technologies. It develops, manufactures, and sells the latest equipment to meet customer needs for personnel saving and labor saving, such as automated payment machines and front desk work management systems, including to general hotels, leisure hotels, general hospitals and clinics, golf courses, as well as order terminals, operating systems, and other products to restaurants. It also provides other services that generate recurring revenue, including maintenance and software upgrade services. In terms of its track record of deliveries to all types of facilities within Japan, its market shares are high for all facilities except for clinics. Among them, according to the Company it has the top shares in each market for automated payment machines. The strengths of this business include that, as a fabless manufacturer, it itself conducts each stage from the development of equipment and systems through to sales and maintenance.

In terms of the market environment, the medical industry has started to improve convenience for patients, and during the with-COVID-19 period, in the hotel industry, domestic travel is expected to recover due to the measures to support travel, while inbound demand is also expected to recover thanks to the easing of restrictions on entering Japan, and the need to invest in personnel saving and labor saving through DX is increasing even more. Within this situation, the "Sma-pa Myna Touch," which is a card reader with face authentication that is compatible with the Company's online eligibility verification, is proving popular among general hospitals and small to medium-sized clinics as it has proprietary functions that enable the reading of various card-based certifications like health insurance cards and medical certificates in addition to contactless forms. In adjacent markets as well such as golf courses, retailers, and pet clinics, demand is considered to be large from their affinity with the Company's devices and they are expected to achieve comparatively high growth in the medium to long term. However, although the Company had expected demand to grow in the hotel and healthcare businesses, uptake has been slower than expected in the short term because customers are waiting for the issue of new paper currency and their business picked up sharply.

(5) Energy business

The energy business, which was launched following the liberalization of energy sales in 2016, involves selling low-risk high-voltage and low-voltage electricity and city gas procured on a relative basis from Tokyo Electric Power Company Holdings, Inc. <9501> (hereinafter, TEPCO), with which the Company has a business alliance, to supply commercial stores of the Company's customers (low-voltage electricity) and commercial facilities (high-voltage electricity) in areas other than TEPCO's areas through "USEN Energy." It also sells city gas as an agency through "USEN GAS" and provides a consulting service for saving energy using LED and commercial air-conditioners. It is also focusing on them as products that will spur new customer acquisition in the store services business and cross-selling.

In March 2022, the Company began launched the "U-POWER" service. Whereas "USEN Energy" has an agency model, "U-POWER" has an own energy procurement model. It offers three low-voltage electricity plans with different ratios of green energy and two high-voltage electricity plans (market-linked and hybrid plans) in response to the need for companies and stores to address SDGs and heightened environmental awareness, supporting stores and facilities to switch to green energy. "U-POWER" is more profitable than the agency model because the Company procures its own electricity and can pass wholesale price increases onto customers, which reduces the risk of negative gross profit. "U-POWER"'s supply capability underpinned by procuring its own electricity, SDGs features, and comprehensive nationwide contracts are popular at a time when new sellers of electricity are struggling to survive fierce competition with conventional electric utilities amid sharply rising energy prices. "U-POWER" is performing strongly by attracting "USEN Energy" customers looking to cancel their contracts and customers of new sellers of electricity that have withdrawn from the business.

Financial results trends

Net sales and profit growth in 2Q FY8/23; steady progress toward forecast

1. 2Q FY8/23 results

In the 2Q FY8/23 results, net sales were ¥133,732mn (up 17.3% YoY), operating profit was ¥9,544mn (up 7.9%), ordinary profit was ¥9,050mn (up 7.3%), and profit attributable to owners of parent was ¥4,958mn (up 12.5%). The Company made strong progress toward its full-year forecast in 1H, with net sales at 54%, operating profit and ordinary profit at 52%, and profit attributable to owners of parent at 54%.

2Q FY8/23 results

(¥mn)

	2Q FY8/22		2Q FY8/23		
	Results	% of net sales	Results	% of net sales	YoY
Net sales	114,016	100.0%	133,732	100.0%	17.3%
Gross profit	42,302	37.1%	44,667	33.4%	5.6%
SG&A expenses	33,452	29.3%	35,122	26.3%	5.0%
Operating profit	8,849	7.8%	9,544	7.1%	7.9%
Ordinary profit	8,432	7.4%	9,050	6.8%	7.3%
Profit attributable to owners of parent	4,408	3.9%	4,958	3.7%	12.5%

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

In Japan, COVID-19 was officially downgraded in May 2023 to a Class 5 disease, the same as influenza. Japan has taken big steps toward living with COVID-19, such as making it a personal choice to wear face masks in public. As rules have been relaxed, so have restrictions on entry into Japan from overseas, which has led to a sharp rise in the number of foreign visitors, and economic activity is returning to normal pre-pandemic levels. Visitor numbers are up for commercial stores, with some government assistance such as resuming domestic travel subsidies, and travel and accommodation businesses are benefiting from the increase in leisure and business travelers. These conditions are favorable for the Company's customers.

However, inflation continues around the world due to food and energy shortages stemming from the Ukraine situation. In Japan, price increases continue for products, services, and utilities because of the impact of factors such as foreign exchange and avian influenza. This has led to consumers cutting back on purchases and weakened consumer sentiment, making the loss of customers a concern for commercial stores that have had to revise their prices. Thus, the business environment has become even more opaque than during the pandemic, with additional issues such as the labor shortage and wage increases as the economy returns to normal, and subsidies being withdrawn, leading to a temporary acceleration in the turnover of commercial stores.

Under these conditions, the Company has been implementing its corporate slogan of "Brighten the future" as "a 'Social DX' company that makes the future closer" by providing products and services that address the various needs and challenges of customers such as commercial stores. As a result, net sales recorded double-digit growth of 17.3%. Although operating profit grew in the high single digits because the strongest growth was in the relatively low margin content distribution and energy businesses, and SG&A expenses rose, including spending on advertising and promotions in the content distribution business and expenses related to investment and lending for growth. That being said, these results are commendable at a transitional period of an economy returning to normal.

Performance varies between segments in transitional period for economy returning to normal

2. 2Q FY8/23 results by segment

In the 2Q FY8/23 results by segment, in the content distribution business, net sales were ¥38,605mn (up 10.9% YoY) and operating profit was ¥3,323mn (up 3.8%); in the store services business, net sales were ¥30,630mn (up 8.3%) and operating profit was ¥4,730mn (up 1.8%); in the communications business, net sales were ¥26,456mn (up 4.7%) and operating profit was ¥2,839mn (up 1.7%); in the business systems business, net sales were ¥9,366mn (down 4.4%), and operating profit was ¥1,270mn (down 27.6%); and in the energy business, net sales were ¥30,288mn (up 70.8%) and operating profit was ¥1,068mn (up 325.2%). These results were mixed in a transitional economy that is returning to normal after the pandemic. We think that the effects of ongoing aggressive investment during the pandemic mainly in the content distribution and store services business, and synergies from group management as well as business portfolio management were fully reflected in the Company's performance.

2Q FY8/23 results by segment (before adjustment)

(¥mn)

Net sales	2Q FY8/22		2Q FY8/23		
	Results	% of net sales	Results	% of net sales	YoY
Content distribution business	34,808	30.0%	38,605	28.5%	10.9%
Store services business	28,273	24.4%	30,630	22.6%	8.3%
Communications business	25,258	21.8%	26,456	19.5%	4.7%
Business systems business	9,796	8.5%	9,366	6.9%	-4.4%
Energy business	17,733	15.3%	30,288	22.4%	70.8%

Operating profit	2Q FY8/22		2Q FY8/23		
	Results	Profit ratio	Results	Profit ratio	YoY
Content distribution business	3,200	9.2%	3,323	8.6%	3.8%
Store services business	4,648	16.4%	4,730	15.4%	1.8%
Communications business	2,790	11.0%	2,839	10.7%	1.7%
Business systems business	1,753	17.9%	1,270	13.6%	-27.6%
Energy business	251	1.4%	1,068	3.5%	325.2%

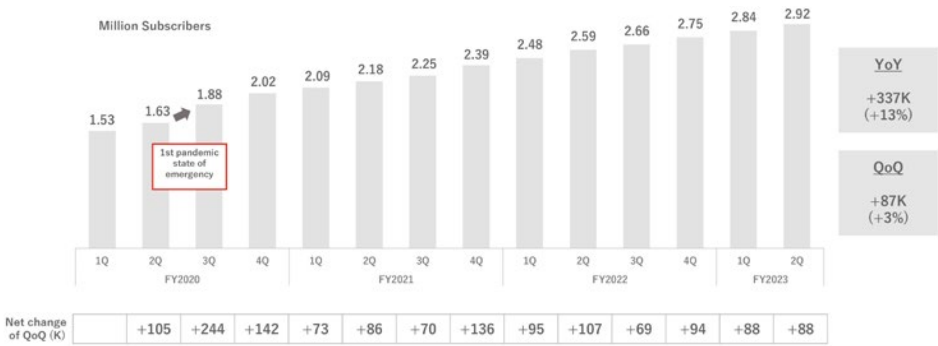
Source: Prepared by FISCO from the Company's financial results

(1) Content distribution business

"U-NEXT" recorded a solid increase in the number of paid subscribers of 340,000 YoY to 2.92mn at end-2Q FY8/23, although nesting demand is petering out as the economy returns to normal after the COVID-19 pandemic, restrictions on movement are lifted, opportunities to go out increase, workers return to their workplaces after teleworking, and in-person live concerts and events resume. Although competition intensified in the race to corral viewers and develop and source content, the Company took effective action such as its coverage strategy, upgrading its "ONLY ON" strategy, exclusive streaming of popular sports content such as the PGA Tour, JLPGA women's pro golf tour, and Bellator MMA. Another likely effective decision was to enable purchase of movie tickets using "U-NEXT" points as a video streaming service that transfers customers to movie theaters because the Company prioritizes the experience of watching a movie in a movie theatre.

In terms of cost, the foreign exchange market remains unfavorable for purchases of overseas content, with the yen weaker YoY. Although promotional costs typically impact on profit margins in 1H because they increase in the new year holiday season, the total declined YoY as a result of a shift from TV commercials to co-sponsoring events and spot ads on TVer and TikTok. Nonetheless, the increase in operating profit in 1H was in the single digits YoY despite double-digit net sales growth due to the higher cost of purchasing content stemming from the aforementioned yen depreciation.

Trends in paid subscribers in the content distribution business



Source: The Company's results briefing materials

(2) Store services business

With a mission to "create the future of stores," the store services business makes store management solution proposals from a fresh perspective, providing total store DX support as a package from front-of-house to back-office operations. By providing full support from introducing the service to after-sales follow-up helps customers streamline their operations as well as promote labor-saving and contactless operations. The Company actively promoted the use of catering service robots in restaurants to solve customers' problems in the with-COVID-19 period, such as dealing with labor shortages and improving productivity, as well as providing safe, contactless, and efficient customer service. The Company also began helping "children's cafeterias," a community service for underprivileged children at 100 locations nationwide, to improve conditions at these facilities by providing "USEN MUSIC" free of charge. Business is recovering to pre-pandemic levels for customer stores of "Hitosara," a customer attraction support service for restaurants that also handles Tabelog, while "Savor Japan," a foodie site for foreign visitors to Japan, has recorded a sharp increase in reservations after restrictions on entry into Japan were lifted. Virtual Restaurant, which joined the Group in September 2022, focused on attracting member stores and developing new restaurant brands by harnessing the Group's sales channels.

As a result, although cancellations due to store closures increased in January and February 2023, contracts were up YoY and QoQ due to a steady increase in new contracts. Profit increased marginally despite steady sales growth due to higher personnel expenses and depreciation, depreciation of lump-sum depreciable assets, and allowance for bad debt. Per-customer spend tends to be high for a new contract, which usually entails multiple store DX contracts, and it thus contributes to earnings after absorbing one canceled contract. The Company also provides support for store closures, such as acting as an agency for renting the property with furniture, equipment, and fittings, and subleasing. The Company also offers a rent guarantee service to commercial stores struggling with credit because of the pandemic, and the number of users is on the increase.

Financial results trends

Store services business -Number of contracts

Source: The Company's results briefing materials

(3) Communications business

Remote working and online meetings are still common in the with-COVID-19 period. This has further increased the need for tools to improve business efficiency and save labor. Communication remains a challenge for companies where some employees are in the office and others work remotely. The Company therefore worked on proposals for new services, including the utilization of tools. "USEN Hikari Plus" (the Company's own optical line service for commercial stores) recorded a steady increase in new customers, making the transition from a one-time commission revenue model to a recurring revenue model. It also launched "USEN Hikari 01" (optical line service for individuals) in response to a heightened need for lifestyles that harness the Internet, such as music and video distribution as well as setting up for remote working. Sales grew in the mid-single digits YoY because new customer acquisitions remained upbeat for communication lines and networks for SMEs and security services. Operating profit was flat because the year-earlier profit growth effect in ICT for corporate customers as a result of a change in revenue recognition standard disappeared, and work with low gross profit accrued in 1Q FY8/23.

(4) Business systems business

Even in facilities whose focus had been on hospitality services performed by people, demand is growing for the Company's products such as automated payment machines in the with-COVID-19 period due to the labor shortage and need for contactless, non-face-to-face services. The Company sees this as a major business opportunity and has been stepping up its sales. It offered a range of products and services to hotels with growing guest numbers as a result of an uptick in domestic travel due to travel subsidies by national and local governments and number of overseas visitors to Japan as a result of lifting restrictions on entering the country, helping to solve issues such as the labor shortage and need for contactless, non-face-to-face services. For hospitals and clinics, the Company began selling "FIT-B for Clinic," the smallest and latest self-service register in the business, which is space-and labor-saving and responds to the need for contactless, non-face-to-face services.

In collaboration with JA Mitsui Leasing, Ltd., it also began a service for hospitals and clinics that provides one-stop support from the opening stage, including raising funds for leasing and installing DX equipment, including next-generation KIOSK terminals. The Ministry of Health, Labour and Welfare (MHLW) has made confirmation of online qualifications compulsory in principle, although some facilities have been given a grace period. The Company therefore focused on the installation of “Sma-pa Myna Touch,” a card reader with a face authentication function to help progress DX among medical institutions in general. However, the Business Systems business posted lower sales and profit, having lost the year-ago boost from COVID-19 subsidies, customers holding back on purchases in anticipation of the issue of new paper currency in 2024, hospitals and clinics taking a wait-and-see approach after the grace period was established, and hotels falling behind on investment due to a sudden surge in business after domestic travel subsidies resumed and number of foreign visitors to Japan rebounded. That being said, a recovery trend has started on a QoQ basis.

(5) Energy business

Energy market conditions remain unstable as power generation costs remain at a high level and major power utilities have applied to raise regulated prices. In this context, although “USEN Energy” (high voltage), which operates on an agency model, has recorded some contract cancellations, the market-linked/hybrid “U-POWER” (self-procurement model) contracts increased because it attracted USEN Energy customers looking to cancel their contracts and customers of new sellers of electricity that have withdrawn from the business. Sales increased, due in part to a rise in the fuel cost adjustment unit price. Operating profit grew at a faster rate than sales due to an increased share of the profitable “U-POWER,” far exceeding the full-year forecast of ¥700mn in 1H.

Full-year Company forecast unchanged despite strong progress through 2Q

3. FY8/23 outlook

For the FY8/23 results outlook, the Company is forecasting net sales of ¥247,000mn (up 3.8% YoY), operating profit of ¥18,400mn (up 6.2%), ordinary profit of ¥17,300mn (up 6.5%), and profit attributable to owners of parent of ¥9,200mn (up 5.9%). In 2H also, it will utilize to the greatest possible extent its management resources, including its stable customer base, video content, music content, various IoT products, and network infrastructure. Its policy is to maximize Group synergies by utilizing various sales channels, including telemarketing and online marketing, in addition to its strong direct sales platform, and during the with-COVID-19 period, to respond to the rapidly and greatly changing consumption behaviors and corporate activities, technologies, and societal environment. Through this, it will achieve sustainable profit growth and increase shareholder value and enterprise value.

FY8/23 is the second year of the medium-term management plan “Road to 2025.” It is a year of big changes, with sharp yen depreciation and removal of COVID-19 restrictions on movement. Although yen depreciation raising overseas content purchase prices is a concern, the Company intended to absorb this by stabilizing earnings through increased recurring revenue, improving the breakdown of content purchased by increasing the share of domestic content, and negotiating purchase conditions. The Company expected the removal of COVID-19 restrictions on movement to boost earnings of commercial stores, restaurants, and hotels because the movement of people increased sharply in Japan. Although yen depreciation is beginning to reverse, the lifting of COVID-19 restrictions had an unexpected bottleneck effect on hotels and other facilities overwhelmed by the faster-than-expected recovery in the movement of people. The Company must also factor in the cost of integrating “Paravi,” which is still under review, and “Paravi”’s earnings performance, which includes an operating loss. We assume that for the above reasons, the Company maintained its initial full-year forecast despite strong progress through 2Q.

FY8/23 outlook

(¥mn)

	FY8/22		FY8/23		
	Results	% of net sales	Forecast	% of net sales	YoY
Net sales	237,927	100.0%	247,000	100.0%	3.8%
Operating profit	17,321	7.3%	18,400	7.4%	6.2%
Ordinary profit	16,241	6.8%	17,300	7.0%	6.5%
Profit attributable to owners of parent	8,687	3.7%	9,200	3.7%	5.9%

Note: "Paravi"'s earnings are not reflected in the forecast.
Source: Prepared by FISCO from the Company's financial results

For the FY8/23 results outlook by segment, unchanged from the initial forecast, in the content distribution business, it is forecasting net sales of ¥74,000mn (up 3.6% YoY) and operating profit of ¥7,300mn (up 16.0%); in the store services business, net sales of ¥61,000mn (up 4.9%) and operating profit of ¥8,700mn (down 3.8%); in the communications business, net sales of ¥53,000mn (up 4.4%) and operating profit of ¥5,700mn (up 6.2%); in the business systems business, net sales of ¥21,000mn (up 9.7%) and operating profit of ¥3,400mn (up 3.8%); and in the energy business, net sales of ¥42,000mn (up 0.9%) and operating profit of ¥700mn (up 36.7%).

Segment outlook for FY8/23 (before adjustment)

(¥mn)

Net sales	FY8/22		FY8/23		
	Results	% of net sales	Forecast	% of net sales	YoY
Content distribution business	71,432	29.6%	74,000	29.5%	3.6%
Store services business	58,172	24.1%	61,000	24.3%	4.9%
Communications business	50,764	21.1%	53,000	21.1%	4.4%
Business systems business	19,151	7.9%	21,000	8.4%	9.7%
Energy business	41,626	17.3%	42,000	16.7%	0.9%

Operating profit	FY8/22		FY8/23		
	Results	Profit ratio	Forecast	Profit ratio	YoY
Content distribution business	6,294	8.8%	7,300	9.9%	16.0%
Store services business	9,048	15.6%	8,700	14.3%	-3.8%
Communications business	5,367	10.6%	5,700	10.8%	6.2%
Business systems business	3,277	17.1%	3,400	16.2%	3.8%
Energy business	512	1.2%	700	1.7%	36.7%

Note: "Paravi"'s earnings are not reflected in the forecast.
Source: Prepared by FISCO from the Company's results briefing materials

In the content distribution business, although in the industry there is a sense that a temporary lull will occur after the nesting demand, the Company is forecasting that the excellent results will continue, with sales to increase and profits to rise by double digits. When considering that following the reopening, the wallet share and time share of video distribution will be shifted to other products and services, the forecasts are for the net increase in the number of paid subscribers to be around 200,000 in one year and for net sales growth in the low single digits in the first half of the year. It seems the cost of procuring overseas content will increase due to the weak yen, but the Company forecast appears somewhat conservative because the Company is increasing content sourced in Japan and reviewing terms and conditions, user acquisition cost is falling, the net increase is paid subscribers is trending up, and promotional costs in 2H are lower than in 1H. Although "Paravi" is likely to contribute to net sales, its profit contribution is unclear at this stage because a detailed review of the integration effect has not been completed.

The store services business forecasts the same number of contracts YoY by maintaining the customer base of the music distribution service for commercial stores. It also looks for a steady increase in store DX product contracts such as POS cash registers, catering service robots, and digital signage. The Company forecasts lower profit, however, due to increases in depreciation on DX equipment and personnel expenses to strengthen the service structure, and a decline in the number of music distribution contracts with individuals. We think the forecast for the store services business is conservative because store DX product contracts have recently shown a steady rise, and profit was up in 2Q despite booking a one-time allowance for bad debt.

The Communications business targets sales and profit growth by a shift from one-time revenue to recurring revenue. Flat operating profit is forecast for ICT for corporate customers despite sales being on an upward trend due to cost increases associated with yen depreciation and growing head count. The Company expects a modest rise in sales and profits for agency operations, but higher sales and profits for its own optical line service for commercial stores driven by a steady rise in the number of contracts. Sales continue to turn down for services for individuals, but profit is expected to be flat as a result of the MVNO business turning profitable. Trends so far are in line with the Company forecast.

The business systems business looks for higher sales and profits on expectations of business confidence improving in the travel, accommodation, and entertainment businesses in the transition to living with COVID-19. General hotels expect an increase in actual demand underpinned by travel support policies, but anticipate a reactionary downturn after a boost from Tourism Agency subsidies in FY8/22. A rise in sales and profit is forecast for hospitals and clinics as a result of “Sma-pa Myna Touch” uptake, sales expansion of next-generation reception machines and strengthened cross-selling to clinics. As previously noted, however, there have been many recent factors contributing to earnings undershoot. Earnings are likely to pick up in FY8/24, however, because of the fading impact of the loss of subsidies, a temporary boost in demand to handle new paper currency, last-minute demand for “Sma-pa Myna Touch,” and a recovery in customers’ motivation to invest as the sudden surge in business returns to normal.

The energy business looks for marginal sales growth and sharp profit increase because it is taking positive action to counteract factors causing uncertainty such as high crude oil prices. Lower sales are forecast for “USEN Energy” as customer numbers decline because the Company is no longer taking new high-voltage electricity customers, but it expects a marginal operating profit increase due to improved profitability associated with price hikes and lower sales agency commissions due to a drop in customer count. A significant improvement in profitability and surpassing of the profit-loss breakeven point is forecast for “U-POWER” as a result of a steady rise in the number of contracts, due in part to the popularity of green energy. “U-POWER”’s recent earnings performance has been brisk and far stronger than expected. Although short-term trends are a contributing factor, and thus the robust performance through 2Q may not continue into 2H, we regard “U-POWER” as the main factor underpinning full-year earnings.

Medium-term management plan

Targeting consolidated operating profit of ¥22bn to ¥25bn in FY8/25

1. The medium-term management plan, "Road to 2025"

The Company is aiming to progress store and facility and lifestyle DX by utilizing the management resources it has cultivated in music distribution, such as its customer base, and by further increasing the sophistication of its value creation process. Conversely, it is aiming to increase enterprise value by strengthening the profitability and growth potential of the existing businesses, achieving non-continuous growth by utilizing M&A and other methods, progressing a flexible financial strategy that maintains discipline and achieving stable and continuous shareholder returns. The Company's purpose is to evolve to become "a 'Social DX' company that makes the future closer," and toward achieving this, in February 2022 it formulated the medium-term management plan "Road to 2025."

In the medium-term management plan, in consideration of the changes in the external environment due to incidents such as COVID-19 and the Ukraine situation, the targets are divided into two scenarios, which are a base case of lower-limit targets and an upside case of achievement targets. In both scenarios, the Company is aiming for operating profit to grow by double digits (four-year compound annual growth rate (CAGR), 9.0% to 12.5%) and plans to achieve consolidated operating profit of ¥22bn to ¥25bn in FY8/25. In the case of the Company, the market characteristics and growth potential are different for each segment, so a key point is that it has a strategy for each segment, but basically, they are upgraded strategies from the previous versions.

Numerical targets in the medium-term management plan

(¥bn)

	FY8/21 Results	FY8/25 targets (base case)		FY8/25 targets (upside case)	
		Target	Four-year growth rate	Target	Four-year growth rate
Net sales	208.4	274.0	31.5%	286.0	37.2%
Operating profit	15.6	22.0	41.0%	25.0	60.3%
Operating profit margin	7.5%	8.5%	0.5%	8.7%	1.2%
Profit attributable to owners of parent	8.0	12.0	50.0%	13.5	68.8%
EBITDA	24.4	33.0	35.2%	36.0	47.5%
EBITDA-CAPEX (includes investing and financing, and prepaid contents)	13.8	16.5	12.2%	19.5	41.3%

Source: Prepared by FISCO from the Company's medium-term management plan materials

For operating cash flow, the Company has raised the target from ¥15.7bn at the time the plan was formulated to ¥21bn to ¥24bn in the plan's final fiscal year, which is to be achieved through steady profit growth and a precise financial strategy. As the fourth period total, it will create operating cash flow of more than ¥80bn. The Company plans to invest more than ¥40bn of this in business investment, more than ¥15bn in repaying borrowing, and more than ¥4bn in paying dividends, and it intends to use the remaining amount of more than ¥16bn for growth investment (excluding buffers). The anticipated uses are considered to be for large-scale M&A such as integration with "Paravi" and for uses appropriate as "a 'Social DX' company" in new business development. It is estimated that the development targets will be store, facility, and lifestyle DX, the backup of Japan's productivity improvements, and in related businesses, such as digitalization in the entertainment field, while its policy for M&A is to limit proposals to those peripheral to its existing businesses and not to handle different industries or fields.

As its financial targets, the Company will continue efficient management that utilizes leverage and is targeting improving the equity ratio to 30% to 40% while maintaining ROE at about 20%. In addition, it will continue to reduce the leverage ratio and the D/E ratio and secure sufficient funding capacity at all times. Through this, it should be able to respond flexibly for even greater growth investment. The Company prioritizes sustainability as "a 'Social DX' company" and intends to progress measures to resolve environmental issues and social issues. Among them, it has set four themes as those it will work on as the priority issues: "Contribute to reduction in environmental burden and the creation of a recycling-oriented society" (environment), "Ensure mutual prosperity involving all stakeholders via the creation of a working environment in which everyone can work with enjoyment" (society), "Pursue sound and highly transparent management by constantly updating our approach" (governance), and "Make people happier, help their communities flourish, and strive for a better society via the use of technology" (business), and its policy is to realize sustainable corporate growth and a sustainable society.

The content distribution business and store DX are driving growth

2. Growth strategy by segment

The Company conducts business portfolio management on classifying businesses into the cash cow business, stable-growth businesses, and high-growth businesses, and it has not changed its previous policy of redistributing growth funds from the cash cow business to the high-growth businesses. It classifies the cash cow business as music distribution in the store services business, the stable-growth businesses as the business systems business and the communications business (within which, ICT for corporations), and the high-growth businesses as the content distribution business and store DX (in the store services business, POS cash registers and Wi-Fi, and in the communications business, the Group's own optical lines for commercial stores, etc.)

For the FY8/25 operating profit targets by segment, in the content distribution business, the target is ¥8.2bn to ¥10bn; in the store services business, ¥10.5bn to ¥11bn; in the communications business, ¥6.8bn; in the business systems business, ¥4bn to ¥4.3bn, and in the energy business, ¥0.5bn to ¥1.5bn. It seems the targets for each business have been divided into a base case and an upside case. For Company-wide costs, the profits from the upside case, of the profits exceeding the base case, will be used as the source, and it seems that it will additionally allocate funds to investment to strengthen the Group's growth potential and ability to adapt to its environment, including for human resources development, education, and re-skilling training, and also for corporate branding and to enhance welfare.

(1) Content distribution business

The video distribution market is a growth market in which competition is fierce, so the Company will further strengthen its “coverage strategy” and “ONLY ON strategy” that are the sources of its competitive advantages. In conjunction with this, in music distribution services, it will start its own fully fledged distribution of non-video content, such as deeply related live music and music content, and it will monetize content including by creating videos of popular IP in original e-books, such as manga and novels. For these highly competitive Company contents, which include videos, books, music, and live performances, its policy is to enhance all-in-one entertainment by enabling them to be enjoyed on a single app. As a result, in FY8/25 it is aiming for the number of paid subscribers to reach 3.1mn to 3.5mn (four-year CAGR of 7% to 10%), recurring sales alone of ¥72.3bn to ¥76.7bn (four-year CAGR of around 6%), and operating profit of ¥8.2bn to ¥10bn. It seems that the reason why the difference between the operating profit base case and upside case is larger than that of other businesses is that it is difficult to forecast consumption trends in the with-COVID-19 period and also the pace of expansion of growth markets. Incidentally, the base case assumes that growth will temporarily slow down as a rebound to the nesting demand. Considering the current steady growth of Japan’s content distribution market, which has plenty of room to grow compared to Europe and the United States, and “Paravi,” which was integrated as part of the “coverage strategy,” it is probably already unnecessary to assume the base case.

(2) Store services business

The Company is working on a strategy centered on store DX for which high growth is expected, and it is assumed that music distribution will trend from unchanged YoY to a slight decrease. In terms of what it is focusing on the most, its policy is to continue to provide stores with total work support, from their front work through to their back-office work, by building a communications environment, such as Wi-Fi, and installing smart devices, including POS cash registers. It is also promoting up-sales through a one-stop service by the Group, from sales through to maintenance. Further, by building a partner network of 10,000 companies, it obtains 100,000 items of new business information per year, and it is strengthening highly responsive direct sales for newly opened stores that have a high contract completion rate. For already opened stores, for both existing customers and unacquired customers, it utilizes non-direct sales channels, including agencies and telemarketing, from the viewpoint of sales efficiency. By implementing these measures, the Company intends to increase the number of contracts from 912,000 at the end of FY8/21 to 1.052mn by the end of FY8/25. It also plans to increase the number of billings by POS cash registers, which is a typical smart device, from 21,000 cases to 41,000 cases.

(3) Communications business

In ICT/SaaS for corporations, the Company is focusing on cross sales, including support for security measures that have become more complex and maintenance and operations outsourcing for cloud and data centers as a BCP measure. In digital infrastructure, it is expanding its lineup, while in office environment improvements, it is responding by developing new services. In sales, on the one hand it is creating new potential customers by strengthening digital marketing, while on the other hand it is establishing new sales methods tailored to the times, such as online sales negotiations and inside sales. In optical lines for commercial stores, it is further progressing switching from agency lines to its own highly profitable lines, while at the same time, it is accelerating up-sales of IoT/DX products. Through these efforts, for the FY8/25 results, it is aiming for net sales of ¥25.9bn (four-year CAGR, 9%) and operating profit of ¥4.2bn (7%) for ICT/SaaS for corporations, and net sales of ¥11.7bn (18%) and operating profit of ¥600mn (stably achieve profits) for the Group’s own optical lines for commercial stores.

(4) Business systems business

For its existing customers of hotels and general hospitals, the Company will strengthen DX support based on their needs for non-face-to-face and contactless operations, and for labor saving and improved efficiency. Also, by leveraging facility DX solutions, from a position of simply selling and maintaining automated payment machines, it is aiming to have a presence one stage higher as a visionary partner for its customers. In particular, for hotels, the Company expects a return to Japan's growth strategy of becoming a leading healthcare and tourist destination country through the recovery of inbound demand. For small clinics, dentists, dispensing pharmacies, and other establishments, from "Sma-pa Myna Touch" as the starting point, it will dig deeply to develop markets, including by enhancing cross-sale products and services. Conversely, for adjacent markets, including golf courses, retailers, restaurants, pet clinics, and tourist facilities, it will progress developments of products that incorporate the latest technologies, such as AI, biometric authentication (face authentication), and cashless and post-payment payments. Through these efforts, in FY8/25 it is targeting net sales of ¥13.1bn for hotels (four-year CAGR of 3%), ¥7.5bn for general hospitals (10%), and ¥4.4bn for adjacent markets (19%).

(5) Energy business

The Company plans to strengthen "U-POWER" that it launched in March 2022. It is a profitable service because the Company procures its own electricity. It aims for a sharp increase in the "U-POWER" customer count from 41,000 to 62,000 (versus zero in FY8/21) by making the highly competitive green energy compatible with the SDGs into a growth driver.

Towards progress for the medium-term management plan upside case

3. Progress of the medium-term management plan

Conditions have been more challenging than expected for the business systems business, but the mainstay content distribution and store DX businesses performed solidly. The energy business has been brisk contrary to the Company's expectations, and business conditions have been solid overall with the recent sharp yen depreciation beginning to reverse. The effects of the Company's previous strategies in the content distribution business will likely continue to materialize. Cost synergies from the integration of "Paravi" are expected to emerge in FY8/24 as well as synergies from integration in the medium term. Store services had some cancellations from closed stores, but trends appear to have stabilized recently. Focus businesses are growing steadily in the communications business, while the energy business is expected to continue its robust performance. Earnings will likely slow for the business systems business in FY8/23 before rebounding in FY8/24 thanks to increased movement of people following the end of COVID-19 restrictions and recovery of foreign visitors to Japan, and the labor shortage. It will likely maintain stable growth from FY8/24 onward. From the foregoing, of the two scenarios, we expect progress of the medium-term management plan to continue to track the upside case.

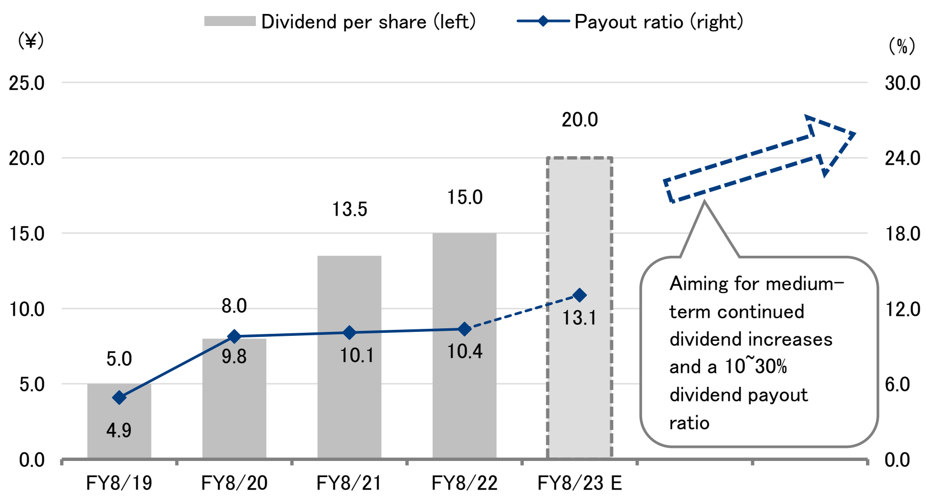
Shareholder return policy

Plans to increase annual dividend and payout ratio

1. Dividend policy

With regard to dividends, the Company has a fundamental policy of allocating surplus funds once a year at period end based on results assessed comprehensively in terms of the financial position, profit situation, new investment plans, and other factors. The general meeting of shareholders is the decision-making body for the payment of dividends from retained earnings. The Company views return of earnings to shareholders as a key corporate policy, and plans to raise the payout ratio from 10% to 30% in the medium term by continuing to increase dividends. Based on this policy, the Company revised up its FY8/23 dividend forecast from ¥18 per share (¥9.0 interim, ¥9.0 period-end) to ¥20 per share (¥10.0 interim, ¥10.0 period-end) and forecasts a payout ratio of 13.1%, up from 10.4% in FY8/22.

Trends in dividend per share and payout ratio



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

In the shareholder benefit program, the "Premium Benefit Club" ended. "U-NEXT" content distribution service will continue

2. Shareholder benefit program

The Company offers a shareholder benefit program to show appreciation to shareholders for their support, deepen shareholders' understanding of business content by using Group services, and encourage long-term ownership. Specifically, for the "U-NEXT" content distribution service, shareholders with holdings of 100 shares to 999 shares receive 90 days of free service use along with ¥1,000 worth of points, and shareholders whose holdings amount to 1,000 shares or more receive one year of free service use and ¥1,800 worth of points each month. The Company ended the provision of the "Premium Benefit Club," which is one of its shareholder benefits programs, on the last day of February 2023, and in the future it intends to reward shareholders mainly by increasing dividends. The Company plans to maintain the "U-NEXT" shareholder benefits program, which is effective for attracting individual investors.

Information security

Striving to reduce security risk for the Group as a whole

The Company is strengthening personal information protection capabilities and continues to implement educational programs. However, it cannot give a guarantee of complete protection and there is always risk of personal information leaks due to improper access from an external source, system trouble, insider crime, human mistakes, and management mistakes at outsourcing and service provision partners. Given these challenges, the Company manages the information system at a data center, employs a firewall, and continually assesses vulnerability in web applications as a more proactive information security effort. The Company allocates notebook PCs and smartphones to individuals as part of work-style reforms. It uses notebook PCs installed with a security chip (TPM), while its smartphones use mobile device management (MDM). Moreover, in order to provide services that can be used safely and securely, the Group as a whole is reducing security risk by establishing "Usirt," centered on the Company, and implementing external audits in a planned manner.

FISCO

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