COMPANY RESEARCH AND ANALYSIS REPORT

USEN-NEXT HOLDINGS Co., Ltd.

9418

Tokyo Stock Exchange First Section

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Summary

Increasing sales and profits by leveraging group customer assets mainly from music distribution business and diverse sales channel synergies

USEN-NEXT HOLDINGS Co., Ltd. <9418> (referred to below as “the Company”) is a holding company inaugurated through a merger of U-NEXT Co., Ltd. <9418> (surviving company) and USEN Co., Ltd. <former 4842> in December 2017. It operates with six segments, including content platform business that supplies video distribution service to individuals, the founding music distribution business that distributes background music (BGM) to restaurants and other stores, broadband service, and store and facility operation assistance tools and solution services.

Main subsidiaries are USEN, which operates a music distribution service, U-NEXT, which provides a flat-rate video distribution service, and ALMEX INC., which sells commercial equipment and systems. The Company’s 12 other subsidiaries and group companies cover various businesses, including areas peripheral to the main subsidiaries. USEN’s founding business began in 1961 and subsequently built a wired broadcast network that extended throughout Japan.

Since the IT revolution at the end of the 20th century, USEN promoted broadband service and digitalization of video distribution and other services. In 2009, it founded U-NEXT as an independent entity (from USEN) to expand broadband and video distribution services. However, it decided to reintegrate operations in order to take further advantage of strengths as a group company, including the customer base and sales channels held by the two companies, in December 2017.

Financial Results in FY12/17 were ¥114,291mn in net sales (+149.3% YoY) and ¥5,867mn in operating income (vs. a ¥396mn operating loss in the previous year). One-time costs for the merger and bolstering sales promotions in the content platform business weighed modestly on results. In FY8/18, the Company targets ¥108,000mn in net sales and ¥5,500mn in operating income. This outlook includes one-time costs from moving the headquarters and other activities and works out to double-digit profit growth on a real basis.*

* Due to the merger and fiscal-period change, FY12/17 covers nine months of income from former USEN group companies (Mar-Nov) and FY8/18 covers eight months from former U-NEXT group companies (Jan-Aug) and nine months from former USEN group companies (Dec-Aug).

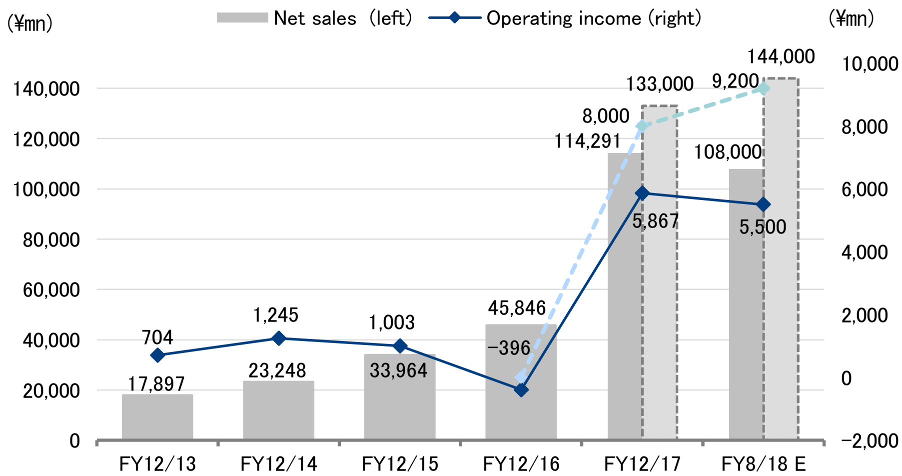
Content platform business is currently in a growth phase and needs funds for content procurement and sales promotions. Store operation solutions business relies on overall group capabilities. Through the merger, the Company wants to promote growth by applying stable strong income from music distribution business to high-growth businesses and raise profitability through synergies driven by group company strengths, such as customer assets and sales channels.

We think markets for the Company's other businesses besides store music distribution and business systems are generally "red ocean" areas. However, they can be largely divided into markets with growing frontiers, such as video distribution, and markets with rough waves, such as Internet line agent sales and MVNO service. Furthermore, while store music distribution and business systems are "blue ocean" areas, new trends are emerging with the arrival of new business operators accompanying Internet and other technology reforms for the former and reinforcement of businesses by major manufacturers in the latter. Given this environment, we believe the merger is well timed to reinforce strengths, cover weaknesses, broaden opportunities, and address threats. For video distribution, music distribution to stores, and other businesses where it has strengths and growth opportunities, we think the Company is capable of succeeding against massive foreign-capital firms mainly relying on capital resources and other competitors by leveraging market expansion and integration synergies.

Key Points

- U-NEXT and USEN combined businesses and formed a holding company in December 2017; this effort aims to make effective use of group assets and knowledges
- Seeking to utilize high income in music distribution (founding business) and the group customer base and sales channels to drive growth in video distribution and store operation solutions
- Faces one-time costs from moving the headquarters and other activities; though expects double-digit growth in operating income on a real basis in FY8/18

Results trends



* Pre-merger U-NEXT values prior to FY12/16; dotted line shows 12-month converted estimates
Source: Prepared by FISCO from the Company's financial results

Company profile

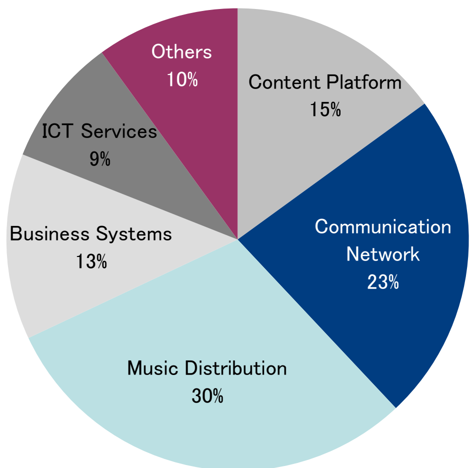
Diversification from the founding business of “music distribution” now a holding company

1. Company profile

The Company utilizes a holding-company format and provides music distribution service (founding business), flat-rate video distribution service, broadband service, and store and facility assistance tools and solutions via subsidiaries. Business segments are “content platform,” which delivers personal digital content distribution services, “communication network,” which handles agent sales of Internet services and other services from communication carriers, personal mobile communication services, and fixed broadband line service, “music distribution,” which mainly supplies BGM service for restaurants and other stores, “business systems,” which supplies automated payment machines and operation management systems to medical entities, hotels, and other businesses, “ICT,” which provides office communication lines, and “others,” which covers new businesses.

Main subsidiaries are music distribution service operator USEN, flat-rate video distribution service operator U-NEXT, and business systems firm ALMEX. USEN primarily supplies “USEN440” and other paid music broadcasts to stores and is the overwhelming leader in the paid music broadcast market. It also handles ordinary home music distribution service “music AirBee!” and satellite ordinary broadcast “SOUND PLANET” over a communications satellite. U-NEXT runs a video distribution service that supplies multiple device types (set-top-boxes, PCs, TVs, and mobile handsets). It is rapidly growing with help from content advantages. ALMEX supplies automated payment machines, management systems, and other total solutions to medical institutions, leisure and business hotels, and other facilities and holds a top share for automated payment machines in this market. Other subsidiaries run a variety of businesses, including peripheral areas for major subsidiaries.

Percentage of net sales in FY12/17



* Former USEN’s business segments converted to 12 months
Source: Prepared by FISCO from the Company’s financial results

Promoted digitalization with music distribution business at the core

2. History

Mototada Uno founded USEN in 1961 as Osaka Yusen Broadcasting and later built a wired broadcast network nationwide. When Yasuhide Uno took over as President in 1998, he promoted digitalization focused on music distribution business and pursued a wider range of businesses, including broadband service using the Company's infrastructure, video distribution, electronic books, and other content provision service, and store assistance service. U's Broad Communications (now, U-NEXT), which was established in February 2009 as a spin-off from U's Marketing, a USEN subsidiary, rolled out broadband business and absorbed TV paid video distribution service ("U-NEXT") and sales agent business for personal optical lines and other communication lines through a corporate split-off from USEN in December 2010. The Company decided to reintegrate USEN and U-NEXT in order to more effectively leverage the strengths, such as customer base and sales channels, of both companies in December 2017.

History

Date	Event
June 1961	Mototada Uno began two-channel wired music broadcasts on 2P cable as Osaka Wired Broadcasting
October 1987	Started multi 440 channel stereo wired music broadcasts
July 1998	Yasuhide Uno became Representative Director and President
April 2000	Changed the company name to USEN Broad Networks Co., Ltd. and moved the headquarters to Nagatacho, Chiyoda ward (Tokyo)
March 2001	Began optical fiber broadband service in portions of Tokyo's Setagaya and Shibuya wards
April 2001	USEN listed shares on the OSE (Osaka Securities Exchange) Nasdaq Japan Market (now, the TSE (Tokyo Securities Exchange) JASDAQ market)
October 2006	Acquired ALEMX INC. as a wholly-owned subsidiary through an exchange of shares
October 2006	Acquired Gaga Communications Corporation (now, GAGA CORPORATION) as a wholly-owned subsidiary through an exchange of shares
June 2007	Began GyaO NEXT (now, U-NEXT), a video distribution service for TVs
April 2009	Transferred 51% of outstanding shares of GyaO Corporation to Yahoo Japan Corporation
July 2009	Transferred all shares of Gaga Communications (now, GAGA) to T.Y. Limited, Inc. and KINOSHITA MANAGEMENT CO., LTD.
December 2010	U-NEXT; separated the "U-NEXT business and personal optical line and other sales agent business" from USEN using an absorption-type split
July 2012	Changed the gourmet information site brand to Hitosara
August 2012	U-NEXT started multi-device video distribution service
July 2013	USEN listed shares on the TSE JASDAQ market due to the TSE and OSE market merger
September 2013	U-NEXT began sales of "U-mobile * d," an LTE mobile data communication service under its own brand
December 2013	Began provision of "USEN on Smartphone" flat-rate music distribution service for smartphones (now, SMART USEN)
April 2014	U-NEXT started "BookPlace for U-NEXT," a membership e-bookstore
October 2014	Opened U-NEXT Store, a store to test and purchase U-NEXT and U-mobile service and low-cost smartphones, in Minami Aoyama
December 2014	U-NEXT listed shares on the TSE Mothers Market
February 2015	U-NEXT began operating "Anime Unlimited" service provided by SoftBank Mobile Corp. and SoftBank Corp.
July 2015	Began provision of OTORAKU, a store BGM distribution service, through collaboration with RecoChoku Co., Ltd.
October 2015	Implemented a major overhaul of the U-NEXT service site
November 2015	USEN's consolidated subsidiary ALMEX formed a capital and business alliance with Unirobot Corporation
November 2015	USEN reached a fundamental agreement on a business alliance with Tokyo Electric Power Company
December 2015	U-NEXT changed its listing to the first section of TSE
July 2017	Extraordinary general shareholder meetings for the two companies approved the final contract on the merger
December 2017	Changed the company name to USEN-NEXT HOLDINGS Co., Ltd. through the merger of U-NEXT and USEN

Source: Prepared by FISCO from the Company's website

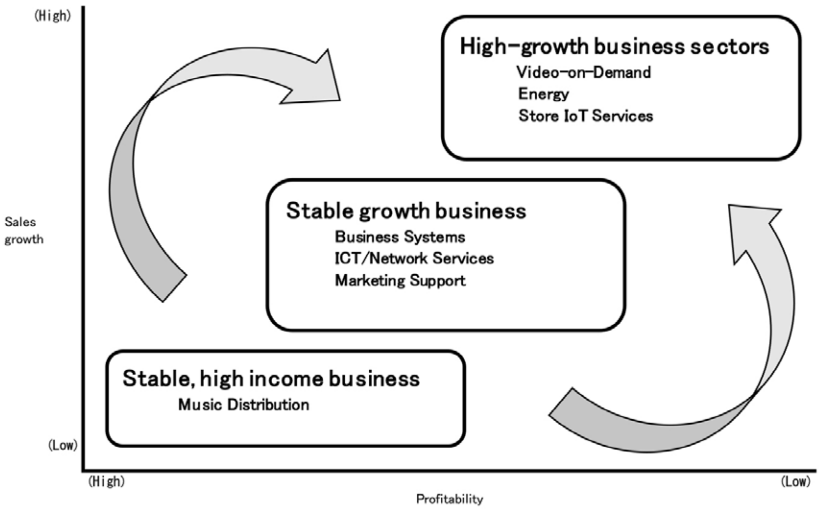
U-NEXT x USEN = USEN-NEXT HOLDINGS

3. Merger and creation of a holding company

The Company was formed after a merger of U-NEXT and USEN on December 1, 2017. The integration aims to create group synergies from cross-selling mainstay products of group companies by mutually utilizing their strengths, including music and video contents, network infrastructure, and customer base, at a higher level and collaborating in their respective sales channels. It also targets realization of dynamic growth strategies as a new corporate group capable of dealing with IoT, AI, and other next-generation technologies. Furthermore, it seeks to improve operational cost efficiency via consolidation of overlapping costs at group companies.

From a standpoint of growth potential, the Company sees music distribution as a stable strong income business, business systems, ICT/communications, and marketing support as stable growth businesses, and video distribution, energy, and store IoT as high growth businesses. Another key goal of the integration is application of cash obtained in the stable strong income business to high growth businesses. For example, the Company hopes to actively apply telemarketing and agents, in addition to conventional direct sales, to its extensive customer assets in music distribution service, while also strengthening sales of communications lines and store solutions to boost sales per customer.

Group's focus theme



Source: Prepared by FISCO from interviews

Business overview

As a holding company, the Company consists of 13 consolidated subsidiaries and two equity-method affiliate companies. Subsidiaries have their own functions and roles within the group and comprise business segments in an overlapping manner.

Group businesses and subsidiaries

Businesses	Subsidiaries	Role
Content Platform	U-NEXT	Video distribution service for individual and content platform operation and sales
	U-NEXT MARKETING	Sales of video distribution service
Communication Network	U-NEXT	Provision and sales of personal MVNO service and fixed broadband line service
	USEN NETWORKS	Agent sales of communication lines, etc.
	USEN-NEXT LIVING PARTNERS	Agent sales of communication lines, etc.
	U-NEXT Marketing	Call center and AI business
	Next Innovation	Agent sales of communication lines, etc.
	Y.U-mobile	Provision and sales of MVNO service for individual
	U-MX	Agent sales of communication lines, etc.
	D.U-NET (Equity-method affiliate)	Provision and sales of condominium communication lines
	minimini-NEXT (Equity-method affiliate)	Agent sales of communication lines, etc.
Music Distribution	USEN	Operation and sales of wired broadcasts and digital music broadcasts and sales of store system solutions
Business Systems	ALMEX	Development, production, and sales of hotel, hospital, and golf course automated settlement systems, etc.
ICT Services	USEN ICT Solutions	Corporate line sales
Others	USEN	Energy business
	USEN Media	Customer recruitment assistance business
	U'S MUSIC	Management and development of music copyrights
	USEN Techno-Service	Electrical and communication facility installation consignments, and various equipment and information & communication terminal refurbishing and kitting

Source: Prepared by FISCO from the Company's securities report

New/existing content line-ups and quality and service driving growth by the group

1. Content platform business

Content platform business operates video distribution (video-on-demand; VOD) service "U-NEXT". The U-NEXT service charges a monthly fee to individuals for viewing access by television (either through a set-top box connection or Internet connection), PC, smartphone, tablet, or other devices of video content (movies shown at theaters and dramas, animated programs and variety programs aired on televisions), electronic book content (novels, comics, magazines, photograph collections, and others), and music content (Japanese music, Western music, classical music, enka songs, and others). It offers unlimited viewing of mainly older content and pay-per-view access to quasi-new and new works.

Leader companies in the flat-rate video distribution market are dTV, Hulu, the Company (U-NEXT), Amazon (Prime Video), and Netflix. Services include dTV, which is operated by NTT DOCOMO INC. <9437>, with access to more than 120,000 content items at a fee of ¥500 per month (tax-excluded price; same below), Hulu, a subsidiary of Nippon Television Holdings Inc. <9404>, with over 40,000 items at a fee of ¥933, Prime Video, which is run by massive US-based Amazon <AMZN> with over 32,000 items at a fee of ¥370 (plus the ¥3,611 Prime annual members fee), and US-based Netflix <NFLX>, with 30,000 items at fees of ¥650, ¥950,and ¥1,450 per month depending on image quality. Amazon Prime and Netflix stand out in proprietary overseas content, dTV has many short content items for smartphones with less attractive quality, and Hulu carries many overseas dramas and domestic TV programs. In recent years, dTV and Hulu have lost momentum, while Amazon Prime Video and Netflix appear to be growing thanks to sales promotions leveraging their capital resources.

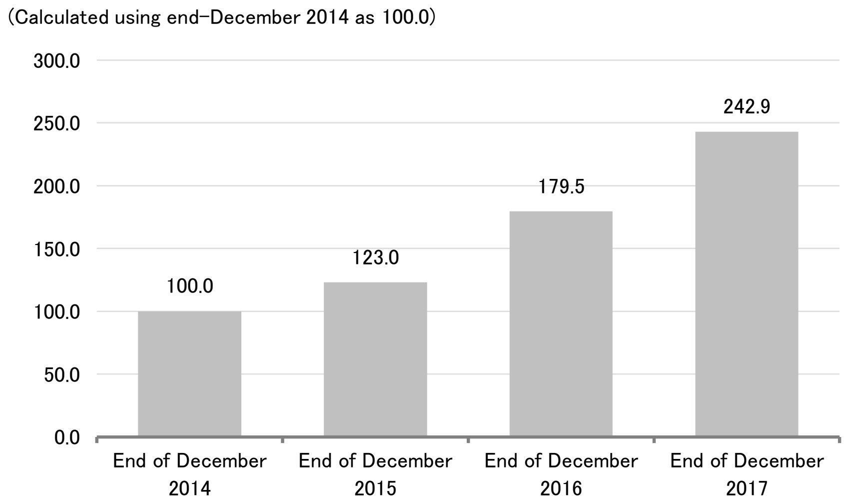
The Company, meanwhile, charges ¥1,990 per month. While this may seem expensive at first glance, its service is achieving rapid growth in the market. The main reason is an advantage in content. Users have unlimited access to more than 65,000 content items, such as movies and TV programs and can select from over 45,000 rental items. Though a fee is charged, there is also a robust line-up of the latest works that have just been released or aired. The service allocates 1,200 points on the 1st of each month, thereby enabling effectively free access to the latest pay items within the point range. It is also the only major service that carries adult content. The overwhelming victory by TSUTAYA Co., Ltd. over US-based major Blockbuster LLC, which entered Japan, during the growth years in rental videos, highlights the importance of adult content in expanding content demand.

The Company also has an extensive line-up of animated programs and Korean drama shows and is making inroads with “geeks” and women. It offers family-oriented major content from Disney and others too and includes a service for unlimited reading of 70 or more magazines. Points mentioned earlier can be used to purchase books and comics and receive discounts on movie tickets. Family accounts allow for simultaneous viewing by up to four people, and the privacy of each viewer is protected by security. This effectively works out to about ¥500 per month per individual viewer, a relatively cheap price. We think the Company is best positioned to serve as a replacement for rental videos.

The main issue is capital resources. While this is not the absolute only factor that determines success in video distribution business, content procurement and sales promotions require a certain amount of funds. US-funded companies have leveraged capital resources to recruit customers, despite mixed reviews since much of their content is not geared to Japanese people. Amazon Prime Video could be called essentially free due to its inclusion as a benefit of Amazon Prime membership. Netflix invests heavily in its own content. These two companies frequently run high-priced TV commercials. Given these conditions, the Company has been steadily adding users each month by utilizing sales via the Internet, at agents, and at movie theater booths and listing and affiliate advertisements and promoting its advantage in contents.

The Company stands out in business initiatives by building alliances with a variety of companies. It works with companies that have large customer base in communications, distribution, and real estate industries, including Yamada Denki Co., LTD. <9831> and TSUTAYA, through provision of service in an OEM format. Other services include “Anime Unlimited,” an animated program app promoted with SoftBank Inc. <9984>, and video distribution services available for registration by fan-club members only, such as EXILE TRIBE FAMILY. U-NEXT subscriber volume hence has risen 2.4-fold over three years and increased 35% YoY in 2017. Business scope is expanding at a healthy pace with acquisitions at a pace of 120,000 subscribers in half a year. Flat-rate video distribution service reportedly had a market size of just over ¥160bn in 2016 (+16% YoY) and the Company holds a No.3 share at 16%. This is a high-growth mainstay business for the Company.

Growth rate in U-NEXT subscribers



Source: Prepared by FISCO from the Company's website

Digital communication is an important business resource for efforts to expand the customer base and strengthen cross-selling activities

2. Communication network business

Communication network business handles Internet-line sales agent service, MVNO (lower-cost smartphone sales) service "U-mobile", personal fixed broadband line service "U-NEXT Hikari", and condominium fixed broadband line service "U-NEXT Hikari 01". Sales agent service mainly promoted sales of FLETS optical lines from NTT East Corporation and NTT West Corporation and received sales commissions based on the number of lines sold. The Company utilized this income to expand the distributor network nationwide. However, sales of FLETS lines have been declining since NTT East and NTT West began wholesale provision of optical access service as the "optical collaboration model" in February 2015. The Company hence began selling U-NEXT Hikari, which is the optical collaboration model.

U-Mobile, an MVNO service, uses communication lines from NTT DOCOMO and SoftBank and sells lower-priced smartphones and SIM cards to individual customers. It sets monthly usage fees at a cheaper level than the services supplied by existing major mobile phone companies and mainly sells service through electronics resellers and over the Internet. While this has been a highly lucrative business in past years, environments have significantly changed for both line service and MVNO service to the point of requiring special actions due to system revisions, initiatives by large carriers, and increase in competitors. Nevertheless, this business is an important resource for the Company with its aims of expanding the customer base and strengthening cross-selling activities.

Targeting transformation from stable income to high growth business through effective utilization of a robust customer base

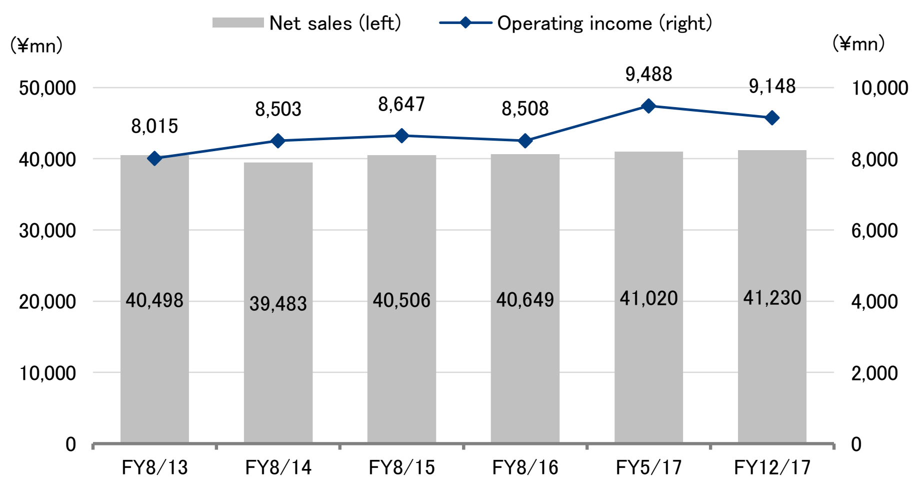
3. Music distribution business

Music distribution operates the USEN service for broadcasting music and information to stores, offices, and homes nationwide. The Company has properly handled copyright procedures for all of the music it supplies. Users rent service tuners from the Company, and the tuners utilize dedicated coaxial cable, communications satellite, or Internet line infrastructure as appropriate for the tuner installation environment. Stores comprise the vast majority of customers with particularly high ratios for restaurants, retailers, beauty salons and barbers, and hospitals. Chain store users range from national chains to chains focused on local areas. This business handles more than just music broadcast service and also supports store operations on a one-stop basis with coverage from opening assistance to building the business environment and sales promotions (store operation solutions business).

(1) Music distribution business

This business has a strong customer base of more than 600,000 users and generates steady sales. The Company holds an overwhelming share of about 80% in store and facility BGM. Profitability is high too, and this business generates cash that supports the group strategy. It is a “stable high income” business. Key attributes underpinning the robust customer base are more than 500 channels and excellent quality. The service offers specialty channels, such as J-POP, Western music, jazz, relaxing music, and classical music, as well as channels that support song requests and meets the music needs of all store environments. Furthermore, sound quality applies optimal acoustic pressure adjustment for use as BGM to all broadcast songs. The Company has extensive support operations with 150 branches nationwide, 700 salespeople, and 700 engineers. This gives it the ability to cover services from installations to aftercare. We think the deep-rooted popularity of this service makes sense with its robust music line-up, quality, and support capabilities and provision of CD players and other hardware, monthly software purchase costs, software renewals and song selection, and time-consuming copyright processing at a monthly fee of ¥4,000-5,000.

Results in the music distribution business



* FY5/17 values converted to 12 months based on nine-month results from September 2016
FY12/17 values converted to 12 months based on nine-month results from March 2017
Source: Prepared by FISCO from the Company’s financial results

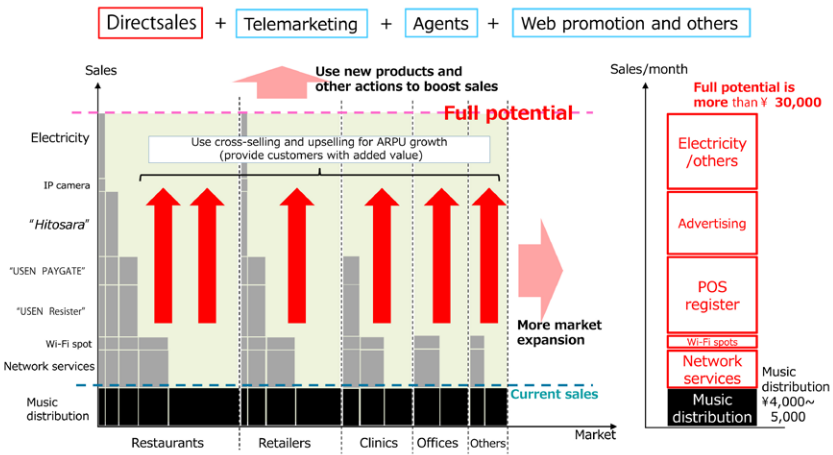
Besides ordinary music distribution, this business also covers office BGM that is refreshing and relaxing and lets people know when office hours are ending, customized broadcasts that address the unique needs of chain operators, and alliances with overseas BGM companies, and personal and home music distribution service. Additionally, it offers “OTORAKU” service with trouble-free installation. This is a BGM app for making customized BGM that can be used at stores. The app naturally covers major domestic music labels and even extends to overseas independents, distributing a rich genre of songs from pops to easy listening. While it requires IT literacy to utilize a tablet, the app facilitates customization of a BGM playlist suited to the store environment and many playlists prepared by BGM professionals that cover from staple songs to seasonal choices and popular rankings.

It is estimated that just under two million stores and other commercial sites use BGM in a market with three million sites and more than half of these sites have not dealt with copyright issues. Amid growing global awareness of intellectual property, the Japanese Society for Rights of Authors, Composers and Publishers (JASRAC) has adopted a more rigorous stance toward stores that have not complied with procedures and is taking actions against more locations. The Company promotes awareness to non-compliant stores along with JASRAC, and these activities are boosting recognition of improper use and the need for compliance with copyright procedures at stores. If this trend continues, non-compliant stores might offer opportunities as new customers in the future. We think this business has growth potential given this situation.

(2) Store operation solutions

Music distribution business is not only and important income base for the group, but also provides a large customer base. These customers currently have stronger needs for store operation solutions than music distribution. Many stores are self-run standalone sites or smaller chains. The Company is also dealing with customers that lack the scale benefits of national chains. Information technology has advanced significantly in retail and service industries in recent years. This trend has raised the hurdle of what smaller and very-small stores need to address even higher. As a solution, the Company provides service with one-stop delivery of cutting-edge equipment and systems that cannot be easily deployed by smaller and very-small stores. The popularity of this service is growing. This service is a way for the Company to improve customer satisfaction and raise average customer spending because it involves one-stop supply of products and services. Store operation solutions business hence is positioned as a “high growth area.” A key purpose of the merger is supporting one-stop provision of group business resources, including products, services, and site assistance, to the customer base.

Effective Use of the Group’s Customer Assets (Reused)



Source: From the Company’s results briefing materials

A tablet POS register and ordering system which uses handy devices are particularly popular within these solutions. Key attributes driving this appeal are multi-functionality that allows for automated sales compilation, analysis, and management, low cost, iPad-enabled operability with a stylish design and intuitive features, and 365-day support through 150 locations. The Company has a broad range of other service content as well, such as setting-up reservation and payment systems and total arrangement and installation of infrastructure and equipment for opening businesses and stores. Furthermore, it delivers solutions tailored to store formats and usage methods, such as "USEN Register for Beauty" (tablet POS register for beauty salons).

Store operation solution services

Service	Service content
USEN Denki, energy conservation products	Energy consulting service for stores
USEN Register	Multi-function, low-priced tablet POS register
Store Assurance Insurance for Food Business	Casualty insurance that covers store risks
UPLink	Store official app creation service
REACH STOCK	App that connects producers and restaurants
Hitosara	Foodie Site Showing Chef's Portraits
USEN Time Recorder	Cloud-based employee time recorder and shift management
d magazine for Biz	Corporate e-magazine unlimited reading plan
SAVOR JAPAN	Gourmet site that introduces Japanese chefs to the world
OTORAKU	iPad app for easy development of store BGM
USEN Economy Interpretation	Telephone call interpretation service in five languages
canaeru	Content provision for stages of store management
USEN PAYGATE	Credit card settlement device
THE PREMIUM RESERVATION	Gourmet site making reservations at carefully selected restaurants
Business opening capital and store introduction service	Introduces trustworthy partners for opening capital and store transactions
USEN Reservation	Low-priced Web reservation system with advanced functions
USEN SPOT	Builds free Internet environments (unrestricted by carriers or handsets)
Systems for restaurant and store	Total solution for restaurant
IP camera	IP camera service for location checks on a smartphone or tablet

* The Company has many store operation solutions besides the ones mentioned above.
Source: Prepared by FISCO from the Company's website

(3) Planned acquisition of CANSYSTEM (music distribution industry environment)

The Company announced in January 2018 that it plans to conclude a final contract and acquire CANSYSTEM Co., Ltd., the No.2 player in the store music distribution industry, as a wholly-owned subsidiary by the end of July 2018, premised on gaining approval from the Japan Fair Trade Commission. This move aims to enhance group value through broader sales expansion efforts in store operation solution services carried out jointly by the two companies since their capital and business alliance in 2015 and through development of new products and new services by sharing accumulated knowledge and knowhow from their respective provision of services to the store market for over 50 years.

Robust ALMEX holds unique positions in the group and industry

4. Business systems

Subsidiary ALMEX handles business systems, the third major business area. It supplies automated payment machines and operation management systems to business hotels, city hotels, and leisure hotels, automated payment machines and patient acceptance machines to comprehensive hospitals and other medical institutions, and automated payment machines and check-in machines to golf courses. As a fabless manufacturer, it handles system development, sales, and maintenance. It also sells ordering terminals and operating systems to restaurants. ALMEX has a unique slogan of “delivering techno-hospitality (technology x hospitality) to the world” and promotes a concept of providing hospitality to the customers of facilities installing its equipment through supply of products and services that leverage IT and other cutting-edge technologies.

While “automated payment machines” might seem to be a market segment dominated by large electric equipment manufacturers, ALMEX holds very high shares in Japan at 85% for leisure hotels, 65% for business hotels, 65% for large medical institutions, and 70% for golf courses. The reason for this strong presence goes back to very high demand for automated payment machines in Japan’s economic bubble period of 30 years ago in the leisure hotel industry, which confronted labor shortages and also tried to accommodate customer preference to avoid face-to-face contact. In this environment, ALMEX aggressively pursued sales as a specialty firm and supplied systems that combined unique ideas, such as karaoke service, and existing technologies, and were customized for individual leisure hotels. It obtained current high market shares by broadening target market scope with horizontal application of knowledge and knowhow. ALMEX’s core strength is accumulated knowhow for automated payment machines and related reception activities in a variety of markets. Furthermore, it achieves stable income with limited volatility due to equipment replacement demand periodically at existing customer locations related to renovations and other factors and running income from maintenance and other services at just under 50% of sales.

Labor savings is already needed nationwide and in all industries because of the prospect of decline in Japan’s future working population. Business hotels, in particular, are likely to be a growing market because of construction pick-up ahead of the Tokyo Olympics and Paralympics. Furthermore, with the aim of capitalizing on growth opportunities from inbound and outbound business, ALMEX is promoting multi-lingual support in existing products and services, operating a leisure hotel site for foreigners visiting Japan, and developing the Southeast Asian market through a local entity established in Kuala Lumpur (Malaysia) in 2014. Given these trends, the Company views business systems as a “stable growth” area and is striving to expand this business.

ICT and others businesses supporting store operation business

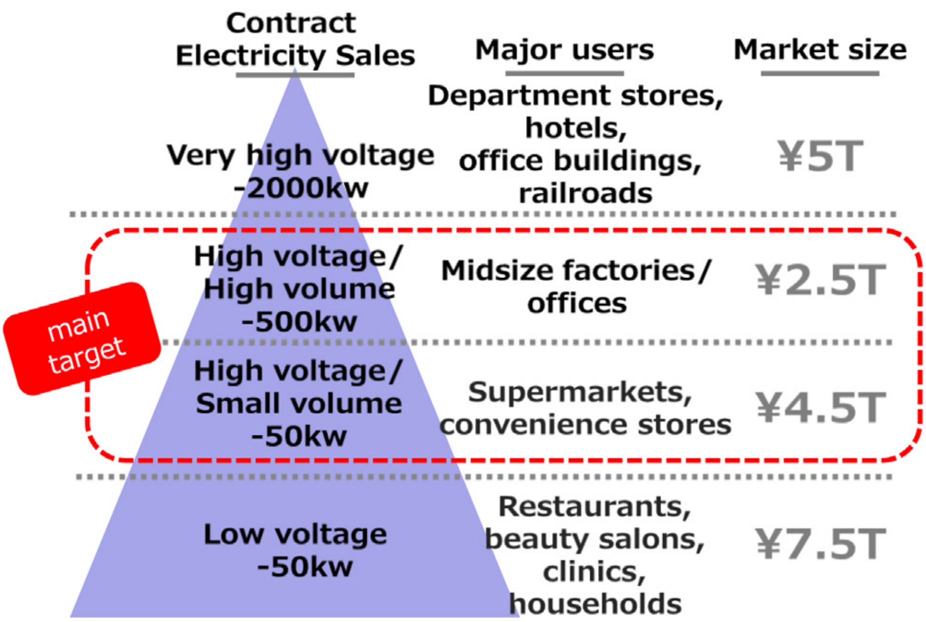
5. ICT business, others business

The ICT business handles sales of ICT services, including “USEN GATE 02” Internet line, dedicated line, and other corporate network service, Google, Cybozu Inc. <4776>, and other cloud services, data communications and MDM mobile services, and data services. The Company was the first provider worldwide to offer Internet connection service from optical fiber and has provided services to more than 40,000 companies in the constantly changing and advancing ICT industry. We think breadth of the service line-up is an important strength in this business. With its ability to combine services to meet customer needs, the Company offers an integrated contact point for the network environment to customers. This removes the need to interact with multiple vendors and is useful in BCP strategy. Line services provided by the Company deliver quality on par with leased lines from a cost-effect perspective. Furthermore, the multi-vendor strategy contributes to better customer satisfaction and higher satisfaction as partner companies supplying services. The Company has received awards from Internet Initiative Japan Inc. <3774>, Cybozu Inc. <4776>, and others.

Changes in the ICT industry are accelerating with all things connecting to the Internet, shift in product purchases from ownership to usage aims, and growth in the sharing economy and services consumption. Additionally, amid changes in lifestyle linked to working style reforms, technology is becoming increasingly vital in various scenes given the need to sustain and improve labor productivity and the appearance of new technologies, such as clouds, AI, VR, and 5G. USEN ICT Solutions spun off from USEN as an independent entity in December 2017 in order to effectively address these changes.

The Company’s others business currently supplies tools for store operation solutions, rather than being standalone businesses (this applies to ICT business too). Marketing support business operates “Hitosara”, a marketing support service for restaurants. Hitosara is an information site that covers gourmet restaurants. It focuses on chefs (Hito) and meals (Sara) and seeks to offer new appeals for restaurants. By narrowing scope to relatively high-end restaurants, the Company differentiates this site from competitors, such as Hot Pepper Gourmet and Gurunavi. Hitosara has established a certain market position and grown to more than 20mn UUs per month. As a Tabelog agent, it proposes efficient marketing support using media mix. Other sites include “SAVOR JAPAN”, a multi-lingual version of the Hitosara gourmet site that targets foreigners visiting Japan as an inbound strategy with English, simplified Chinese, traditional Chinese, and Korean support, and the “WeColle” wedding media that targets women who are beginning to think about getting married with a four-pronged strategy (free magazine, Internet, events, and salon). The Company also wants to expand its user base globally, particularly in Asia, in addition to Japan as a growth strategy and intends to present its content on not only the Internet, but also in events, books, and other media. In energy business, the Company has a business alliance with Tokyo Electric Power Company Holdings, Inc. <9501> to handle wholesale and sales agent activities for high-voltage and low-voltage electricity to stores and other customers. While it only launched the business in September 2016, contract volume has been steadily growing and the Company hopes to generate profits by summer 2020. The Company sees the energy business as a “high growth” area that offers a hook for cross-selling of store operation solutions and other services.

Target market for energy business



Source: From the Company's results briefing materials

Financial Results trends

Segment income trends clarify the motivation for merging operations

1. Segment growth potential and profitability

Looking at income trends by business segment, U-NEXT's content platform business and communication network business respectively had one-time profit dips in FY12/17 and FY12/16, but are generally achieving strong sales and profit growth. Operating margins, however, are low. USEN's music distribution, business systems, and ICT businesses, meanwhile, have robust operating incomes and margins. In particular, music distribution business has operating margin in the 20% range. The issue is weak growth potential. The Company sees growth opportunities in content platform business and store operation solutions (which is part of music distribution business). While content platform business is growing quickly, it requires capital to procure content. Store operation solutions business is an area premised on the group's overall capabilities. These trends highlight the motivation for this merger of moving funds from stable high-income businesses to strong growth businesses and pursuing synergies from the business resources of group companies.

Financial results trend by segment

Net sales

(¥mn)

	FY12/13	FY12/14	FY12/15	FY12/16	FY12/17	Average growth rate (%)
Content Platform	6,228	8,526	12,003	15,760	19,590	33.2
Communication Network	11,668	14,721	21,960	30,085	31,664	28.3
Music Distribution	40,498	39,483	40,506	40,649	41,231	1.1
Business Systems	14,968	16,457	15,602	16,653	17,609	1.7
ICT Services	9,415	9,793	10,006	10,607	12,035	5.3
Others	3,294	3,537	4,060	5,704	13,172	38.9

Operating income prior to adjustment

(¥mn)

	FY12/13	FY12/14	FY12/15	FY12/16	FY12/17
Content Platform	290	625	899	927	42
Communication Network	681	1,082	678	-614	1,748
Music Distribution	8,015	8,503	8,647	8,508	9,148
Business Systems	1,494	2,069	1,938	2,023	2,096
ICT Services	532	745	724	710	900
Others	-291	-448	-382	-315	-1,661
Adjustments	-462	-268	-574	-709	-3,785

Operating margin prior to adjustment

(%)

	FY12/13	FY12/14	FY12/15	FY12/16	FY12/17	Average growth rate
Content Platform	4.7	7.3	7.5	5.9	0.2	5.1
Communication Network	5.8	7.4	3.1	-2.0	5.5	4.0
Music Distribution	19.8	21.5	21.3	20.9	22.2	21.2
Business Systems	10.0	12.6	12.4	12.1	11.9	11.8
ICT Services	5.7	7.6	7.2	6.7	7.5	6.9
Others	-8.8	-12.7	-9.4	-5.5	-12.6	-9.8

* USEN and U-NEXT values presented separately for FY2013-16; former USEN converted to 12 months in FY12/17
Source: Prepared by FISCO from the Company's financial results

The merger modestly increased balance-sheet pressure. Inclusion of former USEN's market-value balance sheet created goodwill in the difference with the share acquisition book value, including the premium portion, and use of loans to cover the bulk of funds needed for the merger increased the liabilities ratio. Nevertheless, this situation differs from the 2000s when increases in risk-taking goodwill led to large impairment losses because this goodwill addition involves a capital strategy to improve synergies mainly in core businesses. We expect boosts in profitability and growth potential at low risk. Improvement of financial content is a goal of the merger, and the Company is applying a portion of other capital surplus, which increased due to decline in capital and capital reserves, to carryover losses.

Profitability improved in real terms

2. FY12/17 results

The Company announced FY12/17 results with ¥114,291mn in net sales (+149.3% YoY), ¥5,867mn in operating income (vs. a ¥396mn operating loss in the previous year), ¥3,303mn in ordinary income (vs. a ¥436mn loss), and ¥427mn in net income attributable to parent shareholders (vs. a ¥935mn loss). However, these results consolidate nine months (March 1 to November 30, 2017) from USEN, the absorbed company in the merger. The following table presents converted results that adjust for the abnormal inclusion and merger one-time costs. We think these values indicate improvement in profitability.

FY12/17 results

(¥mn)

	FY12/16	FY12/17	% of net sales	Change rate (%)	Merger one time expenses	Performance after conversion	% of net sales
Net sales	45,846	114,291	100.0	149.3	-	133,000	100.0
Operating income	-396	5,867	5.1	Reached profitability	1,000	8,000	6.0
Ordinary income	-436	3,303	2.9	Reached profitability	2,600	6,500	4.9
Profit or loss attributable to owners of parent shareholders	-935	427	0.4	Reached profitability	4,800	3,000	2.3

* Covered nine months (March to November) from former USEN; converted results show values converted to 12 months and excluding one-time costs
Source: Prepared by FISCO from the Company's results briefing materials

USEN Group's fiscal periods

	FY12/17 cumulative 3Q	FY12/17 full year	FY8/18 1Q	FY8/18 full year
U-NEXT	January-September	January-December	January-March	January-August
USEN	March-August (6 months)	March-November (9 months)	December-February (3 months)	December-August (9 months)

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

Portfolio management at the group level

3. Segment trends

Content platform business reported ¥19,710mn in net sales (+25.1% YoY), including internal sales, a healthy gain, but operating income fell sharply to ¥42mn (-95.5%). Communication network business posted ¥32,385mn in net sales (+7.6%), including internal sales, and ¥1,748mn in operating income (vs. a ¥614mn operating loss due to taking charges for credits with concerns about retrieval rights and excessive inventories), recovering substantially. Music distribution business booked ¥31,463mn in net sales, including internal sales, and ¥6,861mn in operating income. Business systems had ¥13,308mn in net sales, including internal sales, and ¥1,572mn in operating income. ICT business had ¥9,088mn in net sales, including internal sales, and ¥675mn in operating income. Others business recorded ¥9,954mn in net sales, including internal sales, and a ¥1,246mn operating loss.

FY12/17 segment results trends

External sales

(¥mn)

	FY12/16	FY12/17	% of net sales	Change rate (%)
Content Platform	15,760	19,590	17.1	24.3
Communication Network	30,085	31,664	27.7	5.2
Music Distribution	-	30,923	27.1	-
Business Systems	-	13,207	11.6	-
ICT Services	-	9,026	7.9	-
Others	-	9,879	8.6	-

Operating income

(¥mn)

	FY12/16	FY12/17	% of net sales	Change rate (%)
Content Platform	927	42	0.2	-95.5
Communication Network	-614	1,748	5.5	Reached profitability
Music Distribution	-	6,861	22.2	-
Business Systems	-	1,572	11.9	-
ICT Services	-	675	7.5	-
Others	-	-1,246	-12.6	-
Adjustments	-709	-3,785	-	-

* Former USEN covers nine months (Mar-Nov); sales are external sales
Source: Prepared by FISCO from the Company's financial results

Content platform business achieved healthy growth in subscriber volume amid expansion of the video distribution service market with ongoing efforts to improve the user experience, bolster content, and develop the market. For content, the Company moved forward in reinforcement of the line-up, such as receiving exclusive distribution rights to Korean program content. We think its distribution of new movies, such as major-hit "Beauty & the Beast," also contributed to subscriber acquisitions in 2017. Additionally, we believe enhancement of U-NEXT points allocated as a monthly present to users of "video unlimited viewing service" from July 2017 with a 20% increase (from 1,000 to 1,200 points) and doubling the length of the usage deadline (from 45 days to 90 days) helped lift the number of subscribers. However, the Company also incurred higher promotional costs for the aggressive effort to expand subscribers and larger content costs from broadening content and the rise in members.

In communication network business, sales agent service for Internet lines continued healthy growth in services for small-mid offices, a focus in recruitment efforts. U-mobile MVNO service started sales of "Yamada New Mobile," an OEM service for Yamada Denki. Furthermore, the Company continued to apply stricter credit reviews and pursue quality reforms at sales agents, thereby by strengthening its credit management capabilities.

Music distribution business improved the line-up of store and commercial facility services in store operation solutions that deliver total services from music distribution to business launch support, business environment development, and marketing support and sales promotions. Main offerings are “USEN Register”, a multi-functional, low-priced tablet POS register, “USEN Register Table Top Order”, a labor-saving system for table orders as a USEN Register option, “UPLink”, a store app creation service, “USEN SPOT” series, a Wi-Fi service for stores, “Viewla” series, an IP camera that can be managed remotely using a smartphone, “USEN Reservation”, a restaurant reservation service, and “USEN PAYGATE”, a card settlement service. The Company also put efforts into promoting use of “Sound Design for OFFICE”, an office BGM service that improves the workplace atmosphere, and “Kokoro No Hokenshitsu”, an ASP service for mental healthcare measures. It also released “REACH STOCK”, which connects chefs and restaurants to producers nationwide, with the aim of realizing synergies with the Hitosara gourmet information service for marketing support.

Demand is growing in the hotel market, which is undergoing a construction boom ahead of the Tokyo Olympics and Paralympics, for deployment of IT solutions that address foreigners visiting Japan and fill the gap from labor shortages. In business systems, the Company thus continued to release new hotel management systems, automated payment machines, and other products and strengthened proposal-type sales. Additionally, it conducted reforms in development and production processes and field services that aim to enhance quality in new products and customized products. It also released automated payment machines for clinics and pharmacies that reduce space and “Unibo”, the next-generation social robot for hotels and hospitals.

In ICT business, the Company handles over 160 services as a multi-vendor through the USEN GATE 02 brand that has steadily reinforced the service line-up. Network-related service business boasts strong sales value results in Internet connection services provided to smaller companies, and cloud service business has been broadening scope, including sales of Google’s G Suite and Cybozu’s various SaaS services.

In others business, Hitosara restaurant marketing support service actively pursued differentiation with competitors by publishing related books and promoting other initiatives. The Company also aggressively entered peripheral fields, including issuance of web magazines and free magazines for the beauty market and organizing wedding events. Energy business performed well, mainly in high-voltage, small-volume demand, as part of store operation solutions and with ramp-up of investments and sales activities through a newly-established dedicated sales division.

Forecast double-digit operating income growth in FY8/18

4. FY8/18 outlook

The FY8/18 guidance calls for ¥108,000mn in net sales, ¥5,500mn in operating income, ¥4,500mn in ordinary income, and ¥1,700mn in net income attributable to parent shareholders. While it does not present YoY changes because of the adjustment in the fiscal year, the Company aims to achieve double-digit profit growth on a 12-month covered basis that excludes one-time costs for the headquarters move and other activities.

FY8/18 outlook

(¥mn)

	FY12/17	FY8/18 E	% of net sales	Change rate (%)	FY12/17 Converted results	FY8/18 Converted results outlook	Change rate (%)
Net sales	114,291	108,000	100.0	-	133,000	144,000	8.3
Operating income	5,867	5,500	5.1	-	8,000	9,200	15.0
Ordinary income	3,303	4,500	4.2	-	6,500	7,600	16.9
Profit attributable to owners of parent shareholders	427	1,700	1.6	-	3,000	3,300	10.0

* Former USEN covers nine months (Dec-Aug). Converted results are values converted to 12 months and exclude one-time costs.
Source: Prepared by FISCO from the Company's results briefing materials

Looking at the plan, the Company clearly approaches FY8/18 as a period for mutual utilization of business resources held by U-NEXT and USEN, such as video content, music content, IoT products, network infrastructure, and stable customer base, and pursuit of group synergies. It thus intends to energetically promote the various businesses and anticipates higher sales in all areas other than MVNO, fixed-line broadband line, and related sales agent businesses in slumping markets. The Company also plans to move the headquarters with the aim of consolidating group company locations and expects setback in FY8/18 income from moving costs. Over the medium-term, however, we expect income contributions from improving business efficiency and maximizing synergies.

5. Comparison with similar companies

We think the Company's shares are trading modestly cheaper than the level justified by profit scale because of low recognition in the stock market after just completing the merger and with its wide range of businesses. Key features in the market, meanwhile, are video distribution service in content platform business, and music distribution (+ peripheral) services in music distribution business. This reflects their prospects as growth drivers. As seen in the strong market cap of ¥2.8trn at the closing price on the first day given to Spotify, a music distribution business, in its listing on the NYSE on April 4, 2018, this is a popular theme in the stock market. We believe the Company is capable of raising its presence among major companies in the content distribution segment once merger synergies show up and a growth trajectory becomes apparent.

Comparison of major listed companies in content distribution related business (FY2018 company outlooks)

(¥mn)

Code	Name	Fiscal period	Net sales	Operating income	Market cap*3	Distribution brand
9418	USEN-NEXT HOLDINGS	FY8/18*1	144,000	9,200	61,018	U-NEXT
3938	LINE	FY12/18*2	200,000	11,000	959,831	LINE LIVE
4751	CyberAgent	FY9/18	420,000	30,000	740,860	abemaTV
7860	Avex	FY3/19	164,000	7,000	74,038	dTV (alliance with NTT DOCOMO, INC.)
9468	KADOKAWA DWANGO	FY3/19	231,000	8,000	84,220	niconico Douga

*1 12-month converted values, *2 FISCO estimates, *3 Closing prices on May 16,2018
Source: Prepared by FISCO from each company's financial results, etc.

Medium-term management plan

Expectations for formulation of a post-merger medium-term management plan

1. Basic policy and management strategy

With the transition to a holding-company framework through the merger and a core policy of "delivering the next essential thing," the Company intends to pursue maximization of shareholder value and enterprise value as a corporate group that continues to be necessary to and receive expectations from society through creation of new value and services.

To maximize group enterprise value, the Company aims to maintain sales, EBITDA, and capital spending as planned and has set benchmarks for the equity ratio, which reflects financial balance soundness, and ROE, which consists of the profitability indicator (net profit margin), efficiency indicator (gross capital turnover ratio), and effectiveness of utilizing liabilities (financial leverage). We expect the Company to disclose the specific values once merger activities have settled down.

The Company's longer-term business strategy seeks to maximize group synergies, which are the primary merger goal, and improve growth potential and profitability while creating new services. Furthermore, the Company wants to quickly identify needs and business opportunities in fast-changing technology and social environments and enlist IT capabilities, such as IoT and AI. It hopes to achieve income through fast decision-making and pursue maximize shareholder and enterprise value. By sharing customer assets, bolstering collaboration among group companies, and promoting focus on specialized areas, the Company aims to expand business value in five sectors – consumer, BtoB communications, store business, media, and business systems.

Strengthening internal control of risk using KPIs

2. Risks and issues

The Company's businesses, besides USEN and ALMEX, are unlikely to obtain overwhelming market shares and content and IT services are exposed to business risk from competition and becoming obsolete. Additionally, the Company engaged excessive investment and incurred heavy impairment losses in the 2000s. We believe this risk has substantially diminished due to management's emphasis on the importance of internal management using KPIs as goals. Nonetheless, we think it could improve market confidence by raising the commitment to KPIs by disclosing them.

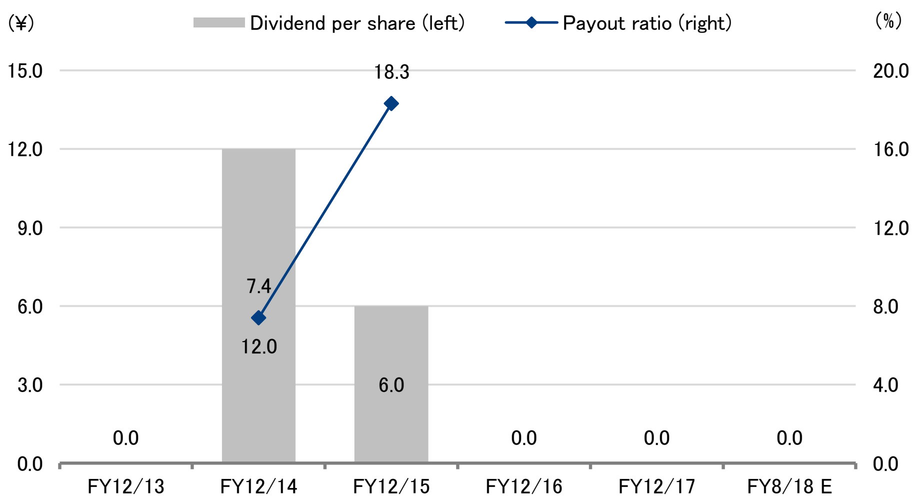
Shareholder return policy

Postponed the dividend to focus on merger activities

1. Dividend policy

The Company has presented a basic policy of making decisions on allocation of surplus funds based on results and in light of comprehensive assessment of the fiscal state, financial condition, and the new investment plan. It also intends to pay dividends from surplus funds once a year at fiscal-year end. While the Company views return of profits to shareholders as an important policy, it decided to postpone dividends from surplus funds in FY12/17 and FY8/18 in order to strengthen the business foundation for realizing new growth via the merger and dynamically respond to business environment changes.

Trends in dividend per share and payout ratio



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

2. Shareholder benefit program

The Company provides a benefit program to shareholders who own one unit (100 shares) or more of its stock that consists of waiving the initial fee and usage fees for 90 days in the U-NEXT video distribution service. It also gives them 1,000 points that can be used in U-NEXT service (shareholders who are already members only receive the points). Furthermore, it waives the initial fee for mobile data communication service U-mobile's calling plus plan and gives a ¥5,000 cash return via postal money order. Reception of these shareholder benefits requires registration through a dedicated URL.

Information security

Carefully managing security for work-style reforms

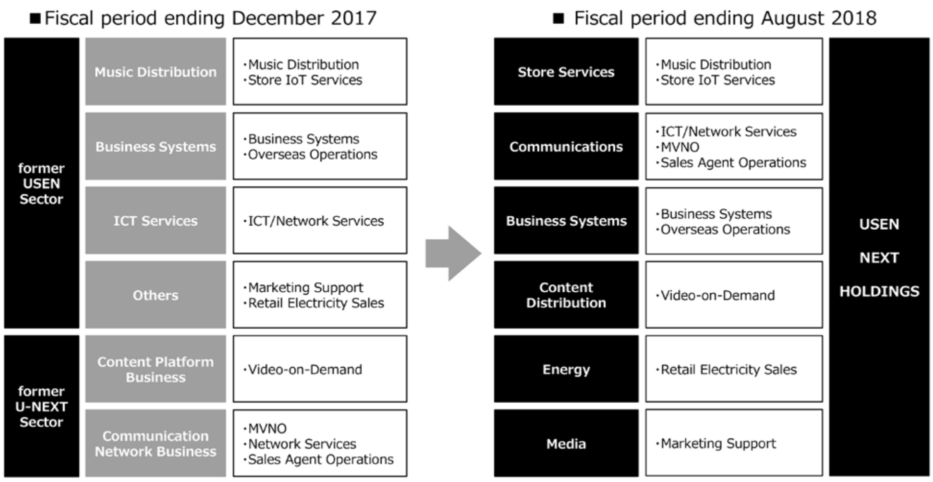
The Company is strengthening personal information protection capabilities and continues to implement educational programs. However, it cannot give a guarantee of complete protection and there is always risk of personal information leaks due to improper access from an external source, system trouble, 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 greatly reduces security risk by equipping notebook PCs with a security chip (TPM) and utilizing mobile device management (MDM) in smartphones.

Subsequent event

New business segments

The Company adopted new business segments in 1Q FY8/18 results announced on May 10, 2018. While the FY12/17 results simply listed former U-NEXT and former USEN business segment because the merger took place during the period, this time it presented new segment categories aligned to group business attributes. Specifically, it combined former U-NEXT's communication network business and former USEN's ICT business as the communications business, it created new categories for marketing support business and energy business, which had been booked under others business, and it brought together businesses handled by subsidiaries U's Music Co., Ltd. and USEN Techno-Service Co., Ltd. with former music distribution business and renamed the segment as the store services business.

New segments



Source: From the Company's results briefing materials

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