COMPANY RESEARCH AND ANALYSIS REPORT

USEN-NEXT HOLDINGS Co., Ltd.

9418

Tokyo Stock Exchange First Section

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Summary

Rising IoT/DX demand and content distribution in an earnings growth phase

1. Business model for stimulating growth and creating synergies among businesses

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 content distribution service for individuals. USEN and U-NEXT reintegrated in December 2017. The reintegration aims to circulate funds from the cash-cow music distribution business to flat-rate content 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 five 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. In the communications business, the Company engages in sales and services particularly with respect to ICT for corporate customers and optical line service for commercial stores. 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 the energy business, the Company sells electricity and gas, which serves as a “hook” offering for the store services business. Despite the broad scope of its business domains, it has generated synergies and built operations for in-depth support of changes in conditions and new requirements.

3. Earnings driven by strong business performance in 1H FY8/21

In 1H FY8/21 results, net sales were ¥101,207mn (up 6.2% year-on-year (YoY)) and operating profit was ¥8,021mn (up 35.0%). Amidst the outbreak of COVID-19, the Company has been providing services focused on its music distribution services and well aligned with circumstances surrounding the pandemic, leveraging its positioning and synergies as a platformer. As such, restaurants and other such commercial stores greatly affected by the COVID-19 pandemic came to rely on the store services business. Moreover, the store services business has been facilitating improvements being made to office environments and facility management, while also helping companies cope with the new normal, particularly when it comes to remote work arrangements as well as the need to avoid face-to-face encounters and direct contact. In services for individuals, the content distribution business has emerged as a significant growth driver, spurred on by substantial growth of the video distribution market against a backdrop of stay-at-home demand. Whereas performance varied among the Company’s different businesses amid the COVID-19 pandemic, those that fared well generated substantial earnings gains.

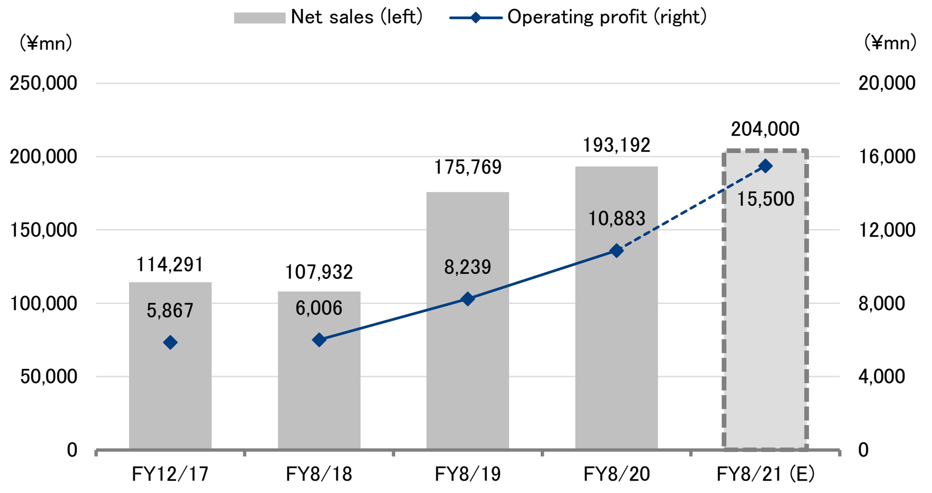
4. Operating profit for FY8/21 poised to already exceed the final target of the medium-term management plan

The forecasts for the Company's FY8/21 results are net sales of ¥204,000mn (up 5.6% YoY) and operating profit of ¥15,500mn (up 42.4%). In April 2021, the Company released upward revisions with respect to its net sales and operating profit forecasts, which it increased relative to initial projections by ¥2,000mn and ¥4,500mn, respectively. The Company issued the upward revisions due to factors that include its favorable 1H FY8/21 results, the likelihood of its store services business and content distribution business continuing to achieve strong performance, and the prospect of its business systems business and other operations mounting a recovery. Operating profit for the full year is poised to exceed that of the medium-term management plan's final operating profit target set for FY8/24 three years ahead of schedule. From FY8/22 onward, the Company's store services business and business systems business are particularly likely to help boost its earnings. We think the content distribution business in particular holds promise of achieving inconceivably swift growth in part given the rapid pace of headway being made toward digital transformation (DX) when it comes to viewership of video content, which constitutes enormous market. We are keeping a close eye on content of the next medium-term management plan, which the Company is likely to release as early as this autumn.

Key Points

- The COVID-19 pandemic has affirmed the Company's strengths in store services and its growth potential in content distribution
- Substantial upward revision to operating profit forecast for FY8/21 suggests that the Company is likely to exceed the final target of its medium-term management plan
- Have expectations regarding the next medium-term management plan, particularly when it comes to content distribution which has entered an phase of earnings growth

Results trends



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 from March 2017 to November 2017, while FY8/18 covers the nine-month period from December 2017 to August 2018.
Source: Prepared by FISCO from the Company's financial results

Company profile

Risks translate to opportunities that involve positively leveraging the business portfolio

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, other commercial stores, and various facilities including hotels, hospitals and offices. It also runs a service that distributes videos, e-books, and other digital content under a flat-rate program to individuals. The Company creates synergies by engaging in cross-selling of Group company mainstay products. This involves leveraging the respective strengths of such companies, particularly in terms of the customer base consisting of some 880,000 commercial stores and other such enterprises, music and video content, expertise in assisting commercial stores, network infrastructure, and sales capabilities in terms of direct sales platforms, telemarketing, and agency networks. It also promotes a dynamic growth strategy that incorporates next-generation technologies such as 5G, IoT (Internet of Things), and AI (Artificial Intelligence).

Since the outbreak of COVID-19 at the start of 2020, the pandemic has gone on to deal a heavy societal and economic blow on a global scale. It has affected many corporations in Japan, including the Company and its customers, many of whom are SMEs. Nevertheless, the Company managed to achieve earnings growth in FY8/20 and then again in FY8/21, upon having diversified its business risk by positively leveraging the Group portfolio. This was particularly the case with respect to its content distribution business, which entered into an earnings growth phase against a backdrop of stay-at-home demand, as well as the store services business, which made progress in building its revenue base as a result of struggling SMEs greatly relying on its offerings.

Revenue base strengthened due to 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, and other content provision services. U's Broad Communications (now, U-NEXT), a broadband service provider, took over the TV paid video distribution service and sales agent business for optical lines for individuals 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. The Company is currently in the process of building a robust revenue base which has involved concentrating shared Group functions and creating synergies.

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

3. Business overview

The Company has five business segments: store services, communications, business systems, content distribution, and energy. 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 commercial stores including restaurants, retail stores and various facilities, engages in sales and installation of sound equipment, manages music copyrights, and provides store IoT and other store operation solution services. The energy business sells electricity and gas, which serves as a "hook" offering to attract customers in the store services business. The business systems business provides automated payment machines and front desk management systems to hotels, hospitals, and other customers. The communications business sells ICT products and services for corporate customers and optical line service for commercial stores. 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 in its various businesses by shifting from one-time profit at the time of the sale to recurring income obtained through monthly usage fees.

* Effective from FY8/21, the store services business has absorbed the former media business, which offers "Hitosara" and other services that use media to attract customers.

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., USEN Media CORPORATION	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
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

(1) Store services business

The store services business provides solution services mainly related to the Group's mainstay music distribution business, which is the Company's original business, and to store management. The Company has more than 50 years of history in the music distribution business, and it provides the U MUSIC 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 commercial stores, and a particularly high percentage of them are restaurants, retailers, beauty salons, and clinics, while there are also a wide variety of chain stores, ranging from nationwide chains to community-based chains. The Company has around 10mn songs and AI 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 handles everything ranging from installation and construction through to after-sales care, enlisting its strong support network consisting of 170 locations nationwide as well as a workforce of more than 2,000 direct sales and installation professionals. In addition, when considering that for a monthly fee of ¥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 700,000 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, companies in the retail and service industries have been rapidly shifting to IoT technologies and engaging in digital transformation (DX) initiatives amid a scenario where use of wireless local area networks is becoming increasingly prevalent. However, 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. The Company refers to this as its "USEN IoT PLATFORM Vision," which entails one-stop solutions combining products and services encompassing POS cash register, AI camera, self-order, and cashless payment technologies around an axis of music distribution. The Company has been engaging in daily efforts to expand functionality of the USEN IoT PLATFORM, and recently released "U-Regi Ticket & Pay" ticket machines as an optional service for "U-Regi FOOD." The Company aims to extend "U-Regi" service reach to encompass ramen shops, standard cafeterias and other self-serve establishments with mainly counter sales, such as fast food outlets. The COVID-19 pandemic has reaffirmed the worthiness of music distribution and its peripheral services.

The "USEN IoT PLATFORM Vision"

Source: The Company's results briefing materials

(2) Communications business

In communication business, the Company supplies USEN GATE 02, an ICT (Information and Communication Technology) solution, and USEN Hikari broadband internet line service for corporate customers, USEN Hikari plus, 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 has provided 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. Moreover, the Company has achieved steady growth in results from its profitable "USEN Hikari plus" optical line service for commercial stores. With respect to its MVNO services for individual customers, the Company appears to have achieved market reentry with its low-cost "y.u mobile" SIM service featuring the concept of simplicity.

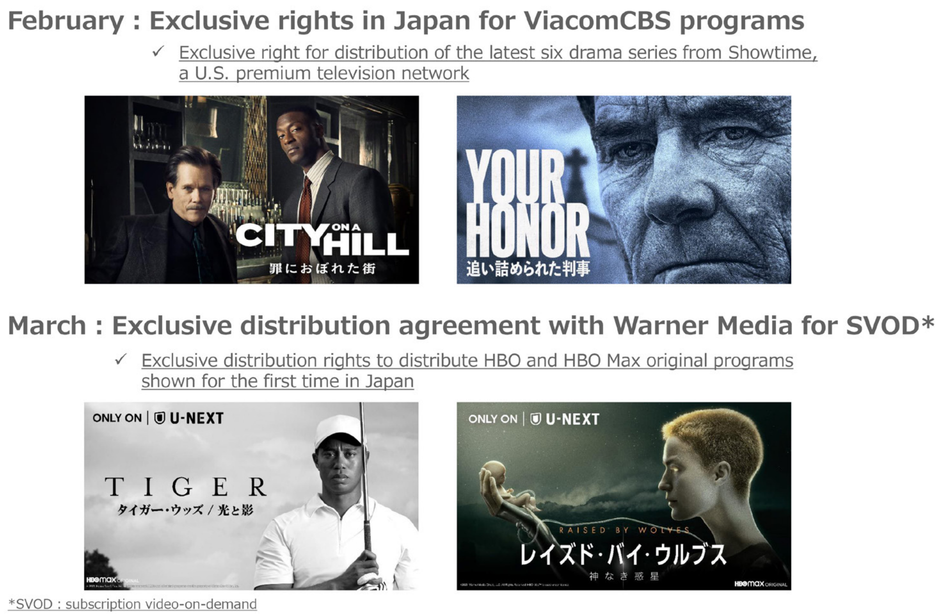
(3) Business systems business

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 fabless 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 autumn, 2021. Moreover, to the extent possible the Company intends to extend coverage of such solutions to various types of hotels encountering challenging circumstances due to the COVID-19 pandemic.

(4) Content distribution business

Through "U-NEXT," the Company provides content distribution 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 220,000 items. This service offers 200,000 content items with unlimited viewing and fast distribution fully loaded with the latest content. Furthermore, since it packages 600,000 e-books too, users enjoy service for two types of content on a single contract. Furthermore, even though the ¥2,189 (including tax) monthly usage fee might seem high at first, it is not actually expensive because the real charge works out to ¥980 (including tax) after factoring in provision of ¥1,200 points per month and a single account allows viewing by up to four people. It is the only major service provider to deliver 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. The content distribution business has managed to enter into a phase of earnings growth in part by tapping stay-at-home demand during the COVID-19 pandemic, as a result of such unequivocally differentiating factors. It would now seem safe to say that the Company may be the only domestic video distribution entity capable of taking on the Amazon <AMZN> Prime Video and Netflix <NFLX> services that invest massive amounts of money with the aims of creating original titles and rapidly expanding their presence. The Company has also entered into a series of major contracts with exclusive distribution rights enabling it to serve as a hub in Japan for overseas content holders in competition against Amazon Prime Video and Netflix. The video distribution market has already entered an era where individual customers use two to three distribution services, amid an apparent pattern of subscribers selecting the Company for its volume of content, Netflix with its original titles, and one other company.

Major contracts with exclusive distribution rights



Source: The Company's results briefing materials

(5) Energy business

In the energy business, the Company engages in business launched to address the liberalization of electricity sales in Japan, which involves selling 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. It then sells such electricity and city gas 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" offering that is a catalyst for acquisition of new customers in the store services business and cross-selling. The distinguishing characteristic of this business is that the Company is able to consistently achieve positive spread, albeit at a low profit margin given the resale nature of the business. Whereas the Company plans to expand its electricity and city gas sales which are to serve as a "hook" offering going forward, it has found itself faced with intensifying competition against regional power companies in various locations when it comes time for contract renewals. Given this situation, the Company has embarked on sales initiatives involving low-voltage power within the TEPCO area, and has accordingly been fortifying efforts in conjunction with TEPCO while also developing collaborative products where the Company's services for stores are combined with electric power.

(6) Other business (financial business)

Besides the five 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

Group management policies steadily implemented during FY8/21

1. Group management policies for FY8/21

In FY8/20, the Company achieved its interim quantitative targets set forth under the "NEXT for 2024" medium-term management plan two years ahead of schedule (operating profit of ¥10bn by FY8/22, etc.), and is furthermore expected to have already exceeded the final quantitative targets of the medium-term management plan in FY8/21 (operating profit of ¥13bn by FY8/24, etc.). This success has seemingly been underpinned by the Company's steady progress in implementing its Group management policies for FY8/21 of "forming an organization for a new era," "accelerating growth in IoT/DX products and services," and "achieving sustainable earnings growth," against a backdrop of the Company's new slogan of "actions needed for the next stage of growth" expressing the sentiment of keeping the focus on growth while continuing to deal with COVID-19. Each of the aforementioned Group management policies consists of its own specific strategic targets. The policy of "forming an organization for a new era" involves pursuing and assessing productivity, consolidating new strengths with a new work format, and forming speed capabilities. The policy of "accelerating growth in IoT/DX products and services" involves increasing the number of customer accounts, promoting customer infrastructure deployments, expanding IoT/DX product sales, and developing new technology products. The policy of "achieving sustainable earnings growth" involves reviving and sustaining high earnings business, revamping the unit cost structure, further accelerating high growth businesses, and reexamining non-core businesses.

Posted sharply higher profits despite the COVID-19 outbreak

2. 1H FY8/21 results

The Company reported 1H FY8/21 results with ¥101,207mn in net sales (up 6.2% YoY), ¥8,021mn in operating profit (up 35.0%), ¥7,632mn in ordinary profit (up 49.5%), and ¥4,373mn in profit attributable to owners of the parent (up 80.0%). Whereas performance varied among the Company's different businesses amid the COVID-19 pandemic, profits increased substantially because the businesses that fared well generated substantial earnings gains. This earnings performance was particularly attributable to certain factors. For one, the Company was called on to play a supporting role using IoT/DX to support greater operational efficiency for establishments such as commercial stores and hotels adversely affected by the COVID-19 pandemic, hospitals, as well as retail stores and facilities such as small to midsize offices. Also, content distribution services for individuals substantially blossomed thanks to stay-at-home demand. As a result, the Company issued substantial upward revisions with respect to its full-year results forecast.

1H FY8/21 results

(\mn)

	1H FY8/20		1H FY8/21		
	Results	% of net sales	Results	% of net sales	YoY
Net sales	95,330	100.0%	101,207	100.0%	6.2%
Gross profit	38,605	40.5%	40,463	40.0%	4.8%
SG&A expenses	32,660	34.3%	32,441	32.1%	-0.7%
Operating profit	5,944	6.2%	8,021	7.9%	35.0%
Ordinary profit	5,103	5.4%	7,632	7.5%	49.5%
Profit attributable to owners of parent	2,428	2.5%	4,373	4.3%	80.0%

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

Business sentiment in 1H gradually rebounded due to factors that include resumption of economic activity and development of vaccines. However, the COVID-19 pandemic persisted unabated with authorities having issued state of emergency declarations in certain regions in January and April of 2021 as a result of a resurgence of the virus at the start of the year. The Company has accordingly been providing services well aligned with the current situation and also looking toward the with-Corona and post-Corona era, thereby facilitating greater efficiency in store operations and management through digital transformation (DX) leveraging Group synergies particularly with respect to the restaurant, tourism and hotel industries which have been substantially affected by the pandemic. The Company responded to the proliferation of remote work by building ICT environments in offices and is supporting new styles of work tailored to ICT environments, and furthermore been actively proposing and providing products and services that address societal needs to avoid face-to-face encounters and direct contact. Meanwhile, in the realm of content distribution services, having been spurred on by a growing market underpinned by stay-at-home demand, the Company has been upgrading its lineup of videos and e-books, enhancing its services, working to gain new customers, and more rapidly expanding the size of operations.

Strengths of store services become apparent with tailwinds fueling content distribution

3. 1H FY8/21 results by segment

Financial results per business segment for 1H FY8/21 were varied as follows. In the store services business, net sales and operating profit were ¥27,674mn (down 4.5% YoY) and ¥4,674mn (down 4.7%), respectively. In the communications business, net sales and operating profit were ¥23,907mn (up 14.8%) and ¥2,029mn (up 10.0%), respectively. In the business systems business, net sales and operating profit were ¥8,404mn (down 22.5%) and ¥1,181mn (down 41.7%), respectively. In the content distribution business, net sales and operating profit were ¥28,806mn (up 39.8% YoY) and ¥3,209mn (up 875.4%), respectively. In the energy business, net sales and operating profit were ¥13,963 (down 8.9% YoY) and ¥211mn (up 441.0%), respectively. The content distribution business made great strides and the store services business is showing signs of recovery, as indicated by these results, which will serve as positive factors heading into the latter half of the fiscal year.

1H FY8/21 results by segment (before adjustment)

(\mn)

Net sales	1H FY8/20		1H FY8/21		
	Results	% of net sales	Results	% of net sales	YoY
Store services business	28,988	30.0%	27,674	26.9%	-4.5%
Communications business	20,818	21.6%	23,907	23.3%	14.8%
Business systems business	10,839	11.2%	8,404	8.2%	-22.5%
Content distribution business	20,598	21.3%	28,806	28.0%	39.8%
Energy business	15,331	15.9%	13,963	13.6%	-8.9%

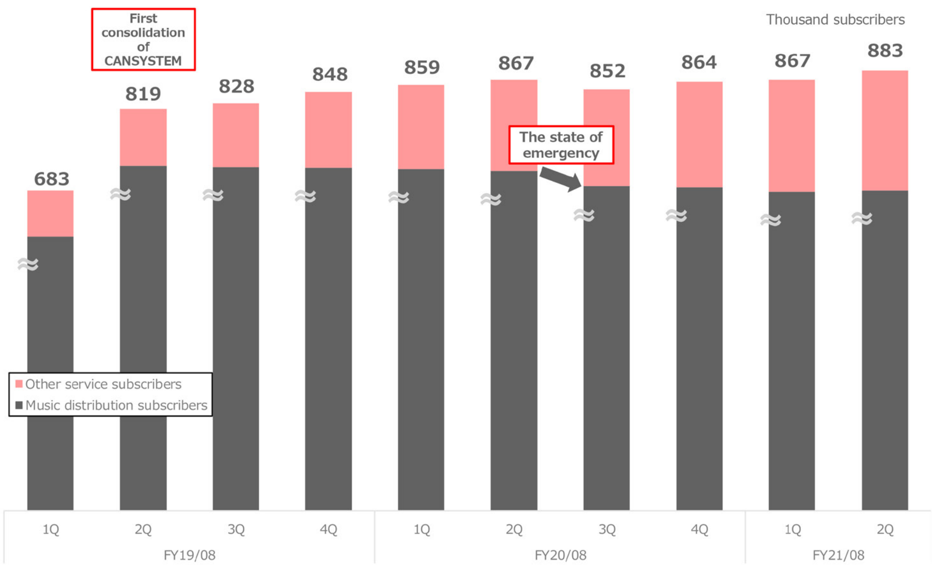
Operating profit	1H FY8/20		1H FY8/21		
	Results	Profit ratio	Results	Profit ratio	YoY
Store services business	4,906	16.9%	4,674	16.9%	-4.7%
Communications business	1,845	8.9%	2,029	8.5%	10.0%
Business systems business	2,024	18.7%	1,181	14.1%	-41.7%
Content distribution business	329	1.6%	3,209	11.1%	875.4%
Energy business	39	0.3%	211	1.5%	441.0%

Note: Store services business figures for 1H FY8/20 have been prepared by adding those of the former store services business with those of the former media business due to integration of the former media business into the store services business, effective from FY8/21.
Source: Prepared by FISCO from the Company's financial results

(1) Store services business

In 1H, the store services business continued to encounter a challenging business environment particularly as a result of restaurants having become subject to a series of requests to shorten their business hours, which included issuance of a second state of emergency declaration in Tokyo, its three neighboring prefectures and elsewhere due to a surge of COVID-19 persisting since November 2020. Under such circumstances, the Company has been offering comprehensive support leveraging Group synergies, with an emphasis on identifying customer needs and providing services with a sense of urgency. Meanwhile, in the store services business the Company has been focusing on increasing sales with respect to the "USEN IoT PLATFORM" for streamlining facility operations while also embarking on efforts to introduce both the "U-Regi Ticket & Pay" ticket machines connected to POS cash registers, and the "Servi" food service delivery robot, thereby helping to avoid face-to-face encounters and direct contact, and cope with achieving labor savings, which have been of great concern to customers. When the government issued its first state of emergency declaration in 3Q FY8/20, the number of contracts decreased on a net basis due to higher customer attrition. However, in addition to the Company's efforts being highly regarded, they also reaffirmed the notion that its services heighten efficiency and productivity and the trend in the number of contracts shifted to a net increase as early as 4Q FY8/20. Subsequently in 1H FY8/21, the number of contracts surpassed levels that had been achieved prior to the outbreak of COVID-19. It is commendable that the Company managed to keep the profit downturn minimal in the store services business given a scenario where there had previously been a surge in demand prior to Japan's consumption tax hike in the previous fiscal year, and where many restaurants are struggling. On the other hand, the former media business, integrated into the store services business in FY8/21, continues to face difficult circumstances given that it mainly engages services that help restaurants attract customers, such as the "Hitosara" and "Tabelog" services.

Store services business – Number of contracts per quarter

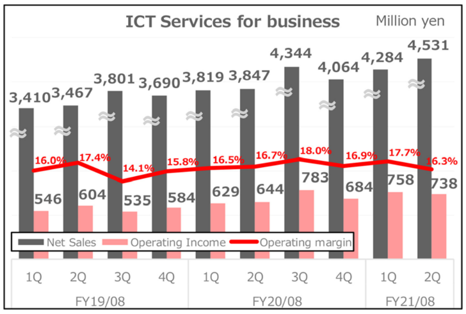


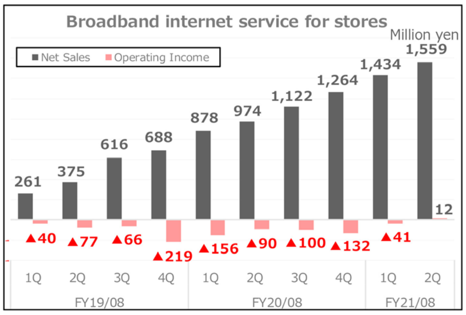
Source: The Company's quarterly results briefing materials

(2) Communications business

Whereas the communications business ordinarily generates strong results, it has been mounting a recovery spurred on as a result of the Company providing ICT environments encompassing network-related services and cloud services for developing office environments as well as data center services, while also proposing one-stop solutions accompanied by background music (BGM) services. The COVID-19 pandemic also seems to have had a relatively positive effect on the communications business, particularly as a result of the greater prevalence of telework arrangements and online meetings. This has included steadily increasing business involving ICT products and services for corporate customers along with the "USEN Hikari plus" optical line service for commercial stores. When it comes to "USEN Hikari plus" in particular, the offering achieved positive earnings for the first time in 1H amid a scenario where earnings are becoming increasingly stable and the gross profit margin is improving as a result of the Company seeking recurring income in the form of proceeds from fees charged on a monthly basis, thereby shifting away from agency business involving one-time proceeds.

Communications business – Quarterly financial results of ICT and optical line service



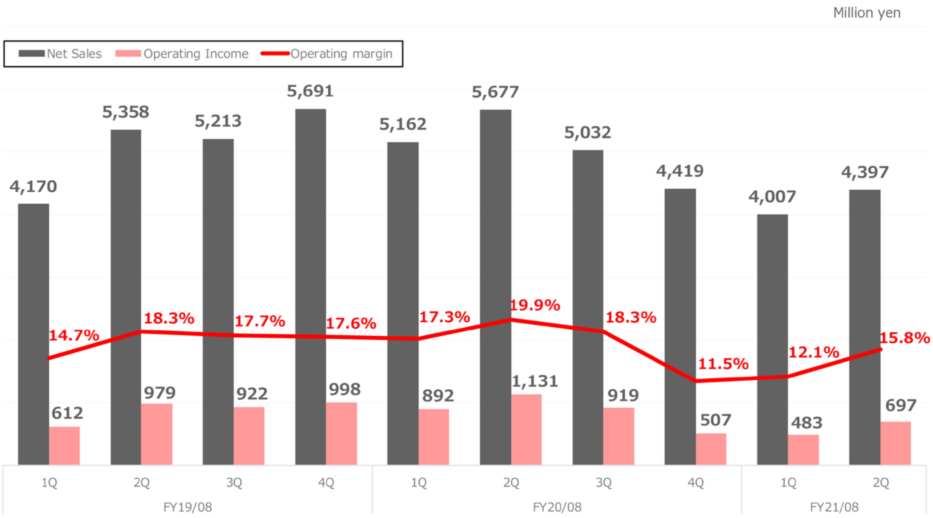


Source: The Company's results briefing materials

(3) Business systems business

Both sales and profits decreased in the business systems business compared with the same period of the previous fiscal year and the previous quarter, amid a scenario where sales involving hospitals and golf courses were insufficient to offset lower sales in struggling hotels, which account for most of business systems business sales. With respect to hotels, the Company's business activities have been affected by a situation since 2H FY8/20 of significantly lower inbound travel demand and voluntary restrictions imposed due to the COVID-19 pandemic, which has led to a drop in occupancy rates at business hotels mainly in the Tokyo metropolitan area, largely due to the decrease in business trips. However, given that these circumstances have been furthermore heightening needs among hotels for smaller workforces and labor savings, the Company is taking a more aggressive approach to sales in hopes of deriving new business opportunities involving entities such as hotels and golf courses where "Omotenashi" services continue to address challenges in terms of reducing face-to-face encounters and direct contact. Meanwhile, Japan's Ministry of Health, Labour and Welfare has been spearheading efforts that will enable patients to use Japan's My Number personal ID cards for online verification of their credentials for proof of health insurance at hospitals, with respect to which the Company generates steady sales of automated payment machines. The My Number card online verification scheme is slated to go into full effect beginning October 2021. Given that the Company's "Sma-pa Myna Touch" card reader is one of the recommended devices selected for the scheme, the business systems business has been actively engaging in sales initiatives looking toward entities such as clinics, small hospitals, and pharmacies that had previously been difficult to approach. As a result, sales and profits of the business systems business consequently both increased in 2Q compared to 1Q FY8/21, when they bottomed out.

Business systems business – Quarterly financial results

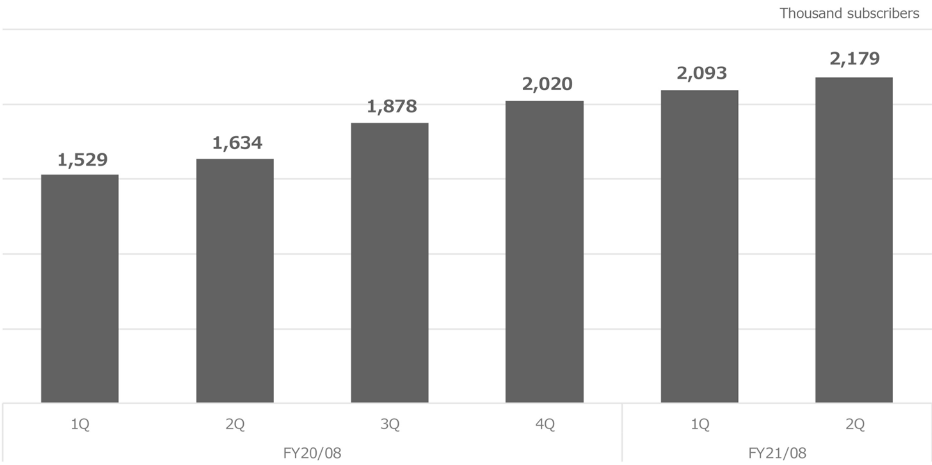


Source: The Company's results briefing materials

(4) Content distribution business

The content distribution business has been encountering a rapidly expanding market for video distribution services along with synergies brought about by heightening stay-at-home demand due to the COVID-19 pandemic, amid a video distribution service market stimulated by smartphone proliferation and the entry of major foreign-owned companies. In the midst of such strong tailwinds, the Company has been persistently improving the user experience, enhancing content, raising awareness, and developing the market. The Company has also been making progress in developing new channels, and has accordingly started to provide "with U-NEXT Denki Electricity" and "with U-Next Denki Electricity (plus gas)" new pricing options combined with "U-Next" services, targeting households that purchase low-voltage electricity from Kansai Electric Power <9503>. Content distribution business sales increased substantially, as a result of the business having consequently managed to achieve an increase in subscriber volume. On the earnings front, segment operating profit jumped tenfold as a result of sales having increased due to substantial initial costs in areas such as distribution infrastructure and content, and despite the Company having allocated additional funds to television commercial expenditures in 2Q. This seems to suggest that subscriber volume has increased to the point where it has surpassed a critical juncture. In other words, it seems that this enterprise is now in a phase where profits will increase at a faster rate than revenue growth, assuming no occurrence of extraordinary costs, as long as subscriber volume keeps increasing going forward. It seems safe to say that this business made great strides as a result of the COVID-19 pandemic.

Content distribution business – Quarterly trends in the number of U-NEXT billed users

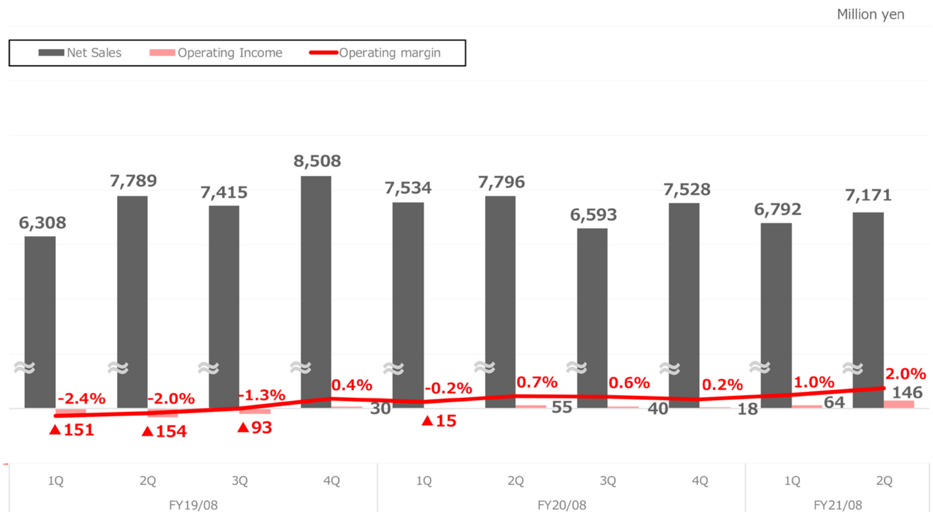


Source: The Company's results briefing materials

(5) Energy business

Customers such as commercial stores and retail facilities haven't sufficiently resumed electricity consumption, amid a scenario where economic activity under the COVID-19 pandemic is not yet on a path of full-fledged recovery. Whereas sales of low-voltage electricity and gas have been gradually increasing, earnings from high-voltage service have been volatile amid a situation where the Company has been encountering intensifying competition and a relative decline in price competitiveness. The operating profit margin in the energy business improved in 2Q, however, partially as a result of new initiatives taken in conjunction with TEPCO. Nevertheless, it is hard to say if the Company will be able to maintain ongoing improvement in that regard.

Energy business – Quarterly financial results



Source: The Company's results briefing materials

Company guidance

Substantial upward revision to full-year results amid favorable performance in 1H

1. FY8/21 outlook

The forecasts for the Company's FY8/21 results are for net sales of ¥204,000mn (up 5.6% YoY), operating profit of ¥15,500mn (up 42.4%), ordinary profit of ¥14,500mn (up 43.7%), and profit attributable to owners of parent of ¥7,500mn (up 52.8%). Moreover, the Company upwardly revised its full-year results forecasts in alignment with its 1H earnings announcement, and accordingly revised its projections substantially higher by ¥2,000mn for net sales, ¥4,500mn for operating profit, ¥4,300mn for ordinary profit and ¥2,500mn for profit attributable to owners of parent.

FY8/21 outlook

(\mn)

	FY8/20		FY8/21			
	Results	% of net sales	Forecast	% of net sales	YoY	Initial forecast
Net sales	193,192	100.0%	204,000	100.0%	5.6%	202,000
Gross profit	76,586	39.6%	-	-	-	-
SG&A expenses	65,703	34.0%	-	-	-	-
Operating profit	10,883	5.6%	15,500	7.6%	42.4%	11,000
Ordinary profit	10,093	5.2%	14,500	7.1%	43.7%	10,200
Profit attributable to owners of parent	4,909	2.5%	7,500	3.7%	52.8%	5,000

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

The forecasts were revised higher upon having factored in earnings trends heading toward 2H in the respective businesses, as well as performance achieved in 1H particularly in terms of a solid showing by the store services business and the earnings growth phase of the content distribution business. In terms of sales, full-year net sales are likely to slightly exceed the initial forecast given that sales of the communications business and content distribution business have been higher than anticipated, and despite lower-than-expected sales in the business systems business and energy business, which have been substantially affected by the COVID-19 pandemic. In terms of earnings, the Company substantially increased its profit forecasts across the board, upon having taken into account factors that include currently increasing profits of the communications business and content distribution business, underlying strengths of store services business, gradual recovery of the business systems business, and Group-wide initiatives that involve reducing cost and SG&A expenses and heightening productivity.

Points underpinning revisions of operating profit across the respective business segments are as follows. In the store services business, the Company substantially increased the full-year operating profit forecast by ¥1.8bn. The upward revision is attributable to factors that include: the Company had conservatively estimated results previously upon having taken into account business conditions of SMEs, the segment's major customers; 1H results of music distribution along with other products and services were strong, particularly due to recovery among existing customers and efforts to break ground in new industries; the accumulating number of contracts serves as a platform for 2H, and; the Company is likely to control SG&A expenses, which will offset cost increases due to depreciation and hiring. In the communications business, the Company upwardly revised the operating profit forecast only slightly due to assumptions of expanded sales promotions and weak broadband service sales agent performance in 2H despite upward momentum in ICT and agency sales of broadband connections to corporate customers in 1H, completion of goodwill amortization, and prevailing steady growth in business involving profitable broadband lines. In the business systems business, the company revised its forecasts downward due to later-than-expected recovery of the hotel market, and despite the likelihood of gradual recovery among hotels and DX investment among hospitals in 2H. In the content distribution business, the Company increased its operating profit forecast significantly by ¥3bn as a result of growth in billed users having exceeded expectations along with strong results from pay-per-view (PPV), and despite increased expenses incurred for strengthening content and sales promotions in 2H. In the energy business, the Company upwardly revised the operating profit forecast slightly as a result of the energy business having secured earnings through new initiatives taken in conjunction with TEPCO, and despite a scenario of electricity consumption having fallen short of expectations in 1H along with the probability of it decreasing in 2H due to seasonal factors. The operating profit outlooks of individual business segments encompass projections for varying sales and profits results among the individual business segments for the full-year FY8/21. Meanwhile, the Company has upwardly revised its overall operating profit forecast as a result of it positively leveraging the business portfolio. It had envisioned slightly higher profits initially, but now anticipates significantly higher profits.

Segment outlook for FY8/21 (prior to adjustments)

(\mn)

Net sales	FY8/20		FY8/21			
	Results	Profit ratio	Forecast	% of net sales	YoY	Initial forecast
Store services business	52,204	27.2%	55,500	26.8%	6.3%	54,500
Communications business	43,984	22.9%	47,000	22.7%	6.9%	43,500
Business systems business	20,291	10.6%	18,700	9.0%	-7.8%	20,500
Content distribution business	45,863	23.9%	58,700	28.3%	28.0%	56,000
Energy business	29,453	15.4%	27,400	13.2%	-7.0%	30,500

Operating profit	FY8/20		FY8/21			
	Results	Profit ratio	Forecast	Profit ratio	YoY	Initial forecast
Store services business	8,840	16.9%	9,000	16.2%	1.8%	7,200
Communications business	4,034	9.2%	4,300	9.1%	6.6%	4,200
Business systems business	3,451	17.0%	2,800	15.0%	-18.9%	3,300
Content distribution business	746	1.6%	5,700	9.7%	664.1%	2,700
Energy business	98	0.3%	280	1.0%	185.7%	200

Note: Initial forecasts for the store services business have been prepared by adding those of the former store services business with those of the former media business due to integration of the former media business into the store services business, effective from FY8/21.
Source: Prepared by FISCO from the Company's results briefing materials

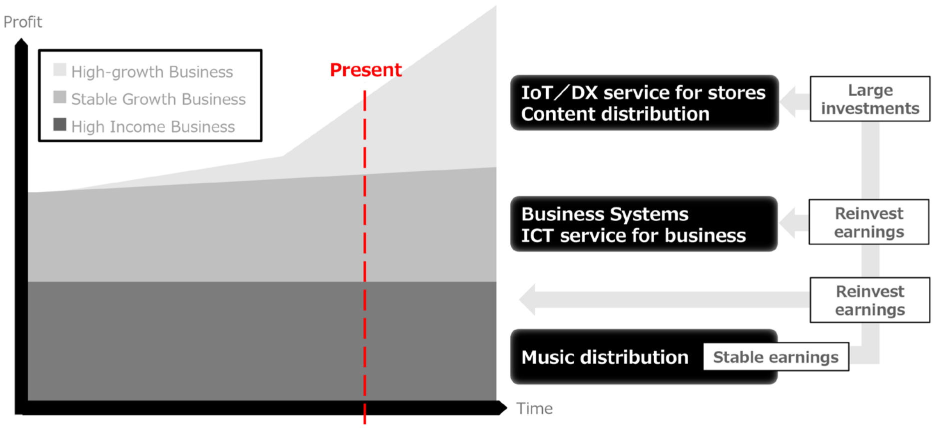
Targets of the "NEXT for 2024" medium-term management plan achieved three years ahead of schedule

2. Medium-term growth scenario

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. Thus far, the Company has been carrying out the fundamental strategies while striking a balance in terms of investment and other factors in a manner that involves dividing its businesses into three separate portfolios*. As a result, in FY8/20 the Company achieved the interim targets of its medium-term management plan two years ahead of schedule, and is furthermore likely to achieve the final targets of the plan in FY8/21, three years ahead of schedule. From FY8/22 onward, we anticipate that businesses struggling due to the COVID-19 pandemic will mount a recovery and that the Company will achieve steady profit growth consistently across the business segments. We think the content distribution business in particular holds promise of encountering inconceivably swift growth in part given the rapid pace of headway being made toward digital transformation (DX) when it comes to viewership of video content in the enormous video and entertainment markets. We are keeping a close eye on the content of the Company's next medium-term management plan, which is likely to be released as soon as the upcoming earnings announcement for FY8/21.

* 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)

Projected earnings growth across the three business portfolios



Source: The Company's results briefing materials

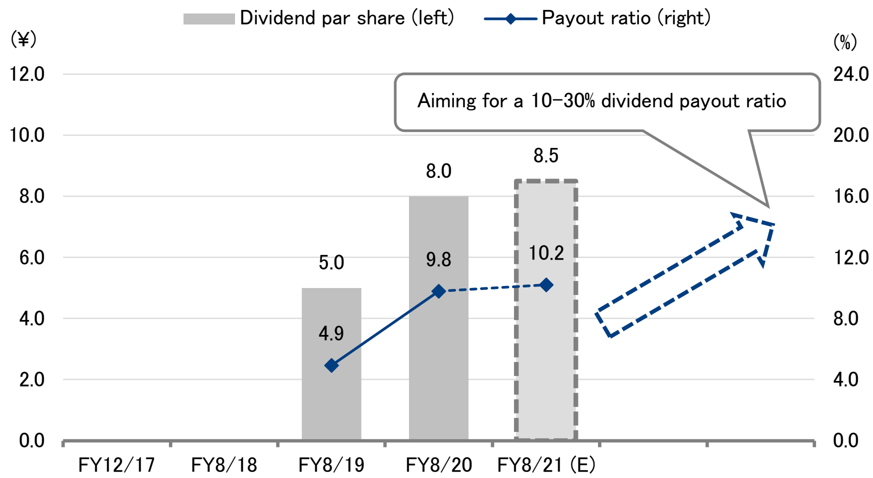
Shareholder return policy

Dividend payout ratio of 10%-30% targeted under the current medium-term management plan

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 general meeting of shareholders is the decision-making body for the payment of dividends from retained earnings. The Company views return of earnings to shareholders as a key corporate policy and paid an ¥8 period-end dividend in FY8/20 as the result of an overall assessment of results and other factors in accordance with the fundamental policy. It plans to pay ¥8.5 per share 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.

Trends in dividend per share and payout ratio



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

Robust shareholder benefit program with dual options

2. Shareholder benefit program

The Company offers a shareholder benefit program to show appreciation to shareholders for their support, deepen shareholders' understanding of business content by using group services, and enhance investment appeal of its shares and encourage long-term ownership. Under the current benefits package, shareholders are eligible for both the "U-NEXT" content distribution service and the "Premium Benefit Club." With respect to the "U-NEXT" content distribution service, shareholders with holdings of 100 shares to 999 shares are to receive 90 days of free service use along with ¥1,000 worth of points, and shareholders whose holdings amount to 1,000 shares or more are to receive one year of free service use 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 over 2,000 products including food, electronic products, gifts, travel or experience services 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 five unit (500 shares) or more of the shares based on listing or registration in the shareholder ledger on the final day of February each year. The points are scheduled to be awarded in early April every year. To be awarded points, shareholders must register and file an application via the USEN-NEXT HOLDINGS Premium Benefit Club website set up especially for the shareholder benefits program. Points awarded are valid for up to two years given that they can be carried over to the subsequent fiscal year. Shareholders may exchange their benefit points for WILLsCoin shareholder benefit coins. The coins may then be exchanged for complimentary products on the Premium Benefit Club Portal membership website for individual investors.

Information security

Takes active measures such as management of the information system at a data center

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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