

USEN-NEXT HOLDINGS Co., Ltd.

9418

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Summary

Booking higher sales and profits despite COVID-19 through rising IoT/DX demand and video distribution in an earnings growth phase

1. Creating synergies and promoting growth with music distribution as the main business

USEN-NEXT HOLDINGS <9418> provides equipment and services needed in operation of stores and facilities with music distribution as the main area to commercial stores such as restaurants and retailers, and facilities such as hotels, hospitals, and offices. The Company also provides “U-NEXT,” a flat-rate video distribution service to consumers. USEN and U-NEXT reintegrated and renamed the company in December 2017. The reintegration aims to circulate funds from the cash-cow music distribution business to flat-rate video distribution service, store operation solutions, and other businesses with substantial growth leeway and thereby promote growth in the various businesses. It also seeks to create group synergies through by closely linking group company strengths, including the customer base, music and video contents, and IoT equipment, and sales channels of each company and cross-selling mainstay products of group companies, thereby maximizing sales per customer, a major overall goal.

2. Built operations for in-depth support of a wide range of businesses

The Company operates six businesses. In store services business, it distributes music to commercial stores and retail facilities, manages music copyrights, and also supplies all types of solution services related to store management, such as IoT products and peripheral services. The communications business sells broadband Internet lines to businesses and mobile communication (MVNO) services to individuals, as along with other services. The business systems business provides automated payment machines and front desk management systems to hotels and hospitals, among other users. The content distribution business distributes videos, e-books, and other digital content to individuals. In energy business, the Company sells electricity and gas, and in media business, it offers customer recruitment assistance service to restaurants and other locations. Despite the broad scope of its business domains, it has built operations for in-depth support of changes in conditions and new requirements and generates synergies.

3. FY8/20 attained interim goals from the medium-term management plan two years ahead of time

In the FY8/20 results, net sales were ¥193,192mn (up 9.9% year-on-year (YoY)) and operating profit was ¥10,883mn (up 32.1%). While FY8/20 was a year of progress in building the income foundation of the Company's various businesses, the impact of the COVID-19 outbreak (“COVID-19”) in 2020 spread to customer stores and facilities. Trends differed among businesses in this environment with healthy activity in contents distribution and IoT/DX aided by stay-at-home demand and wider use of telework versus struggles in restaurant and hotel businesses due to the state of emergency declaration. The Company successfully curtailed the impact of COVID-19 with the portfolio effect of its businesses and attained FY8/22 interim profit goals from the medium-term management plan two years ahead of time.

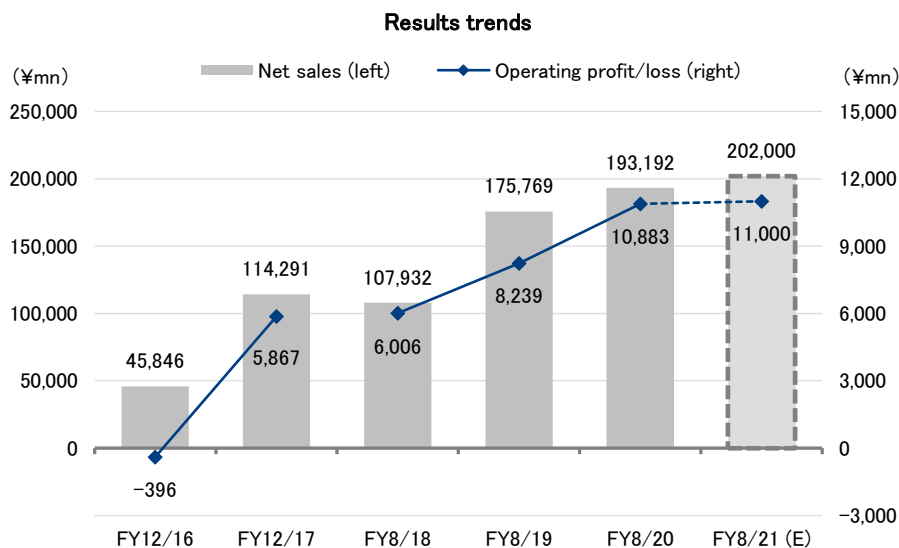
Summary

4. Focus on expanding IoT product sales and video distribution growth in FY8/21

The Company targets ¥202,000mn in net sales (+4.6% YoY) and ¥11,000mn in operating profit (+1.1%) in FY8/21. While it is likely to update interim goals at the very least, we do not expect major changes in business policies. During FY8/21, the plan is focused on a strategy of promoting deployment of customer infrastructure in the store services business, increased sales of IoT and DX products in the business systems business, and further acceleration of high growth in the content distribution business. Furthermore, communication business is receiving a tailwind from digital transformation (DX) in store, office, and personal residence segments, while content distribution business is entering a new stage of earnings growth. Even though some businesses are still facing a difficult environment due to the impact of COVID-19, the overall recovery momentum is expected to grow.

Key Points

- Posted a double-digit profit increase in FY8/20, even with COVID-19, due to the portfolio effect
- Attained interim profit goals of the medium-term management plan two years ahead of time
- Plans to focus on expanding IoT/DX product sales and video distribution growth in FY8/21



Note: The December 2017 management integration of U-NEXT and USEN resulted in an eight-month fiscal year for FY8/18. For USEN, the FY12/17 fiscal period covered the nine-month period (March 2017–November 2017), while FY8/18 covers the nine-month period from December 2017 through August 2018. For FY12/16 and earlier periods, the figures are for U-NEXT prior to the integration.

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

■ Company profile

Assisting store operations, distributing videos to individuals

1. Company profile

The Company provides assistance tools, solutions, and other products and services needed to operate stores and facilities, particularly music distribution (its founding business), through subsidiary companies under a holding company format to restaurants, retailers, and other commercial stores and various retail facilities. It also runs a service that distributes videos under a flat-rate program to individuals. The Company has a base of roughly 750,000 customers, while its group companies possess strengths in music and video contents, commercial store assistance knowhow, network infrastructure, and sales capabilities including direct sales operations, telemarketing, and a network of distributors. It creates synergies through cross-selling of each company's major products and promotes a dynamic growth strategy that incorporates next-generation technologies such as 5G, IoT, and AI.

On entering 2020, COVID-19 has been dealing a blow to societies and economies on a global scale. Companies in Japan have also been fully affected, and the Company's customers, many of which are SMEs, are no exception to this. However, since the group portfolio effect disperses business risk, there was not only a negative impact for the Company but a positive one as well. Progress in building the revenue base also helped to keep the impact of COVID-19 relatively minimal compared to other companies. The Company's presence delivered significant support particularly to smaller businesses. Although results currently appear to be in the process of recovering, we will give a full explanation about the impact of COVID-19 in the review of results.

Rapid expansion of profitability spurred by the reintegration of USEN and U-NEXT

2. History

Mototada Uno founded USEN in 1961 as Osaka Yusen Broadcasting and subsequently built a wired broadcast network nationwide. When Yasuhide Uno took over as President in 1998, he promoted store assistance services and broadband service using the Company's existing customer base and infrastructure, and pursued diversification and digitalization, including video distribution, electronic books, and other content provision services. U's Broad Communications (now, U-NEXT), a broadband service provider, a USEN subsidiary, took over the TV paid video distribution service and sales agent business for personal optical lines and other communication lines and spun off from USEN in December 2010. However, USEN and U-NEXT reintegrated in December 2017 with the aim of leveraging respective customer bases and other management resources and creating synergies. The Company is currently promoting enhancement of profitability through consolidation of shared group functions and other improvements in operation efficiency.

Pursuing synergies among businesses and promoting improvements in the profitability of various businesses

3. Business overview

The Company has six business segments: store services, communications, business systems, content distribution, energy, and media. It mainly consists of businesses that cater to companies and individual business owners and other smaller commercial stores and supplies them to these customers through subsidiaries. The store services business provides music distribution services to restaurants and other stores, engages in sales and installation of distribution equipment, manages music copyrights, and provides store IoT and other store operation solution services. The energy and media businesses provide such customers with sales of electricity and gas, as well as services like “Hitosara” that use media to help attract customers. The business systems business provides automated payment machines and front desk management systems to hotels, hospitals, and other customers. In communication business, the Company sells broadband Internet lines to companies and MVNO service and other offerings to individuals. In content distribution business, it distributes digital content, such as videos and e-books, to individuals. Furthermore, the Company is pursuing not only synergies among its business but also profitability improvement its various businesses by shifting from one-time profit at the time of the sale to recurring income obtained through monthly usage fees.

Business description of consolidated subsidiaries

Business	Operating company	Business description
Store services business	USEN CORPORATION, CANSYSTEM. CO., LTD., U'S MUSIC Co., Ltd., USEN Techno-Service Co., Ltd.	Provides, sells, and implements store solutions, including for music distribution, and manages and develops music copyright, etc.
Communications 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., Y.U-mobile Co., Ltd., and two other companies minimini-NEXT Corporation (equity-method affiliate)	A sales agency for broadband Internet lines, and it proposes and sells office ICT environment builds, provides the U-mobile MVNO service, and also provides and sells broadband Internet lines for individuals
Business systems business	ALMEX INC.	Develops, manufactures, and sells business management systems and automated payment machines for hotels, hospitals, golf courses, etc.
Content distribution business	U-NEXT, TACT	Provision, operation, and sales of U-NEXT movies distribution service to individuals
Energy business	USEN CORPORATION	As part of the lineup of services for business sites and commercial facilities, sells energy-saving services, such as for high and low voltage electric power and gas
Media business	USEN Media CORPORATION	Manages the “Hitosara” customer-attraction service for restaurants, and publishes online magazines, free magazines, etc.
Other businesses	USEN-NEXT Design	Call center consignment business
	USEN-NEXT Financial (equity-method affiliate)	Credit card business, comprehensive credit purchase arrangement, and personal credit purchase arrangement business
	15 other companies	

Source: Prepared by FISCO from the Company's financial results, news releases, and the website




Company profile

(1) Store services business

The store services business provides solution services mainly related to the Group’s music distribution business, which is the Company’s original business, and to store management. The Company has more than 50 years of experience in the music distribution business, and it provides the USEN service that broadcasts music and information for stores and facilities throughout the country, ranging from specialist channels, such as for J-POP and Western music, through to request channels. The majority of its customers are business sites, and a particularly high percentage of them are restaurants, retailers, beauticians, and clinics, while there are also a wide variety of chain stores, ranging from nationwide chains to community-based chains. The Company has over 9.5mn songs and can make playlists suited to any type of industry or business format. It also provides 1,000 types of store announcements for customers, employees, and others as part of the standard package. The Group has a strong support network comprised of 170 bases, 1,100 sales personnel, and 900 engineers, and its approach is to handle everything, from installation and construction through to after-sales care. In addition, when considering that for a monthly fee of ¥4,000 to ¥5,000, customers can eliminate tasks such as installing CD players, continuous software purchases and song selections, and dealing with troublesome copyrights, the cost performance is extremely high, which is the reason for the service’s long-lasting popularity. As a result, it currently has 750,000 customers and boasts an overwhelming share in the store and facility BGM market at more than 90%. The Company leverages this potent revenue base to support the group’s growth strategy with funding.

As services peripheral to the music distribution business, the Group provides various solutions services for store management, including products and services relating to stores, the installation and construction of equipment and interiors, music copyright management, support to acquire human resources, development support, building business environments, and sales promotions. In recent years, progress has been made in introducing IT into the retail and services industries also, but as the hurdles are high for SMEs to introduce cutting-edge equipment and systems by themselves, the Company provides its customers with a one-stop service so they don’t have to do it by themselves. Even among these services, growth has been particularly high for the “U Regi” tablet POS register service and the “U Pay” cashless payment service. Against a backdrop of inroads by wireless LAN and addition of IoT capabilities to business equipment, the Company launched USEN IoT PLATFORM, a one-stop solution for smarter store operations that combines Wi-Fi, store BGM, cameras, and an analysis service. Key services are U AIR, U MUSIC, and U EYES. “U AIR” is a Wi-Fi service for businesses that does not require installation work and can be used right away. “U MUSIC” provides BGM with songs selected by AI and also includes various announcements and a communications feature. “U EYES” is an AI camera unit that combines crime prevention measures and store traffic analysis. The Company hopes to leverage USEN IoT PLATFORM installations to expand cross selling. We discuss USEN IoT PLATFORM in more detail below because of its important role in the Company’s business strategy in FY8/21.

New services in the store services business

Communications	Music + announcements + communications	Camera + analysis
 <p>U AIR</p>	 <p>U MUSIC</p>	 <p>U EYES</p>
<p>New store Wi-Fi that can be used immediately without installation</p>	<p>All-in-one AI BGM, announcements, and communications</p>	<p>AI camera unit that combines crime prevention measures and analysis</p>

Source: From the Company’s website

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Company profile

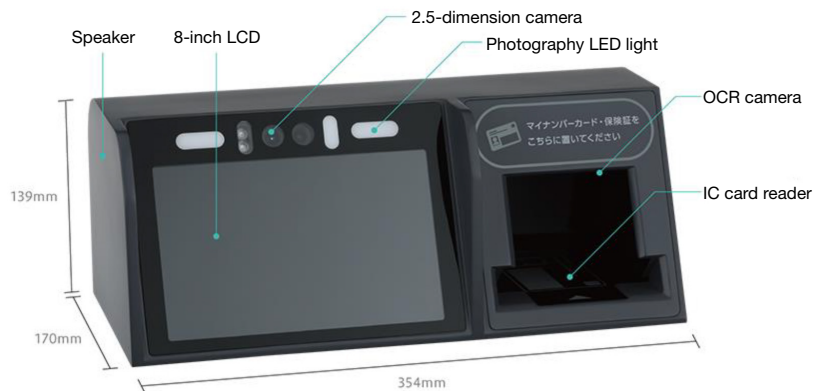
(2) Communications business

In communication business, the Company supplies USEN GATE 02, an ICT solution, and USEN Hikari broadband Internet line service for corporate customers, an optical line service for commercial stores, and y.u mobile MVNO service and U-NEXT Hikari 01 broadband Internet line service for individual customers. The ICT solution offers ICT products and services, such as Google, Cybozu <4776>, and other cloud services, mobile service, data center services and other SaaS and is steadily accumulating results. The strengths of the Company, which provides services to more than 40,000 companies in the ICT industry that is constantly and continuously changing and developing, include its extensive lineup of services and its provision of high levels of convenience, in that it is able to respond to all customer needs relating to the network environment from a single contact point. We think favorable assessment of these initiatives helped in enabling the Company to obtain telework demand during the COVID-19 outbreak. In services for individuals, the Company addressed MVNO service, which remains a highly competitive market, by overhauling U-mobile service, which had a complicated and hard-to-understand fee structure, and relaunching it as y.u mobile, a new low-cost SIM service with a simple concept. While this might be a minor change, it is an important item in building the USEN IoT PLATFORM explained below.

(3) Business systems business

Subsidiary ALMEX INC. solely handles the business systems business. This business supplies automated payment machines and lodging facility management systems to business hotels, city hotels, and leisure hotels, automated payment machines and automated patient check-in machines to general hospitals and other medical institutions, and automated payment machines and check-in machines to golf courses. It also sells ordering terminals and operating systems to restaurants. While automatic payment machines might be considered an area for major electric equipment manufacturers, ALMEX holds the top market share, including shares of 85% for leisure hotels, 65% for business hotels, 65% for large medical entities, and 70% for golf courses. As a fables manufacturer, it develops, sells, and provides maintenance for equipment and systems on its own, which is a strength, which makes it a unique presence within the group. In addition, it is not only improving the efficiency of customers' operations, such as through labor saving, it has also established a strong reputation for developing products that target convenience for facility users, which is a significant differentiating factor. In the "Sma-pa series," a total solution for medical entities, it recently released "Sma-pa Myna Touch," a card reader with facial recognition that supports online confirmation of qualifications, in anticipation of the use of personal ID cards as insurance certificates beginning in March 2021.

"Sma-pa Myna Touch" card reader with facial recognition that supports online confirmation of qualifications



Source: The Company's results briefing materials

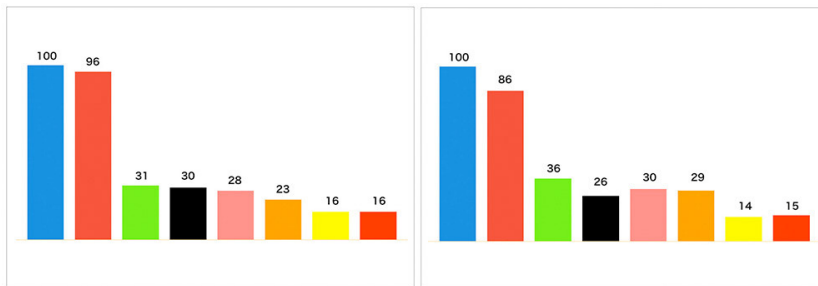
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Company profile

(4) Content distribution business

Through “U-NEXT,” the Company provides Video on Demand, (VOD) services to individuals. For a monthly fee, users can watch video content, such as movies and TV programs, and also read e-books and listen to music, on devices such as their TVs, PCs, and smartphones via the Internet. The most prominent feature is an industry-leading content line-up of more than 200,000 items. This service offers 180,000 content items with unlimited viewing and fast distribution fully loaded with the latest content. Furthermore, since it packages 570,000 e-books too, users enjoy service for two types of content on a single contract. It is also the only service that provides adult content, and the importance of carrying adult content as the key to growing demand to adults can be understood from the overwhelming victory by TSUTAYA Co., Ltd., over US-based major Blockbuster LLC during the growth years in rental videos. Furthermore, even though the ¥1,990 monthly usage fee might seem high at first, it is not actually expensive because a single account allows viewing by up to four people and the real charge works out to ¥790 after factoring in provision of ¥1,200 points per month. As explained above, one might say that the Company is the only domestic video distribution company capable of competing with not only domestic boutique-type video distribution services, but also Amazon <AMZN> Prime Video and Netflix <NFLX> services that invest massive amounts of money to create original products and are rapidly expanding their presence. The video distribution market has entered an era of joint use of 2-3 distribution services, and the pattern of selecting the Company, Netflix, and one other company appears to be increasing.

Ranked first in the number of unlimited viewing anime titles and anime episodes



*Data compiled by GEM Partners: As of December 2019
 • The total number of anime titles and episodes, including foreign movies, Japanese movies, overseas TV and OV, and domestic TV and OV
 • Only the content displayed on the company websites of the main video distribution service providers is counted.
 • In order to be able to analyze the lineups' content types across the various video distribution services, the names in GEM Partners' proprietary database have been aggregated and re-classified.
 Source: The Company's press release

(5) Energy business

In energy business, the Company sells high-voltage and low-voltage electricity and city gas procured from Tokyo Electric Power Company (TEPCO) Holdings, Inc. <9501>, with which it has a business alliance, to commercial stores and retail facilities located outside of the TEPCO area. It also offers consulting services such as for energy savings. This service functions as a “hook” product that is a catalyst for acquisition of new customers in the store services business and cross-selling. The Company only launched the service in September 2016 following the liberalization of electricity sales and, while it is a stable business that reliably obtains spread, one could argue that profit margin is low because it is a resale business. Nevertheless, the Company reached profitability in FY8/20. It intends to continue pursuing increased sales as a hook product, though is reviewing measures to deal with growing competition from regional power companies in various areas at the timing of contract renewal.

Company profile

(6) Media business

In media business, the Company utilizes “Hitosara,” its original gourmet restaurant information site, to deliver customer recruitment assistance services to restaurants. It also functions as a sales agent for other gourmet sites. “Hitosara” focuses on cooks (hito) and cuisine (sara) and differentiates itself by narrowing down its targets to relatively high-end restaurants, thereby securing a fixed market position. The Company’s media business actively engages in media collaboration, including operation of the SAVOR JAPAN gourmet site for foreigners visiting Japan, business alliances with companies that deliver services to foreigner travelers in Japan, and publishing of related books. In FY8/20, however, it encountered a very difficult environment due to steep decline of inbound traffic from 1H and the COVID-19 outbreak in 2H. The Company therefore switched its business model from flat-rate to volume-based billing and is trying to revive business.

(7) Other business (financial business)

Besides the six main businesses, the Company established USEN-NEXT Financial, a joint venture with Shinsei Bank, Limited, and started offering financial services in August 2020. The services include business credit (installment credit and installment payments) for individual business owners and companies that have transactions with the Company, including customers who are starting new businesses, and a business credit card. Business credit supports evening out of payment burden for facilities and equipment needed to start a business through paying in installments. The business credit card can be used to pay for procurement and expenses and also improves the efficiency of spending management by consolidating expenses on the credit card. These services are likely to greatly boost convenience for the Company’s customers. USEN-NEXT Financial is currently preparing other products too, such as vendor leasing and lending.

Financial results trends

Posted sharply higher operating profit in FY8/20 despite the COVID-19 outbreak

1. FY8/20 results

The Company reported FY8/20 results with ¥193,192mn in net sales (+9.9% YoY), ¥10,883mn in operating profit (+32.1%), ¥10,093mn in ordinary profit (+50.6%), and ¥4,909mn in profit attributable to owners of the parent (-19.1%). Despite incurring impact from the COVID-19 outbreak for much of 2H, it posted upbeat results exceeding period-start guidance, and operating profit, ordinary profit, and profit attributable to owners of the parent attained interim goals (FY8/22) from the medium-term management plan that lasts through FY8/24 two years ahead of time. While profit attributable to owners of the parent dropped YoY, this reflected increase in the corporate tax as the tax rate returned to normal on non-recurrence of the tax effect accompanying the sales of fixed assets in FY8/19.

Financial results trends

FY8/20 results

	FY8/19		FY8/20		% of change
	Results	% of net sales	Results	% of net sales	
Net sales	175,769	100.0%	193,192	100.0%	9.9%
Gross profit	69,753	39.7%	76,586	39.6%	9.8%
SG&A expenses	61,513	35.0%	65,703	34.0%	6.8%
Operating profit	8,239	4.7%	10,883	5.6%	32.1%
Ordinary profit	6,702	3.8%	10,093	5.2%	50.6%
Profit attributable to owners of parent	6,069	3.5%	4,909	2.5%	-19.1%

(¥mn)

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

Individual owners and small and very small companies are the main operators of commercial stores that are the Company's customers, and many faced difficulties due to store and retail facility closures and shorter operating hours during the state of emergency period prompted by the COVID-19 outbreak. Recovery after the state of emergency period, though slow, and the Go To campaign and other measures have restored activity to some extent. However, things have not improved to the point of full-fledged restoration of economic activities yet. Due to these conditions, the Company delivered a variety of assistance, including no-cost provision of messages to prevent COVID-19 infections to hospitals, supermarkets, and restaurants nationwide, take-out delivery support for restaurants, and no-charge provision of cloud camera service to stores as a crime prevention measure at suspended stores. It bolstered the line-up of new IoT services for stores to meet non-face-to-face and contactless needs. While results in business with commercial stores faces these challenges, video distribution to individuals, a segment with increased needs due to expansion of staying indoors and telework, corporate ICT solutions drove sales growth. Gross margin only fell slightly, despite struggles in high-margin store services and commercial systems, thanks to coverage with communication and video distribution services. Furthermore, the Company was successful in projects to improve productivity promoted prior to the COVID-19 outbreak and also enhanced productivity through revision double costs in its organization bloated by the merger and at CANSYSTEM CO., LTD. acquired as a subsidiary. It lifted sales promotion efficiency as well through digitalization of sales promotions for commercial stores and adjustments to listing and affiliate activities that lacked clear effect. SG&A expenses growth trailed the sales expansion pace, lowering the SG&A expenses ratio.

The impact of COVID-19 differed depending on the business

2. FY8/20 results by segment

While FY8/20 was a year of progress in building the income foundation in the Company's various business segments, inbound traffic dropped sharply in 2020 and business conditions significantly eroded at customers following issuance of the state of emergency declaration in April due to COVID-19. Corporate ICT solutions and content distribution to individuals grew and opportunities in the store services business expanded under these conditions. Meanwhile, difficulties at some commercial stores and other sites weakened growth in business system and energy sales businesses. Inbound traffic declined too. Business trends and earnings progress deviated among businesses in this environment. The Company still posted higher profits on an overall basis thanks to its business portfolio effect. Segment results were store services business at ¥52,204mn in net sales (+7.2% YoY) and ¥8,840mn in operating profit (+14.8%), communication business at ¥43,984mn in net sales (+9.9% YoY) and ¥4,034mn in operating profit (+52.7%), business systems business at ¥20,291mn in net sales (-0.7% YoY) and ¥3,451mn in operating profit (-1.7%), content distribution business at ¥45,863mn in net sales (+36.2% YoY) and ¥746mn in operating profit (+73.1%), energy business at ¥29,453mn in net sales (-1.9% YoY) and ¥98mn in operating profit (vs. a ¥368mn loss in the previous fiscal year), and media business at ¥4,112mn in net sales (-21.8% YoY) and a ¥36mn operating loss (vs. a ¥355mn profit in the previous fiscal year). Below, we take a detailed look at income conditions in these businesses.

FY8/20 results by segment (before adjustment)

	FY8/19		FY8/20		% of change
	Results	% of net sales	Results	% of net sales	
	(¥mn)				
Store services business	48,699	27.3%	52,204	26.6%	7.2%
Communications business	40,027	22.5%	43,984	22.5%	9.9%
Business systems business	20,434	11.5%	20,291	10.4%	-0.7%
Content distribution business	33,667	18.9%	45,863	23.4%	36.2%
Energy business	30,022	16.9%	29,453	15.0%	-1.9%
Media business	5,256	3.0%	4,112	2.1%	-21.8%

	FY8/19		FY8/20		% of change
	Results	Profit ratio	Results	Profit ratio	
	(¥mn)				
Store services business	7,703	15.8%	8,840	16.9%	14.8%
Communications business	2,643	6.6%	4,034	9.2%	52.6%
Business systems business	3,512	17.2%	3,451	17.0%	-1.7%
Content distribution business	431	1.3%	746	1.6%	73.1%
Energy business	-368	-1.2%	98	0.3%	Became profitable
Media business	355	6.8%	-36	-0.9%	Dropped to a loss

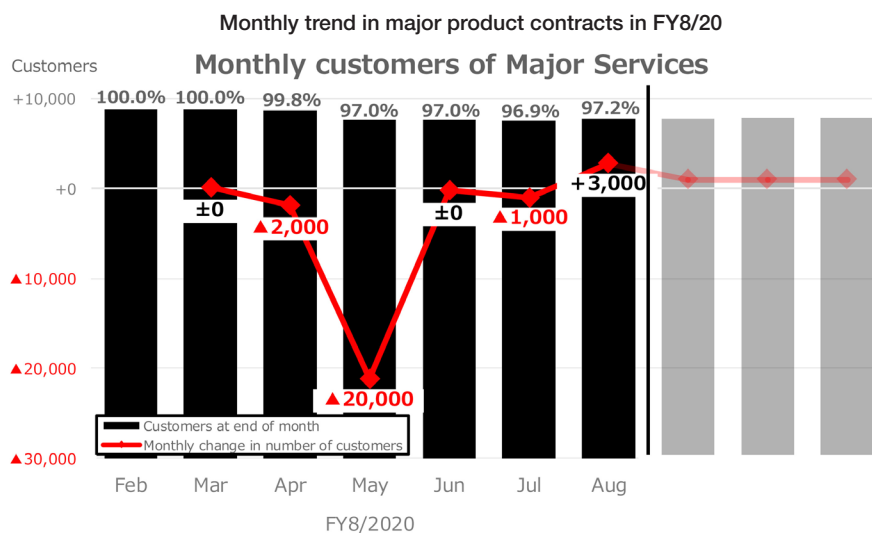
Source: Prepared by FISCO from the Company's financial results

Financial results trends

(1) Store services business

In stores services business, the Company bolstered its line-up of store and retail facility services for commercial stores and chain stores and actively recruited IoT/DX needs. It also promoted total solution support that covers opening assistance, cultivation of the business environment, customer recruitment and sales promotion with emphasis on music distribution and IoT areas. Given these efforts, the Company's "U Regi" multi-function, low-price tablet POS registers and "U Pay" payment service fared well amid heightened needs to support the reduced tax rate and cashless payments related to revision of the consumer tax rate in October 2019. "U Regi" sales rose substantially with a 46% YoY increase. Additionally, as measures targeting inbound business, it provided public wireless LAN access service in public spaces, such as shopping streets, large retail facilities, parks, and train stations, and "USEN Omotenashi Cast" indoor announcements in four languages (Japanese, English, Chinese, and Korean). This segment booked strong results in 1H FY8/20 based on these activities.

However, the state of emergency declaration prompted by the COVID-19 outbreak resulted in very difficult income conditions for stores and retail facilities, the Company's customers. This led to an acceleration of contract terminations, mainly by restaurants heavily affected by the steep drop in inbound traffic, and customer volume had a net decline of 20,000 customers in May 2020. Meanwhile, the Company proposed smarter store operations and rolled out measures to address non-face-to-face and contactless needs, such as adding temperature check sensors to its line-up, introducing "U Regi FOOD" tablet POS registers for restaurants in an alliance with LINE, and starting LINE Pokeo, a takeout service that handles store search, order placement, and prepayment entirely on the LINE smartphone app. It continued provision of services tailored to commercial stores, including "tenant rent guarantee service" and "USEN subsidy diagnosis service." As a result, business conditions started recovering in June 2020, and the Company gradually moved forward in reversing May's decline. While revision of the BGM tuner depreciation period added ¥1,124mn to earnings, the segment reported higher profit even without this item.



*The number of customers at the end of February 2020 is 100%
 *Sum of the number of monthly paying customers for store music distribution, POS systems, Wi-Fi and IP camera

Source: The Company's results briefing materials

Financial results trends

(2) Communications business

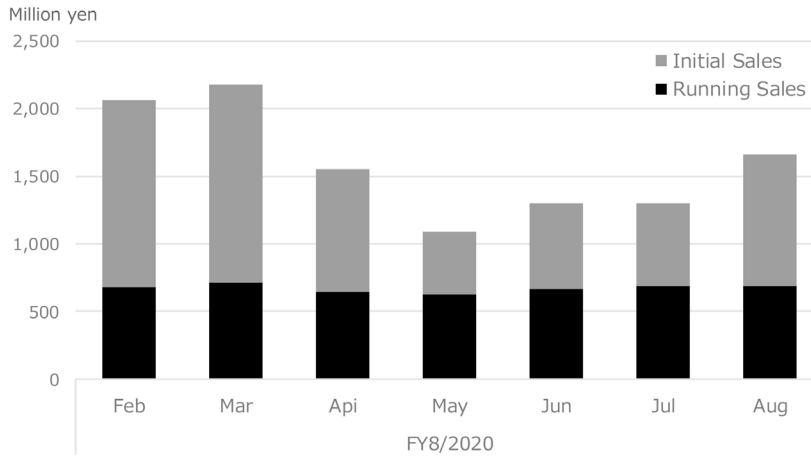
Sales agent business for broadband Internet lines proceeded smoothly with small-scale businesses as the main customers, and the Company advanced in income structure reforms for a shift from one-shot to running business on a healthy 19% YoY rise in sales of “USEN Hikari plus,” its own optical line service. With the USEN GATE 02 brand, it provided one-stop provision of network-related services, cloud services, and data center services. It also supported office work formats through arrangement of a variety of cloud services and built ICT environments at customer offices. It therefore was able to obtain demand related to changes in work formats, such as remote work and online meetings, despite impact from COVID-19. The Company renewed the MVNO service for individuals and is focusing on this business again. While it started MVNO service through an alliance with Yamada Holdings Co., Ltd. <9831>, the Company was unable to effectively differentiate its service due to having the same cost-heavy approach using agents and direct-sales shops as the many other MVNO services that appeared with liberalization of the domestic communication service business. It revised the alliance method with Yamada Holdings and switched to a more clear-cut fee menu with direct acquisition of lines from NTT DOCOMO, INC.. We also expect that monetization will become easier because of inclusion in the USEN IoT PLATFORM (described below) and provision to commercial stores.

(3) Business systems business

In 1H FY8/20, heightened demand for rollout of IT solutions at hotels, an important customer area, ahead of the planned Tokyo Olympics, sustained expansion of inbound traffic, increase in hotel volume, related tougher competition and manpower shortages, and a shift to cashless payments lifted deployments of hotel management systems, automated payment machines, and other products. For hospitals, the segment sold next-generation kiosks with face authentication using AI and insurance certificate confirmation that leveraged technology and knowhow cultivated over many years to general hospitals and others and broadened its domain to small hospitals with development of a payment machine for clinics and dental offices. In 2H, however, equipment deployments did not progress as planned as occupancy rates at hotels fell significantly on decline in inbound traffic and direct impact by the state of emergency related to COVID-19. In response, the Company developed a payment system that realizes fully unmanned payments for restaurants struggling with high costs and released the “Myna Touch” card reader with facial recognition that is capable of confirming certification online (approved by the Ministry of Health, Labour and Welfare). Thanks to the “Go To campaign” effect, the hotel occupancy rate that dropped to the 10-20% level in Apr-July 2020 has rebounded to over 50% recently, and subsidiary ALMEX’s results have moved into a recovery path.

Financial results trends

Business systems business – Monthly sales in the three main industries
 Monthly Sales in the Three Major Market Sectors



*Total sales for the three major market sectors of this business; Leisure hotels, Business hotels and hospitals

*Initial sales : Sales of automated payment machines and other products

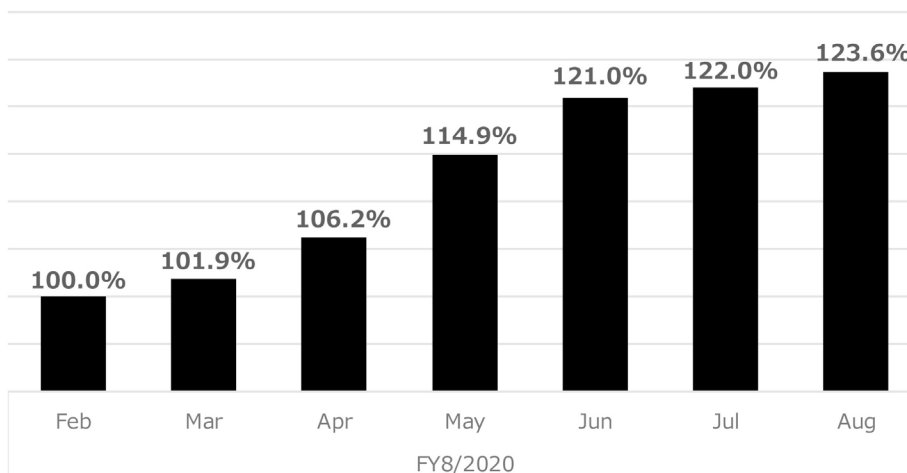
*Running sales : Monthly payments for maintenance services, hotel management systems and other services

Source: The Company's results briefing materials

(4) Content distribution business

Entry by leading foreign-capital firms has stimulated the video distribution services market, while U-NEXT steadily increased subscriber volume by continuing to improve the user experience, enhance content, and develop the market and bolstering TV commercials and web advertising. Contract volume climbed even faster between April and June 2020 with the boost from “stay-at-home” demand driven by COVID-19. This upswing lifted volume above 2mn subscribers, the medium-term goal, at the end of FY8/20, and the Company is still stably raising volume without a downturn. In content, U-NEXT remains the industry leader in the number of titles available for unlimited viewing through expansion of its line-up. It is also enhancing music genres and distributed the crowd-less live show by the Southern All Stars at the Yokohama Arena, a first-time initiative, on June 25, 2020. In device strategies, it focused on viewer satisfaction with a U-NEXT Button for direct activation from a remote control and support for Panasonic Corporation’s <6752> DIGA Blu-ray disk recorder.

Monthly trend in U-NEXT billed users



*The number of paying subscribers at the end of February 2020 is 100%

Source: The Company's results briefing materials

We encourage readers to review our complete legal statement on “Disclaimer” page.

Financial results trends

(5) Energy business

In energy business, the Company faced pressure from decline in electricity consumption volume due to customer store and retail facility closures and shortened hours as the impact of curtailed economic activities accompanying the state of emergency declaration. While it had a net increase in overall supply contract volume (high-voltage + low-voltage contracts) and intends to retain positioning as a “hook” product for store services business and other areas, issues have emerged with tougher competition in high-voltage service and relative decline in price competitiveness. The Company is in the process of addressing these issues with drastic measures such as fee negotiations with TEPCO Holdings and revisions to sales operations.

(6) Media business

Since many restaurants directly impacted by closures and shortened operating hours and decline in foreigners visiting Japan due to COVID-19 were among the Company’s customers, the Company prepared assistance measures under Hitosara service and started an initiative that enables stores listing takeout information to receive food orders from Instagram. It also began “Online Restaurant,” a new eating experience, and “restaurant rental” services. The Company was able to shrink losses, despite difficult business conditions, by curtailing promotion costs.

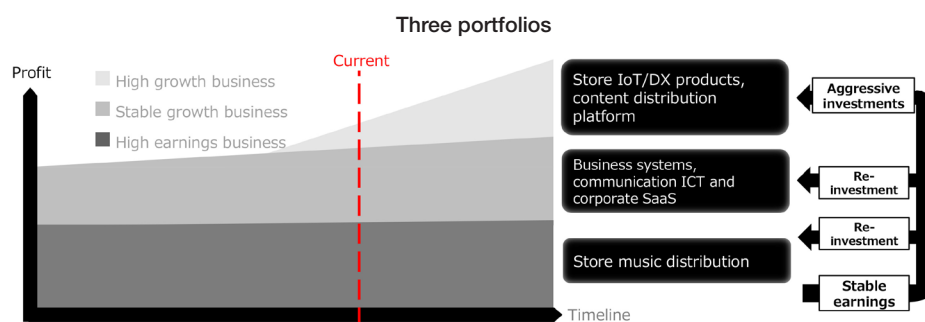
Already attained interim goals from the “NEXT for 2024” medium-term management plan

3. Progress with the medium-term management plan

The Company formulated the “NEXT for 2024” five-year medium-term management plan with a slogan of “Brighten the future” in June 2019. It contains five fundamental strategies – 1) fully leverage customer assets and build a stable income base, 2) further reinforce cash-cow business and aggressively invest created funds into growth areas, 3) improve productivity and raise business efficiency through revisions to the work environment, 4) optimize the financial balance, and 5) make sustainable growth investments and provide continuous shareholder return. By dividing the businesses into three portfolios*, it intends to carry out a well-balanced strategy. Additionally, the Company plans to use ROE, the most important management indicator, and its constituent factors (shareholders’ equity and profit attributable to owners of the parent) as benchmarks and therefore set FY8/24 goals of ¥270bn in net sales, ¥13bn in operating profit, and high-quality financial balance. It also expressed intent to raise the dividend payout ratio to 30% as soon as possible. In FY8/20, it already attained interim goals for FY8/22 two years ahead of time. We think it is likely to update interim goals at least, but it is unclear whether this will extend to revising the medium-term management plan itself in the absence of an outlook for the COVID-19 situation settling down (at a minimum, it seems difficult to revamp the plan in the near term). We thus expect focus on achieving FY8/21 guidance for the time being.

* Business portfolio categories: Cash-cow stable high earnings business with a solid customer base (music distribution business), stable growth business likely to continue gains by meeting stable needs (business systems and corporate ICT/ SaaS service businesses), and high growth business with potential as a future earnings source (content distribution and store IoT/DX service businesses)

Financial results trends



Source: The Company's materials

Progress toward "NEXT for 2024" interim goals

(¥100mn)

	FY8/19	FY8/20	FY8/22 interim goals
Net sales	1,758	1,932	2,300
Operating profit	82	109	100
Ordinary profit	67	101	90
Profit attributable to owners of parent	61	49	45
EBITDA	175	195	200
EBITDA-CAPEX	106	117	100
ROE	33.6%	21.0%	15.0%
Equity ratio	14.9%	18.6%	20.0%
Leverage ratio	4.2	3.6	3.0
Debt equity ratio	3.5	2.7	2.0
Payout ratio	4.9%	9.8%	10-30%

Source: Prepared by FISCO from the Company's medium-term management plan briefing materials, results briefing materials, securities report, and financial results

■ Company guidance

FY8/21 group management policies – “forming an organization for a new era,” “accelerating growth in IoT/DX materials,” “achieving sustainable earnings growth”

1. Group management policies in FY8/21

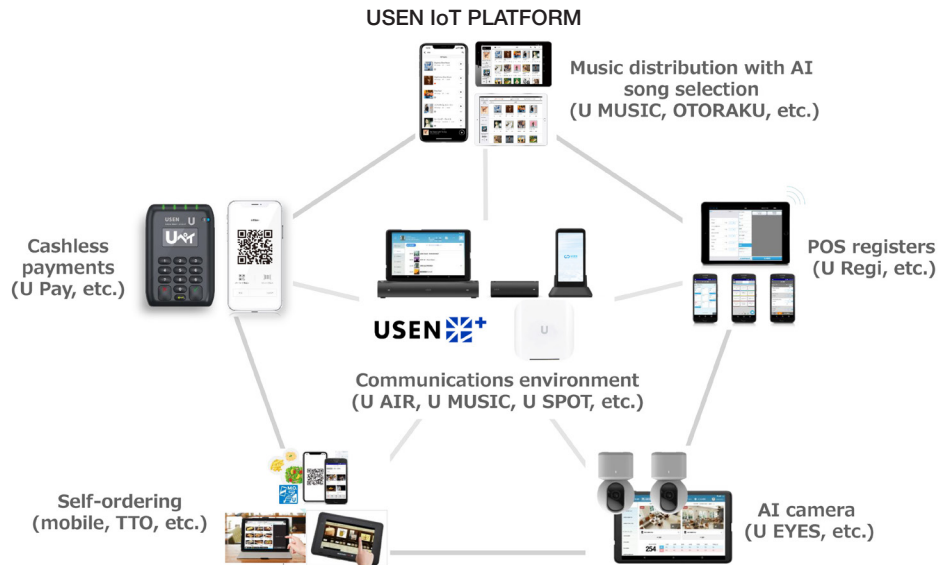
We think FY8/21 is a moderately unique period because of COVID-19 in FY8/20 and attainment of interim goals from the medium-term management plan two years ahead of time. The Company added “now is the time” to the “Brighten the future” slogan to express the sentiment of keeping the focus on growth while continuing to deal with COVID-19. It defined group business policies for FY8/21 under the new slogan of “forming an organization for a new era,” “accelerating growth in IoT/DX materials,” “achieving sustainable earnings growth.” In “forming an organization for a new era,” it intends to pursue and assess productivity, consolidate new strength with a new work format, and form speed capabilities. In “accelerating growth in IoT/DX materials,” it aims to increase customer accounts, promote customer infrastructure deployments, expand IoT/DX product sales, and develop new technology products. In “achieving sustainable earnings growth,” it hopes to revive and sustain high earnings business, revamp the unit cost structure, and further accelerate high growth businesses. The Company has specific goals for each of these three business policies. In particular, it will focus on promoting customer infrastructure deployments, expanding IoT/DX product sales, and further acceleration of high growth businesses.

(1) Promoting customer infrastructure deployments and expanding IoT/DX product sales

In fact, the Company completed the “USEN IoT PLATFORM” as a platform in the store services business with above-mentioned rollout of new services U AIR, U MUSIC, and U EYES. The communication environment is central to the platform, and the overall system constitutes a formation to promote DX at real-world stores. In setting up the communication environment, a vital component, Wi-Fi availability is obviously important and an MVNO service SIM might be a strong weapon depending on the store environment. This accelerates the timing of single-month profitability for the Company’s optical line service used by commercial stores by one year (vs. the medium-term management plan) to FY8/21. Regarding “U Regi,” which also served as a “hook” product for cashless payments and other services, while income was flat in FY8/20 due to the impact of COVID-19, the Company expects renewed increase in momentum.

The Company wants to expand sales of IoT/DX products to medical entities and pharmacies. Medical-related entities are scheduled to deploy personal ID card readers based on facial recognition starting in March 2021 with support from national subsidies aimed at promoting use of personal ID cards as insurance certificates (confirming online qualifications). While general hospitals obtain support via the Company’s advanced “Sma-pa series,” the Company developed “Sma-Pa Myna Touch” for smaller medical-related entities. Only three companies have received approval from the Ministry of Health, Labour and Welfare at this point – the Company, Fujitsu Japan Limited, and Panasonic System Solutions Japan Co., Ltd. The Company’s “Sma-Pa Myna Touch” has an advantage in its ability to read various paper certificates. With over 200,000 medical-related entities (clinics, dentist offices, and pharmacies) nationwide that offer new growth potential, the Company established USEN Healthcare Inc., a marketing company that specializes in the market and intends to bolster sales activities.

Company guidance

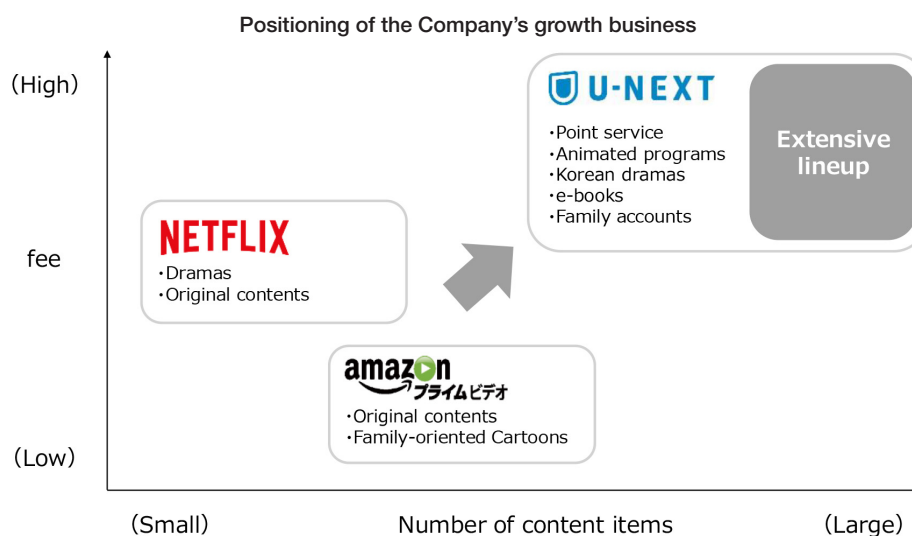


Source: Prepared by FISCO from the Company's materials

(2) Further acceleration of high growth business

Content distribution, which is deemed to be a high growth business, started taking off with “stay-at-home” demand as a catalyst. As mentioned earlier, despite clear differentiation in the content line-up and other aspects, Amazon Prime Video and Netflix are starting to leverage their funding advantage and other companies are putting up stiff resistance. The Company therefore redefined its positioning of content distribution business and revised the growth strategy. As positioning, it is pursuing value as a library, rather than differentiation through production of original content. It comprehensively handles content from a wide range of genre, including the latest titles, and aims for a position as a rental shop replacement service. As the growth strategy, given the prospect of stable sales growth, it intends to expand customer volume and achieve earnings growth by continuing to allocate promotional costs to acquire new users while actively using content procurement costs to sustain existing users. It plans to fully engage in distribution of live music events, such as the Southern All Stars concerts aired in the midst of COVID-19, harnessing its knowhow cultivated in music distribution and industry relationships. It also wants to bolster various genres. The Company expects to accelerate growth in content distribution business with these efforts.

Company guidance



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

Guides for higher sales and profits in FY8/21, though slightly conservative

2. FY8/21 outlook

The forecasts for the Company's FY8/21 results are for net sales of ¥202,000mn (+ 4.6% YoY), operating profit of ¥11,000mn (+ 1.1%), ordinary profit of ¥10,200mn (+ 1.1%), and profit attributable to owners of parent of ¥5,000mn (- 1.8%). While it is difficult to assess because the impact of COVID-19 has both positive and negative aspects, we think guidance is slightly conservative considering activities at commercial stores, the recovery trend in business conditions, and other factors.

FY8/21 outlook

	FY8/20		FY8/21 (E)		% of change
	Results	% of net sales	Value	% of net sales	
Net sales	193,192	100.0%	202,000	100.0%	4.6%
Gross profit	76,586	39.6%	-	-	-
SG&A expenses	65,703	34.0%	-	-	-
Operating profit	10,883	5.6%	11,000	5.4%	1.1%
Ordinary profit	10,093	5.2%	10,200	5.0%	1.1%
Profit attributable to owners of parent	4,909	2.5%	5,000	2.5%	1.8%

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

Since the integration, the Company has strengthened its business resources, including a customer base of 750,000 contracts, video and music content, IoT products, network infrastructure, and robust sales capabilities (mainly direct sales), and achieved synergies. Recently, it quickly tapped into market needs and business opportunities by addressing rapid and substantial changes in consumption behavior, corporate activity, technology, and social environment due to the impact of COVID-19 and applying IT technologies, such as IoT and AI, with fast decision-making. In FY8/21 as well, it is dealing with changes in the various businesses with the aim of fulfilling the slogan of "now is the time to brighten the future."

We encourage readers to review our complete legal statement on "Disclaimer" page.

Company guidance

Segment outlook for FY8/21 (prior to adjustments)

(¥mn)

	FY8/20		FY8/21 (E)		% of change
	Results	% of net sales	Value	% of net sales	
Store services business	52,204	26.6%	51,000	24.9%	-2.3%
Communications business	43,984	22.5%	43,500	21.2%	-1.1%
Business systems business	20,291	10.4%	20,500	10.0%	1.0%
Content distribution business	45,863	23.4%	56,000	27.3%	22.1%
Energy business	29,453	15.0%	30,500	14.9%	3.6%
Media business	4,112	2.1%	3,500	1.7%	-14.9%

	FY8/20		FY8/21 (E)		% of change
	Results	Profit ratio	Value	Profit ratio	
Store services business	8,840	16.9%	7,700	15.1%	-12.9%
Communications business	4,034	9.2%	4,200	9.7%	4.1%
Business systems business	3,451	17.0%	3,300	16.1%	-4.4%
Content distribution business	746	1.6%	2,700	4.8%	261.9%
Energy business	98	0.3%	200	0.7%	104.1%
Media business	-36	-0.9%	-500	-14.3%	Dropping to a loss

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

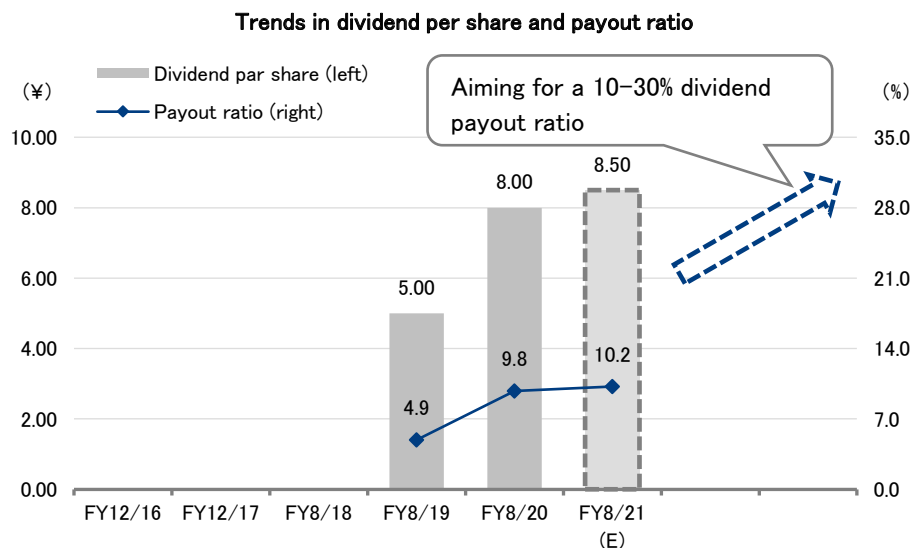
In store services business, the Company expects continued closures of pubs and other national chain stores and therefore anticipates continuation of difficult conditions in 2H FY8/20. It also factors in non-recurrence of profit related to accounting policy change that occurred in FY8/20 and decline in recurring income from cancellation of 20,000 contracts in May 2020. These trends underpin guidance for a decline in profit. While the near-term outlook is challenging, we think the outlook uses cautious assumptions considering strong commercial store support for the Company, inclusion of just 0-1,000 contracts as the monthly net increase in customer contracts, and replacement by pharmacies, prepared food stores, and other businesses when sites are open up after closures. In communications business, the Company projects higher sales and profits based on build-up of recurring income from sales of office software to small businesses and its own optical lines to commercial stores amid the corporate DX trend. In business systems business, it expects recovery throughout FY8/21, even with the large number of struggling hotels and other customers, because of the Go To campaign and Tokyo Olympics and Paralympics events which were delayed from the previous year. The Company plans to bolster sales activities in the regional high-end inn segment, which it had not covered much up to now, that is doing well but trailing in IT support. In content distribution business, the Company recognizes that it has entered an earnings growth phase and expects increase in customer contracts by putting costs toward promotions and content and therefore sharply higher profits. In energy business, despite issues from tougher competition and fee negotiations with TEPCO Holdings, it continues to target expansion in other products with this business as a "hook" offering. In media business, it intends to renew efforts through a shift in the business model from flat-rate to volume-base service amid curtailment of advertising costs by commercial stores due to the impact of COVID-19. This implies a wider loss because of utilizing operational costs. While the Company projects differing profit trends among the various businesses in FY8/21 as explained above, it predicts an overall increase in earnings thanks to the business portfolio effect.

Shareholder return policy

Is expected to enhance the shareholder return policy in the medium term

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, and the shareholder general assembly is the decision-making body for the dividend payment from surplus funds. The Company views return of earnings to shareholders as a key corporate policy and paid an ¥8 period-end dividend in FY8/20 as the result of an overall assessment of results and other factors in according with the fundamental policy. It plans to pay ¥8.5 as the FY8/21 annual dividend. In the “NEXT for 2024” medium-term management plan, it is aiming for a 10-30% dividend payout ratio.



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

Robust shareholder benefit program

2. Shareholder benefit program

The Company offers a shareholder benefit program to show appreciation to shareholders for their support, deepen understanding of business content by using group services, and enhance investment appeal of its shares and encourage long-term ownership. The current benefits consist of “U-NEXT” content distribution service and the “Premium Benefit Club.”

Shareholder return policy

For shareholders holding from 100 to 999 shares, they receive 90 days of free use of the “U-NEXT” video distribution service and ¥1,000 worth of points and shareholders with at least 1,000 shares will now receive one year’s worth of usage fees for the “U-NEXT” service and ¥1,800 worth of points each month. The Premium Benefit Club allocates shareholder benefit points based on the number of shares owned to shareholders who own 500 or more shares. Members can exchange the points for food, electronic products, gifts, travel, experience services, and other choices worth 2,000 points or more at the USEN-NEXT HOLDINGS Premium Benefit Club site exclusively for shareholders. The shareholder benefit points have been established in detail according to the number of shares held, and if the shares are held for at least one year, the number of points is increased to 1.1 times the number in the first year. Shareholders who qualify for shareholder benefits are those own one unit (100 shares) or more of the stock based on listing or registration in the shareholder ledger on the final day of February and final day of August each year. Shareholders who qualify for the Premium Benefit Club are those who own five units (500 shares) or more of the stock based on listing or registration in the shareholder ledger on the final day of February each year.

In the Premium Benefit Club, shareholders can exchange their benefit points for WILLsCoin, a benefit coin for common shareholders. These coins are exchanged for benefit products on the Premium Benefit Club Portal, an individual shareholder membership site. WILLsCoin are valid for a period of 12 months from the final exchange (benefit points and WILLsCoin exchange or WILLsCoin and benefit product exchange). Shareholders can extend the valid period by using benefit points to acquire WILLsCoin or using WILLsCoin to acquire benefit products during the valid period. Furthermore, it is possible to extend the valid period for one year from the transaction date of a purchasing by credit card on the Premium Benefit Club Portal or registration of a Premium Benefit Club Gift Card.

Examples of products that points can be exchanged for in the “USEN-NEXT HOLDINGS Premium Benefits Club”



Source: The Company's results briefing materials

■ 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 MDM in smartphones.



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