COMPANY RESEARCH AND ANALYSIS REPORT

USEN-NEXT HOLDINGS Co., Ltd.

9418

Tokyo Stock Exchange First Section

13-Dec.-2021

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Summary

Expectations and possibilities have further widened following the excellent FY8/21 results

1. Through the effects of the integration, achieved the targets in the medium-term management plan three years ahead of schedule

USEN-NEXT HOLDINGS <9418> provides equipment and services needed in the 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 lucrative music distribution business, which is a source of stable earnings, to promote growth in businesses with substantial potential, such as the flat-rate content distribution service, and others. Another major objective is to create Group synergies by cross-selling mainstay products of Group companies by closely linking Group company strengths, including the customer base and sales channels of each company. Even during the COVID-19 pandemic in FY8/21, it can be said that the integration had major effects, including that the Company achieved the targets in the medium-term management plan three years ahead of schedule.

2. Strengths of the Group as a whole include a deep customer base and sales capabilities, such as for music distribution

The Company operates five businesses. In the store services business, it distributes music to commercial stores and retail facilities, manages music copyrights, and 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 are products supporting the store services business. Each respective business has its own strengths, including that the content distribution business has the industry’s leading content lineup, while the strengths of the Group as a whole include a deep customer base and sales capabilities, such as for music distribution.

3. The excellent FY8/21 results will connect to the next profit structure and cash flows

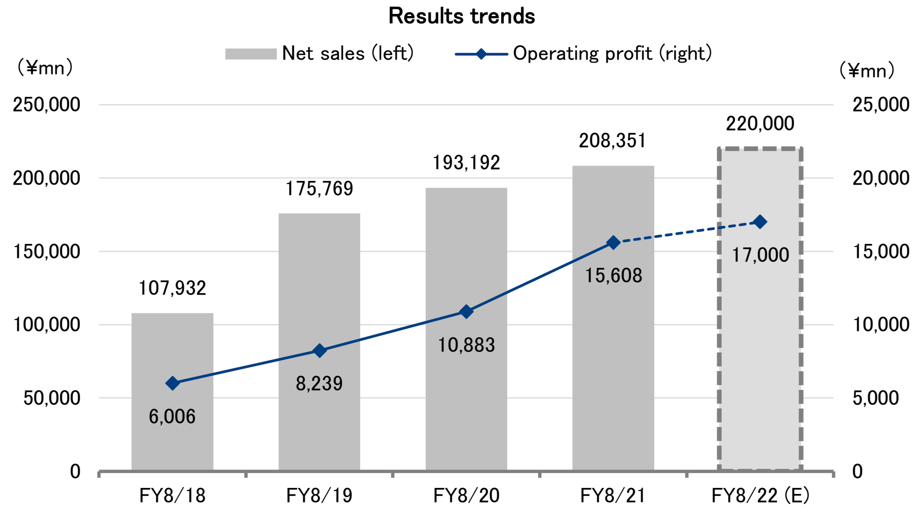
Despite the COVID-19 pandemic, the FY8/21 results were excellent, with net sales of ¥208,351mn (up 7.8% year on year (YoY)) and operating profit of ¥15,608mn (up 43.4%). In particular, in the content distribution business, the Company actively progressed various measures including enhancing the video and e-book product lineup and strengthening services, and as a result, captured the greatly increased demand spurred-on by nesting (stay-at-home) demand and entered a fully-fledged growth phase. Also, even those businesses negatively impacted by COVID-19 utilized their strengths to implement measures tailored to customer needs and were able to minimize the negative impact to the greatest possible extent. As a result, the Group’s customer assets are increasing significantly, and it is considered that this will be the driver that boosts the Company’s earnings in the future. In conjunction with this, EBITDA, which was already at a high level, is showing rapid growth, and is expected to lead to the expansion of various initiatives such as investments, repayment of loans, and returns to shareholders.

4. In FY8/22, operating profit is forecast to effectively increase by double digits, and will formulate a new medium-term management plan

For the FY8/22 results, the Company is forecasting net sales of ¥220,000mn and operating profit of ¥17,000mn. It has not published YoY comparisons, mainly due to the effects of adopting the Accounting Standard for Revenue Recognition, etc., but effectively the forecast is for operating profit to increase by double digits. As the Group's management policies, it has set (1) Respond to the environmental changes in the with- and post-COVID-19 periods and maintain the growth trend, (2) Formulate a new medium-term management plan to replace the previous medium-term management plan whose targets were achieved three years ahead of schedule and an integration report, and (3) Take on the challenge of achieving non-consecutive growth through strengthening human resources and M&A, for which it has previously been cautious. It would seem to be aiming for net sales of ¥1tn in the long term through (3), but at the present time, it is thought to be aiming for steady short- to medium-term growth through (1) and (2). However, it is difficult to anticipate what conditions will be in the with- and post-COVID-19 periods, so the impression is that the forecasts are somewhat conservative.

Key Points

- Due to COVID-19, content distribution is rapidly growing, while store services are also leveraging their strengths
- In FY8/21, operating profit increased significantly and the targets in the medium-term management plan were achieved three years ahead of schedule
- In FY8/22, operating profit is effectively forecast to increase by double digits, and will once again formulate a medium-term management plan



Note: FY8/18 was an eight-month fiscal year. For USEN, FY8/18 was a nine-month fiscal year from December to August. The Accounting Standard for Revenue Recognition, etc. has been applied from FY8/22.
Source: Prepared by FISCO from the Company's financial results

Company profile

Wants to continue to be a corporate group that meets the expectations of and is needed by society

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 Group 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 over 900,000commercial stores and other such enterprises, music and video content and membership, expertise in assisting commercial stores, network infrastructure, and sales capabilities such as 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). In this way, the Company is steadily implementing its brand slogan of “Brighten the future,” which expresses its desire to continue to be a corporate group that meets the expectations of and is needed by society by providing services necessary for society.

Based on the results of the integration, has entered a new business stage

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 services 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 paid TV video distribution service and sales agent business for optical lines for individuals and other communication lines and spun off from USEN in December 2010. However, USEN and U-NEXT reintegrated in December 2017 with the aim of leveraging respective customer bases and other management resources. Using this reintegration as an opportunity, the Company is currently in the process of building a robust revenue base which has involved concentrating shared Group functions and promoting the creation of synergies.

The novel coronavirus pandemic, which spread at the start of 2020, struck a huge blow to society and economies on a global scale. It impacted many companies in Japan, and the Company’s customers, many of which are SMEs, and the Company itself were no exception to this. In this environment, the Company’s strong sales capabilities became a major place of refuge for SMEs in trouble. Also, it dispersed business risk from the effects of the portfolios within the Group and within the businesses, by for instance in content distribution, a market which is rapidly expanding spurred-on by nesting (stay-at-home) demand, it implemented proactive management so as not to miss the business opportunity. As a result, profits grew significantly in FY8/21, and the targets in the medium-term management plan were achieved three years ahead of schedule. This would seem to be a major result of the integration and it can be said that the Company has entered a new business stage.

The content distribution business has started to grow rapidly, while the other businesses are also leveraging their strengths

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 Group companies. 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 these customers low-cost electricity and gas. The business systems business provides automated payment machines and front desk management systems to hotels, hospitals, and other customers, and sells devices and provides maintenance services. The communications business sells ICT products and services for corporate customers and optical line service for commercial stores. In the content distribution business, it distributes digital content, such as videos and e-books, to individuals. Furthermore, the Company is pursuing not only cross-sales and 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 integrated the former media business, which offers “Hitosara” gourmet food website and other services that use media to attract customers.

Business description of consolidated subsidiaries

Business	Operating company	Business description
Store services business	USEN, CANSYSTEM, USEN Media, USEN FB Innovation, USEN Techno-Service, USEN-NEXT Design, U’S MUSIC	Provides, sells, and implements store solutions including for music distribution, and conducts a customer attraction assistance business, a comprehensive assistance business for restaurants, call center outsourcing operations, management and development of music copyrights, 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 that proposes and sells office ICT environment builds, provides the “y.u mobile” MVNO service, and provides and sells broadband internet lines for individuals
Business systems business	ALMEX INC.	Develops, manufactures, sells and maintains 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
	USEN-NEXT Financial (equity-method affiliate)	Credit card business, comprehensive credit purchase arrangement, and personal credit purchase arrangement business
	13 other companies	

Source: Prepared by FISCO from the Company’s convocation notice, website, and financial results

(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, 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 greatest business strength of a 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 selection, 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 solution services for store management, including products and services relating to stores, 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 for shifting to IoT and DX are high for SMEs to introduce cutting-edge equipment and systems by themselves, the Company is moving ahead on providing a one-stop service for them. The Company refers to this as its "USEN IoT PLATFORM Vision," which entails one-stop store support services combining products and services encompassing POS cash register, AI camera, self-order, and cashless payment technologies around an axis of music distribution. The effectiveness of this business has been confirmed during the COVID-19 pandemic, becoming one of the businesses driving the Company's growth and boasting a customer base for store assistance services that has increased rapidly, from around 100,000 in FY8/19 to around 200,000 at present. It is evolving and expanding the "USEN IoT PLATFORM" lineup on a daily basis, and most recently, it has launched items including "USEN My Menu Premium/U Regi Ticket & Pay," a ticket vending machine that can be used even as an order and self-payment machine; "U AIR," a Wi-Fi service for work that enables the internet to be used without requiring line construction; and "U MUSIC," which enables the optimal BGM to be compiled for each store by AI through the integration of data on store BGM accumulated over many years. It is also developing services that connect these work devices and its in-house wireless LAN resources to the latest technologies. In addition, from its abundant lineup, it is developing "USEN Marutto Store DX," a store DX package service, and progressing sales for new OPEN stores that have a high set contract rate.

The “USEN IoT PLATFORM Vision”

Source: The Company's results briefing materials

(2) Communications business

The communications business conducts sales agency operations for broadband internet lines, proposes and sells the building of office ICT (Information and Communication Technology) environments, provides the “y.u mobile” MVNO service, and provides and sells broadband internet lines for individuals. For the building of ICT environments, it provides cloud services and mobile services, such as Google and Cybozu <4776>, and ICT products and solution services linked to SaaS, including data center services. In the ICT industry, which is constantly changing and developing, the strengths of this business are that it provides services to more than 40,000 companies and continues to grow stably from the wide breadth of its service lineup through a multi-vendor strategy, while also offering highly convenient direct sales through which it can respond to each customer's needs relating to network environments through a single customer desk. These initiatives have been highly evaluated and it seems they have enabled this business to capture demand during the COVID-19 pandemic, such as relating to teleworking. With regards to broadband internet lines as well, it is progressing the switch to its own optical lines that are highly profitable from commission fees and aiming to expand recurring-income earnings. In addition, for commercial stores, which are increasing as customers of the Group's own lines, it is progressing up-selling of IoT/DX products.

(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, automated payment machines and check-in machines to golf courses, and order terminals and operating systems for restaurants, as well as labor-saving and other equipment to meet customers' needs. 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, a strength that 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 have a perspective of convenience for facility users, which is a significant differentiating factor. This is leading to the expansion of recurring-income earnings through optional software services.

Recently, in the "Sma-pa Series" of total solutions for medical institutions, "Sma-pa Myna Touch," which was market launched in anticipation of the use of personal ID cards as insurance cards from October 2021, is acquiring an excellent reputation. It is a card reader with facial recognition that supports the online confirmation of qualifications and that is equipped with proprietary functions enabling the reading of various card-based certificates, such as contactless frames and public-expense healthcare vouchers. For the Company, this product represents a tool for developing business in the untapped market of small-to medium-scale clinics. This strong performance for hospitals is to a certain extent covering for the struggles of various hotels in the severe COVID-19 environment. But even hotels have needs for further labor-saving, so needs for the Company's devices remain as strong as ever.

"Sma-pa Myna Touch"

Contactless frames

Source: Reprinted from materials provided by the Company

(4) Content distribution business

Through "U-NEXT," the Company provides content distribution services to individuals. For a monthly fee, users can access content ranging from movie or TV videos to e-books and music via the internet on many types of devices, including TVs, PCs, and smartphones. Its most prominent feature is an industry-leading content lineup (based on a survey by GEM Partners in September 2020). The service offers more than 220,000 items with unlimited viewing and fast distribution of the latest content. Furthermore, since the service includes approximately 700,000 e-books as well, users can access two types of content, "viewing" and "reading," with just a single contract. Also, the monthly fee of ¥2,189 (including tax) for the Company's service may seem high at first, but it's actually not that expensive. After factoring in the provision of ¥1,200 worth of points each month, the real fee is only ¥989 (including tax), and on top of that, a single account can be viewed by up to four people. Moreover, it is the only major service provider to deliver adult content, the importance of which can be understood by the overwhelming victory of TSUTAYA Co., Ltd. compared to US-based major Blockbuster LLC during the growth years of video rental.

Due to these clear differentiation factors, the business has started to rapidly grow in line with the market due to nesting demand during the COVID-19 pandemic. In addition to the Company, the market shares of Amazon <AMZN> and Netflix <NFLX> are also growing rapidly as they are investing enormous sums of money into producing original content, and it can be said that it will be difficult for other companies to compete with them to continue to provide video distribution services. In order to maintain its position, the Company has entered into a series of major contracts with exclusive distribution rights with overseas content holders to enable it to compete against Amazon Prime Video and Netflix. In addition, it is developing its "ONLY ON" strategy to strengthen the works it exclusively distributes on the Can Only Watch on "U-NEXT" and All You Can Watch Only on "U-NEXT" services, while in music distribution, it is also progressing an investigation for the fully fledged development of live music distribution that utilizes its various relationships. That said, the video distribution market has already entered an era in which users concurrently use multiple distribution services, and it appears that a pattern is emerging in which users enter into a contract with the Company, which has a competitive advantage in its span of content, at the same time as entering into a contract with Netflix, whose strength is in original content.

Works through the “ONLY ON” strategy

Source: Reprinted from the Company’s press release

(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 on a relative basis from Tokyo Electric Power Company Holdings, Inc. <9501> (hereinafter, TEPCO), 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 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 developing a business credit card service. Business credit is a service that can evenly distribute the financial burden for facilities and equipment needed to start a business over installment payments. The business credit card can be used to pay for procurement and expenses and 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 moving ahead on providing other products too, such as vendor leasing and lending.

Financial results trends

Spurred-on by COVID-19, each business is leveraging their respective strengths

1. FY8/21 results

In the FY8/21 results, net sales were ¥208,351mn (up 7.8% YoY), operating profit was ¥15,608mn (up 43.4%), ordinary profit was ¥14,768mn (up 46.3%), and profit attributable to owners of parent was ¥8,044mn (up 63.9%), so profits increased significantly. Compared to the initial forecasts, the results were above their respective forecasts, net sales by ¥6,351mn, operating profit by ¥4,608mn, ordinary profit by ¥4,568mn, and profit attributable to owners of parent by ¥3,044mn.

The COVID-19 pandemic has had both positive and negative effects for the Company. With market expansion gaining momentum against the backdrop of the increase in nesting demand, the content distribution business has expanded its video and e-book product lineup and strengthened services. It has accelerated the expansion of business scale by progressing investment, including to acquire new customers and in sales promotions. For customers in the restaurant, tourism, and accommodation industries that have been severely impacted by the pandemic, it is leveraging Group synergies and providing timely assistance to improve efficiency through DX for store management and administration. Also, for offices in which remote working is increasingly being used, it is building ITC environments, offering assistance for new ways of working tailored to these ICT environments, and providing products and services for hotels and hospitals that meet the societal needs of avoiding face-to-face encounters and direct contact. Through these efforts, it has been able to minimize the negative impact of the pandemic to the absolute minimum.

Also, through these measures, the Group's customer assets rapidly increased in FY8/21, from 864,000 to 912,000 for commercial stores, including store services; from 19,000 to 33,000 for SMEs, hotels and hospitals, such as ICT and Myna Touch for corporations; and from 1.69mn to 2.65mn for individuals, including U-NEXT. So even during the COVID-19 pandemic, the Company was able to achieve not only a major increase in profits, but also results that were significantly higher than forecast. These customer assets are not temporary ones and it is considered that they will become the key factor boosting the Company's consolidated earnings in the future. In conjunction with this, EBITDA has also shown rapid growth from an already high level, against the backdrop of businesses with stable earnings and amortization of goodwill, and it is thought that this will lead to the expansion of initiatives such as investments, repayment of loans, and returns to shareholders.

FY8/21 results

(¥mn)

	FY8/20		FY8/21		Rate of change
	Results	% of net sales	Results	% of net sales	
Net sales	193,192	100.0%	208,351	100.0%	7.8%
Gross profit	76,586	39.6%	81,579	39.2%	6.5%
SG&A expenses	65,703	34.0%	65,971	31.7%	0.4%
Operating profit	10,883	5.6%	15,608	7.5%	43.4%
Ordinary profit	10,093	5.2%	14,768	7.1%	46.3%
Profit attributable to owners of parent	4,909	2.5%	8,044	3.9%	63.9%

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

Content distribution is rapidly expanding and store services are leveraging their strengths

2. FY8/21 results by segment

In the FY8/21 results by business segment, the store services business saw net sales of ¥56,112mn (down 0.1% YoY) and operating profit of ¥8,590mn (down 2.5%), the communications business saw net sales of ¥48,179mn (up 9.5%) and operating profit of ¥4,534mn (up 12.4%), the business systems business saw net sales of ¥18,925mn (down 6.7%) and operating profit of ¥2,898mn (down 16.0%), the content distribution business saw net sales of ¥59,956mn (up 30.7%) and operating profit of ¥5,731mn (up 667.7%), and the energy business saw net sales of ¥27,926mn (down 5.2%) and operating profit of ¥354mn (up 258.6%). It appears that results varied depending on the business, but when considering factors such as that the content business made a leap forward and that other businesses were able to secure earnings of a certain level even in the severe COVID-19 environment, it can be said that the inter-business synergies and management strategies were effective.

FY8/21 results by segment (before adjustment)

(¥mn)

[Net sales]	FY8/20		FY8/21		Rate of change
	Results	% of net sales	Results	% of net sales	
Store services business	56,190	29.1%	56,112	26.9%	-0.1%
Communications business	43,984	22.8%	48,179	23.1%	9.5%
Business systems business	20,291	10.5%	18,925	9.1%	-6.7%
Content distribution business	45,863	23.7%	59,956	28.8%	30.7%
Energy business	29,453	15.2%	27,926	13.4%	-5.2%

[Operating profit]	FY8/20		FY8/21		Rate of change
	Results	Profit ratio	Results	Profit ratio	
Store services business	8,808	15.7%	8,590	15.3%	-2.5%
Communications business	4,034	9.2%	4,534	9.4%	12.4%
Business systems business	3,451	17.0%	2,898	15.3%	-16.0%
Content distribution business	746	1.6%	5,731	9.6%	667.7%
Energy business	98	0.3%	354	1.3%	258.6%

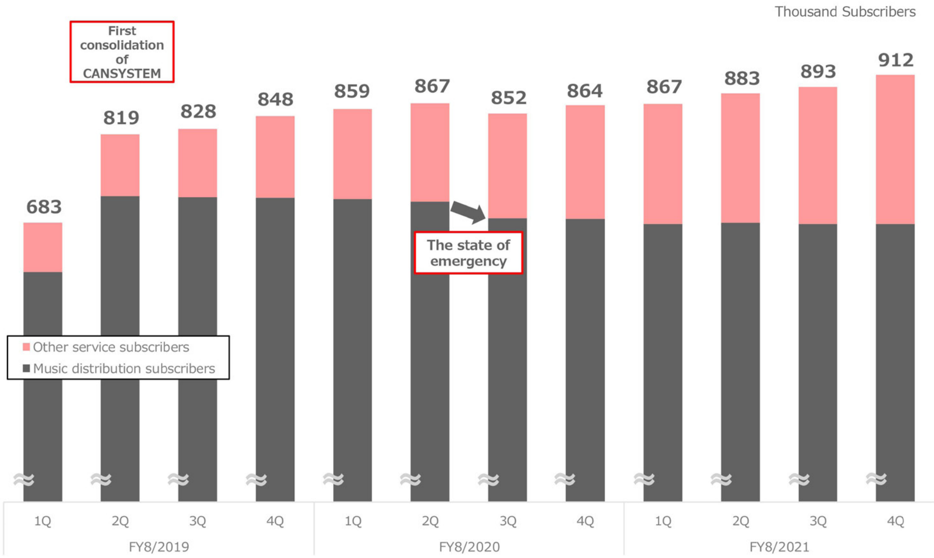
Note: Store services business figures for 1H FY8/20 have been prepared by adding those of the former store services business with those of the former media business due to integration of the former media business into the store services business effective from FY8/21.
Source: Prepared by FISCO from the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

(1) Store services business

Alongside the rapid spread of the novel coronavirus pandemic since November 2020, the declarations of a state of emergency and the priority measures, such as to prevent the spread of infections, have been implemented for long periods in regions throughout the country. Therefore, restaurants in particular have been required to act, including reducing working hours and exhibiting self-restraint on providing alcoholic drinks, and their business environments have continued to be severe. For these customers, the Company has been ascertaining their needs and providing services with a sense of speed, and leveraging Group synergies to provide them with comprehensive assistance. In conjunction with this, it has worked to increase sales including of “USEN Marutto Store DX,” a totally digitized service to meet all the work needs of stores; “U Regi,” a Cloud POS register service; “U Pay,” a payment service; “U AIR,” a work-use Wi-Fi service that does not require line construction; and “U MUSIC,” which uses AI to compile the optimum BGM. Also, for businesses that handle food such as restaurants, it has developed “Store HACCP,” which makes it easier to carry out food hygiene management and store records in accordance with the revised Food Sanitation Act. These services promote improved efficiency, labor saving, and contactless operations for all types of work in customers’ operations, from the front office to the back office, and they can be said to be essential DX in both the with- and post-COVID-19 periods. In July 2021, the subsidiary USEN was certified by the Small and Medium Enterprise Agency as an Assistance Institution for Management Innovation, etc., and going forward, this is likely to further increase the trust placed in and the name recognition of USEN’s store assistance services.

In 3Q FY8/20, when the first declaration of a state of emergency was issued, the number of customers cancelling contracts temporarily increased and the net number of contracts declined. But by 4Q FY8/20, the net number of contracts had quickly returned to an upward trend and since then, the increase in the number of contracts has accelerated and by 4Q FY8/21, it had exceeded the number prior to COVID-19 and reached 912,000 contracts. Looking within the number of contracts, the net number of music distribution contracts continues to remain unchanged, but the number of contracts for other services to stores is increasing. This means that the bundle rate (the number of contracts per store) is rising and that net sales per store will be increased by leveraging the customer base for store distribution services, which accounts for a high share, and it can be said that these trends were in line with the Company’s objectives at the time of the integration. In FY8/21, the former media business was integrated into this business, and it is being conducted mainly consisting of the “Hitosara” and “Tabelog” customer attraction assistance services for restaurants, and therefore severe conditions are continuing. But in this situation, the Company has strengthened new assistance for restaurants, including enabling reservations for “Hitosara” alliance restaurants to be made from Instagram and support movies via digital OOH (advertising media using digital signage) to major cities nationwide. This business’s operating profit declined slightly, but the factors behind this included upfront investment, including in the POS register with no initial costs campaign towards the period end, online promotions, and a sales assistance fund. On the point that the upfront investment will lead to policies in the next period, earnings in this business can be evaluated as trending extremely firmly when considering that among the many struggling restaurants, there are some that have been able to secure a certain level of profits.

Store services business – Number of contracts per quarter

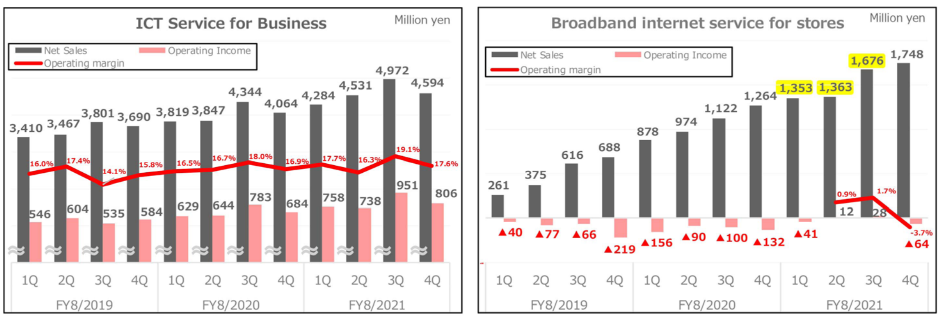


Note: Other services to stores is the total of communication lines, POS cash register services, Wi-Fi services, IP camera services, app creation services, and gourmet food website services. In the event of one customer having contracts for multiple services, each service counts as one.
Source: The Company's results briefing materials

(2) Communications business

This is inherently a strong business, while sometime its services are proposed as a one-stop service together with BGM services. It has been able to smoothly capture needs for ICT environments that have further increased due to COVID-19, including for building excellent office environments, and for network-related, cloud, and data center services. It can be said to be a business in which the effects of COVID-19 have been comparatively positive, including thanks to the expansion of teleworking demand and the increasing use of online meetings. So even in the current situation, sales are steadily growing, including of ICT products and services for corporations for which the business scope has been expanded to educational facilities and public organizations, and of "USEN Hikari plus," which is the Company's own optical lines for commercial stores for which it is progressing the shift from one-shot line commission fees to running-income-type monthly fees. In profits, on the one hand, line commission fees decreased as the Company strengthened sales of its own optical lines, but ICT for corporations grew and the amortization of goodwill (¥300mn in 1H FY8/21) was completed, so it was able to secure an increase in operating profit.

Trends in quarterly results of ICT for corporations and the Company's own optical lines for commercial stores



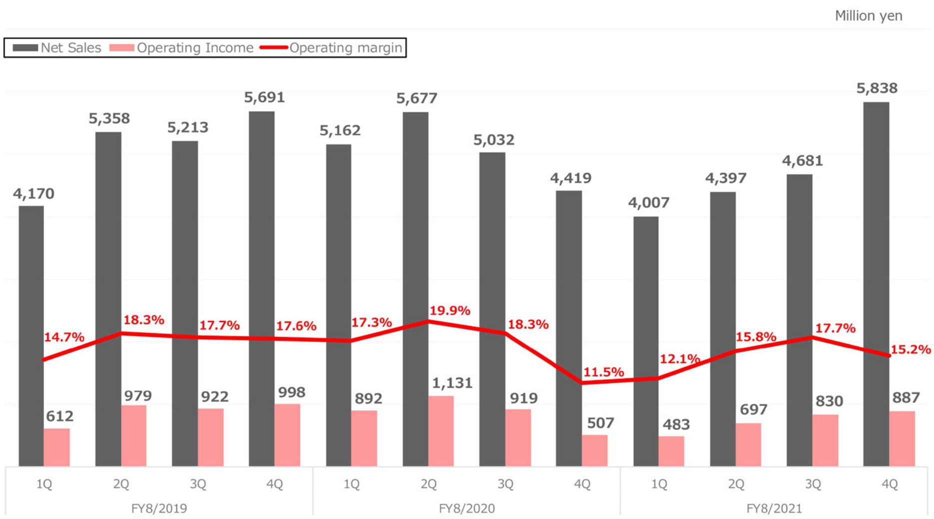
Source: The Company's results briefing materials

(3) Business systems business

Hotels provide the majority of sales in this business, but the sharp decline of inbound demand and the effects of the self-restraint on going out due to COVID-19 have continued for one and a half years since 2H FY8/20. In particular, at business hotels, mainly in the Tokyo metropolitan area, occupancy rates have declined greatly, such as due to the decrease in business trips, and the Company's business activities have also been affected. However, this situation is further spurring-on labor saving and needs for labor saving in hotels, and based on this, it has become essential for hotels, golf courses, and other venues to continuously provide hospitality services that solve the new problems of avoiding face-to-face encounters and direct contact. Therefore, the Company has actively progressed sales with an eye to both the with- and post-COVID-19 periods, including releasing the "IoT Terminal" service to realize smart hotel rooms through DX with the hotel room's TV as the starting point, and "Stay Concierge," which is a DX app to expand contactless points of contact between a hotel and its guests.

Conversely, at hospitals, alongside the market launch of next-generation kiosks that are equipped with facial recognition and insurance card confirmation functions that use AI, the Company has market launched a payment machine for clinics. It has previously delivered machines mainly to conventional, comprehensive hospitals, but this release enables it to approach small-scale hospitals such as general and dental clinics, and the number of machines delivered has steadily increased. Moreover, the My Number personal ID cards for (online) identity verification being progressed by the Ministry of Health, Labour and Welfare began fully fledged operations from October 2021. The Company's "Sma-pa Myna Touch" was selected as one of the recommended devices for this, so this business has been actively conducting sales in every direction, not only to comprehensive hospitals, but also to small-scale hospitals and dispensing pharmacies. For restaurants with strong needs for labor saving, it has developed a personal order system that enables customers to create an original menu for their orders by selecting their favorite ingredients and preferred quantity, and a completely unmanned accounting payment system that is linked to an automatic payment machine. The major hotels have been struggling, so sales and profits declined as sales to hospitals, golf courses, and other sites could not cover for this decline. However, looking toward the post-COVID-19 period, upfront investment in hotels is recovering alongside quarterly improvements in results. In the 4Q, sales of "Sma-pa Myna Touch" increased significantly to ¥1.1bn, but as its gross profit is relatively low, the operating profit margin, which had continuously improved up to that time, temporarily declined.

Business systems business – Quarterly financial results

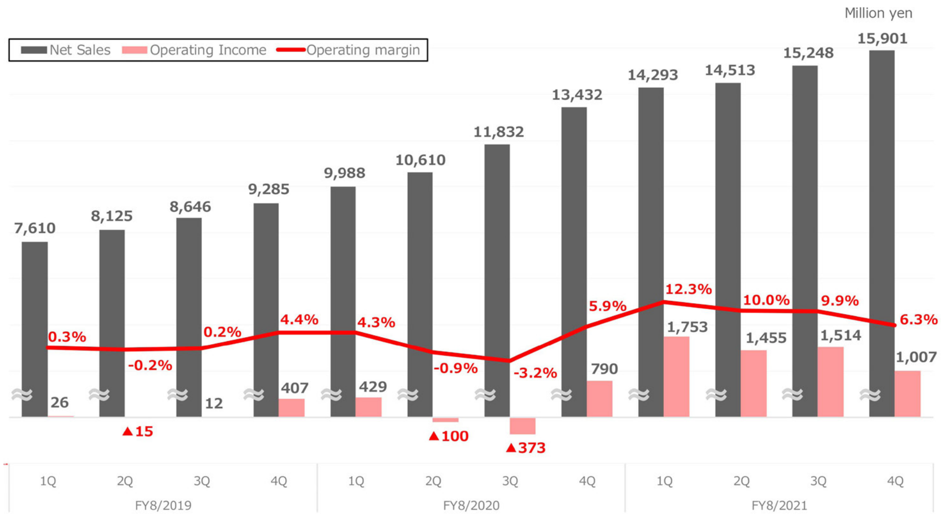


Source: The Company's results briefing materials

(4) Content distribution business

In a situation of the spread of smartphones and the market entries of major foreign companies, synergies have appeared from the increase in nesting demand due to COVID-19, and the video distribution services market is rapidly expanding. In this extremely beneficial situation, the Company has continuously expanded content, enhanced the user experience, improved name recognition, and developed the market. For the expansion of content, in additional to its conventional “coverage strategy” of increasing the number of works covered to an overwhelming number, it is also distributing through unlimited viewing services the popular titles of HBO, the US satellite and cable broadcasting company that is part of the Warner Bros. Group, and of HBO Max, a fixed-fee video distribution service. Moreover, it has also started to develop the “ONLY ON” strategy to strengthen the distribution of works that can only be viewed on “U-NEXT.” To enhance the user experience, various manufacturing companies are equipping the remote controls they provide with sales of new TVs with the “U-NEXT button.” Also, to develop the market, the Company is collaborating with Kansai Electric Power <9503> and has progressed the development of new channels, including starting to provide to households “withU-NEXT Denki” and “withU-NEXT Denki (Gas set),” which offer a new fee menu combining “U-NEXT” and electricity sales. As a result, the number of subscribers (people with contracts) continued to increase greatly, up 18.1% YoY, and sales also grew significantly. In profits, the growth of the number of subscribes exceed the critical point and operating profit increased by seven times as a result. Going forward, alongside this increase in the number of subscribers, profits will enter a phase of growing more than sales. However, it would appear that upfront investment will be essential in order to survive the intensifying competition, and reflecting this, the Company invested in content and promotional costs in the 4Q.

Content distribution business – Quarterly financial results

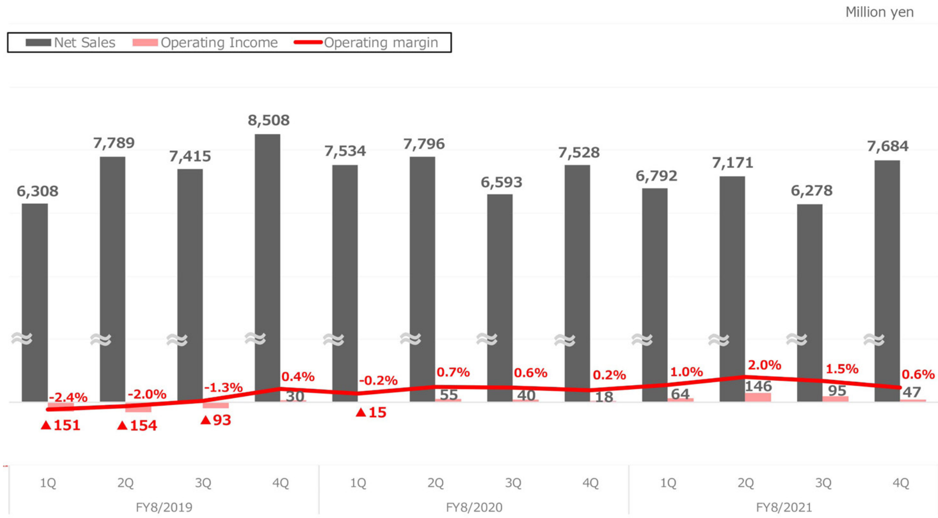


Source: The Company’s results briefing materials

(5) Energy business

Following the outbreak of the novel coronavirus pandemic, economic activities contracted due to the declarations of states of emergency and the priority measures to prevent infections. Therefore, the situation is that the amount of electricity consumed by the customers, of stores and commercial facilities, has not yet fully recovered. The business environment is particularly severe for high-voltage customers due to the intensification of competition and the relative decline in price competitiveness because of the intensifying competition. However, against the backdrop of new initiatives, such as to develop production in collaboration with TEPCO, this business achieved an increase in profits even as sales declined and achieved profitability on a quarterly basis.

Energy business – Quarterly financial results



Source: The Company's results briefing materials

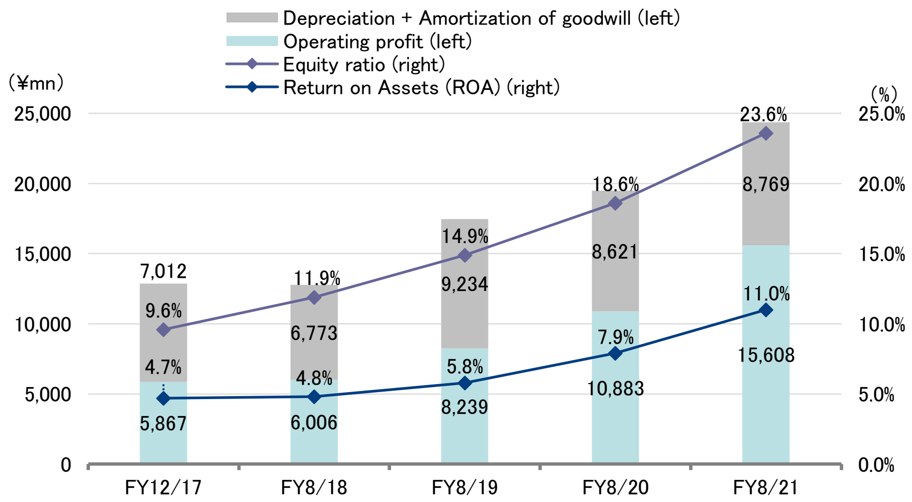
Investments and an improved BS through profit growth, and has room to return profits to shareholders

3. Trends in cash flows

Since the past, the Company has emphasized EBITDA (= operating profit + depreciation + amortization of goodwill), which shows the ability to generate cash, as an indicator. This is because the scale of profits initially after the integration was small compared to currently and the goodwill generated by the integration was a heavy burden on the balance sheet, so it was in response to the markets that viewed the Company's profitability and stability with concern. In other words, it is thought it was necessary for the markets to understand that, in the context of the depreciation and amortization without funding costs and its businesses that stably generate earnings such as the music distribution business, its ability to generate cash was not unstable, and to understand its strategy of allocating this cash into investment in growth businesses, like the content distribution business. In fact, as the Company's ability to generate cash is stable, a virtuous circle has been created in which the integration smoothly generated synergies and therefore profits started to grow immediately after the integration, and goodwill and interest-bearing debt are steadily decreasing and the balance sheet is improving. As a result, not only have the Company's growth potential and profitability improved, the equity ratio, which is an indicator of stability, and ROA, which indicates the efficiency of capital, have also both improved.

In this situation, in the two fiscal years of FY8/20 and FY8/21, profits increased rapidly and EBITDA was also seen to grow. The factors behind this were not only the previously described temporary ones during the COVID-19 pandemic, but can also be said to be the result of the integration's synergies and the growth strategy. Therefore, it is thought that the virtuous circle for cash will further accelerate in the future. In this case, the Company will also have room to expand the scope for using this cash. Cash is generally used for investments, returns to shareholders, internal reserves, and to repay borrowing. Among these uses, internal reserves increase liquidity, so it would not seem necessary to accumulate them in a panic. Also, as the repayment of interest-bearing debt is on schedule, while the Company will repay it early if it can, for this as well it is not thought necessary to increase repayments in a panic. For investments, through investment in the growth businesses, particularly in the content distribution business whose market is expanding due to COVID-19, the Company wants to accelerate investment in content that advances differentiation. For M&A also, for which it became cautious for a time after the integration, it seems that it intends to become more proactive. Fore returns to shareholders, the Company's policy is to continuously increase the dividend alongside raising the dividend payout ratio to a range of 10% to 30%, and it would seem to have ample cash to secure significant funds for this. Through these positive cash developments since the integration, it is likely that the markets' trust in and expectations for the Company's business management will grow more and more.

Trends in EBITDA, the equity ratio, and ROA



Note 1: FY8/18 was an eight-month fiscal year. For USEN, FY8/18 was a nine-month fiscal year from December to August.
Note 2: EBITDA = operating profit + depreciation + amortization of goodwill
Source: Prepared by FISCO from the Company's financial results

In FY8/22, results will grow and will formulate a new medium-term management plan

4. FY8/22 outlook

For the FY8/22 results, the Company is forecasting net sales of ¥220,000mn (up 5.6% YoY), operating profit of ¥17,000mn (up 8.9%), ordinary profit of ¥16,000mn (up 8.3%), and profit attributable to owners of parent of ¥8,500mn (up 5.7%). However, the expected effects of adopting from FY8/22 the Accounting Standard for Revenue Recognizing (ASBJ Statement No.29), are to decrease net sales by ¥2,300mn and operating profit by ¥300mn, including from the effects on sales of the customer-attraction media of other companies in the store services business and the provision of SaaS services in the communications business. In other words, in actuality the forecasts are for net sales of ¥222,300mn (up 6.7% YoY) and operating profit of ¥17,300mn (up 10.8%) for a double-digit increase in profits. The Company has not published YoY comparisons due to the lack of accounting continuity in the consolidated results, but at FISCO, for ease of understanding we have presented reference values through a simple comparison of the new and former values.

FY8/22 outlook

(¥mn)

	FY8/21		FY8/22 (E)		Rate of change
	Results	% of net sales	Amount	% of net sales	
Net sales	208,351	100.0%	220,000	100.0%	5.6%
Gross profit	81,579	39.2%	-	-	-
SG&A expenses	65,971	31.7%	-	-	-
Operating profit	15,608	7.5%	17,000	7.7%	8.9%
Ordinary profit	14,768	7.1%	16,000	7.3%	8.3%
Profit attributable to owners of parent	8,044	3.9%	8,500	3.9%	5.7%

Note: The Company adopted the Accounting Standard for Revenue Recognizing from October 2021. The YoY comparisons are reference values prepared by FISCO through a simple comparison of the new and former values.
Source: Prepared by FISCO from the Company's financial results

For the Group's FY8/22 management policies, it has set (1) Respond to the environmental changes in the with- and post-COVID-19 periods and maintain the growth trend, (2) Formulate a new medium-term management plan to replace the previous medium-term management plan whose targets were achieved three years ahead of schedule and an integration report, and (3) Take on the challenge of achieving non-consecutive growth through strengthening human resources and M&A, for which it has previously been cautious. For (1), it is considered that it will maintain the growth trend by continuing with a balance strategy of attack and defense through appropriate business portfolio management and by adapting its existing businesses to environmental changes. For (2) it plans to formulate a new medium-term management plan and an integration report and announce them in February 2022, which is thought will lead to the promotion of sustainable management. The Company has already achieved the targets in the former medium-term management plan "NEXT for 2024" of operating profit of ¥10bn in FY8/22 two years ahead of schedule and operating profit of ¥13bn in FY8/24 three years ahead of schedule. For (3), up to the present time it has strengthened the existing businesses, including by expanding market shares and improving productivity, and it has successfully launched new businesses in areas peripheral to the existing businesses, such as financing for small-scale businesses and a business for clinics. Going forward, it will recruit first-class and diverse human resources through "CEO's GATE," the President's talent discovery program, and by strengthening internal resources, to solidify the business foundation. It will also add momentum to growth by become more proactive for M&A, for which it has previously been cautious, targeting candidates for which synergies can be expected with the existing businesses. So it seems it is taking on the challenge of achieving non-continuous growth toward net sales of ¥1tn.

For the FY8/22 results by segment, for the store services business, the forecasts are for net sales of ¥56,000mn (down 0.2% YoY) and operating profit of ¥8,600mn (up 0.1%); for the communications business, net sales of ¥50,000mn (up 3.8%) and operating profit of ¥5,100mn (up 12.5%); for the business systems business, net sales of ¥20,500mn (up 8.3%) and operating profit of ¥3,100mn (up 7.0%); for the content distribution business, net sales of ¥67,000mn (up 11.7%) and operating profit of ¥6,900mn (up 20.4%); and for the energy business, net sales of ¥30,000mn (up 7.4%) and operating profit of ¥400mn (up 13.0%). In the store services business, both sales and profits will be negatively affected by the new standard for recognizing revenue, but profits are still forecast to increase while capturing DX demand, such as from commercial stores. The communications business and content distribution business are expected to drive the growth of the Group as a whole through their stable profit growth. The markets of the business systems business and the energy business had become slightly distorted due to COVID-19, but they are expected to normalize so the forecasts are for higher sales and profits. We are starting to see the impact of COVID-19 on the markets settling down, and in FY8/22, there are expected to be rebounds to both its positive and negative effects seen up to the previous period. However, it is extremely difficult to anticipate what these impacts will be, so at FISCO, our impression is that these forecasts are somewhat conservative as a whole.

Segment outlook for FY8/22 (before adjustment)

(¥mn)

[Net sales]	FY8/21		FY8/22 (E)		Rate of change
	Results	% of net sales	Amount	% of net sales	
Store services business	56,112	26.9%	56,000	25.5%	-0.2%
Communications business	48,179	23.1%	50,000	22.7%	3.8%
Business systems business	18,925	9.1%	20,500	9.3%	8.3%
Content distribution business	59,956	28.8%	67,000	30.5%	11.7%
Energy business	27,926	13.4%	30,000	13.6%	7.4%

[Operating profit]	FY8/21		FY8/22 (E)		Rate of change
	Results	Profit ratio	Amount	Profit ratio	
Store services business	8,590	15.3%	8,600	15.4%	0.1%
Communications business	4,534	9.4%	5,100	10.2%	12.5%
Business systems business	2,898	15.3%	3,100	15.1%	7.0%
Content distribution business	5,731	9.6%	6,900	10.3%	20.4%
Energy business	354	1.3%	400	1.3%	13.0%

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

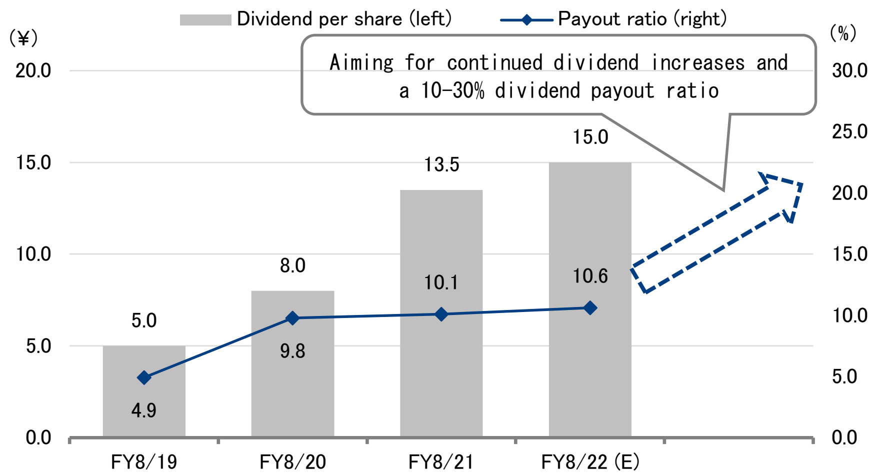
Shareholder return policy

Policy is to continuously increase the dividend, targeting a dividend payout ratio from 10% to 30%

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 ¥13.5 period-end dividend in FY8/21 as the result of an overall assessment of results and other factors in accordance with the fundamental policy. It plans to pay ¥15.0 per share as the FY8/22 annual dividend. The Company is aiming for a 10-30% dividend payout ratio in the medium-term and its policy is to continue increasing the dividend.

Trends in dividend per share and payout ratio



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

Shareholder benefits include the “U-NEXT” content distribution service and the “Premium Benefit Club”

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 hospitality 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 hospitality products on the “Premium Benefit Club Portal” membership website for individual investors.

Information security

Reducing security risk for the Group as a whole

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

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