

USEN-NEXT HOLDINGS Co., Ltd.

9418

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■ Summary

Highly-profitable and high-growth company that generates cash flow

USEN-NEXT HOLDINGS Co., Ltd. <9418> (referred to below as “the Company”) delivers a music distribution service and other related services, and provides a full range of solutions required for running stores and other facilities. The Company also provides “U-NEXT,” a flat-rate video distribution service to consumers. USEN and U-NEXT reintegrated in December 2017, and the integration aimed to direct cash from the cash-cow music distribution business to high-growth businesses such as store operations solutions, and promote growth. Another aim is to mutually utilize the strengths of each group company, including music/video content and network infrastructure, and closely link their respective sales channels to create group synergies by cross-selling the mainstay products of group companies and thereby maximize sales per customer.

The store services business provides music distribution services to restaurants, retail stores and other businesses, hotels, hospitals, and other facilities, manages music copyrights, and provides store IoT products and other solution services necessary for operating stores. The energy and media businesses target such customers with sales of electricity and gas, as well as services like “Hitosara” that use media to help attract customers. The communications business sells broadband Internet lines to businesses and mobile communication (MVNO) services to individuals, as along with other services. The business systems business provides automated payment machines and front desk management systems to hotels, hospitals and golf courses, among other users. The content distribution business distributes videos, e-books, and other digital content to individuals. Although the Company’s business domains are wide-reaching, its sales platform carefully and precisely responds to changes in market conditions as well as customers’ needs.

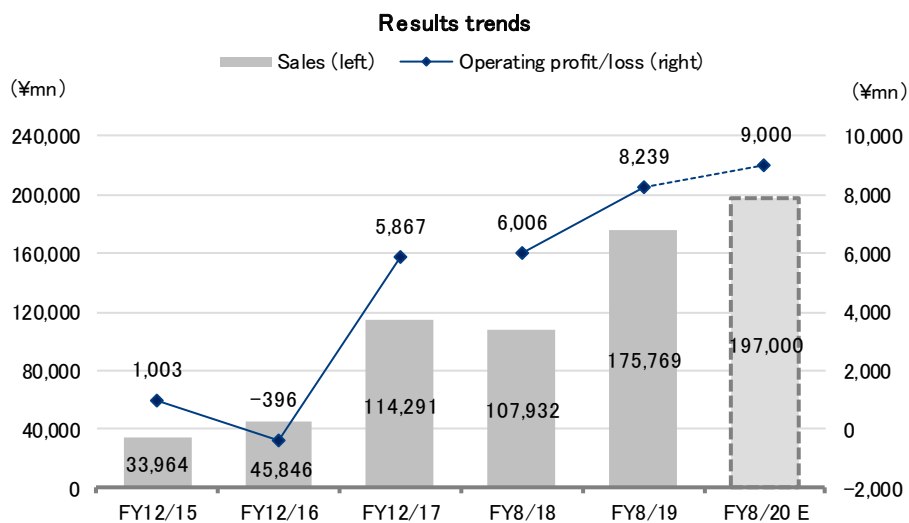
In FY8/19, the Company reported ¥175,769mn in net sales and ¥8,239mn in operating profit. In addition to bolstering its existing businesses for stores, the Company strengthened the energy business and the content distribution business, both of which are positioned as high-growth areas, and in the stably-growing business systems business the Company provided products using cutting-edge technologies and delivered effective solutions addressing the challenges customers face, including the shortage of manpower and cashless payments. The Company’s FY8/20 guidance calls for ¥197,000mn in net sales (+12.1% YoY) and ¥9,000mn in operating profit (+9.2% YoY). To help customers address the pressing issue of manpower shortage, the Company is going one step further than helping customers save labor by starting to offer personnel support solutions services for hiring part-time workers and hiring foreigners as permanent employees in conjunction with the April 2019 amendment of the Immigration Control and Refugee Recognition Act. Also, it is increasingly likely that the strong-performing electricity sales business will become profitable a year earlier than originally expected.

Summary

Many of the Company’s businesses are performing well due to proactive management, so the targets of ¥10bn in operating profit by FY8/22 and ¥13 in operating profit by FY8/24 as set forth in the medium-term management plan “NEXT for 2024” are well within reach. Considering the current performance, the Company might even achieve the medium-term management plan’s targets a year ahead of schedule. At any rate, the Company is looking to achieve double-digit annual average profit growth, which is the benchmark of strong growth. A high level of growth is expected in the energy business, where margins are low because it is a wholesale business, and the medium-range operating margin target is in the 4% range. However, excluding the energy business, the operating margin is expected to be high in the 6% range, while operating margin prior to goodwill amortization costs, which is representative of the Company’s ability to generate cash, is expected to be even higher at 8%. The Company operates in a wide range of domains and makes it difficult to understand, but the Company is a highly-profitable and high-growth company that generates cash flow.

Key Points

- Headed for a stage of fully leveraging management integration synergies
- Aiming for ¥13bn in FY8/24 operating profit
- Might achieve the medium-term management plan’s targets a year ahead of schedule based on the current strong performance



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

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

■ Company profile

Leveraging the customer base of 750,000 users

1. Company profile

The Company is a holding company that provides music distribution services (the founding business), a flat-rate video distribution service, and store and facility assistance tools and solutions via subsidiaries to commercial, retail, and other customer sites. It was established through the reintegration of the former U-NEXT and the former USEN. The integration aims to leverage the customer base, which includes some 750,000 stores and commercial facilities, and which is the Company's greatest asset. In addition to the strong direct sales platform, the idea is to create group synergies by merging the respective strengths of group companies, including each subsidiary's sales capabilities such as telemarketing, web marketing, and agency networks, music and video content, and network infrastructure, and from cross-selling mainstay products of group companies. Another aim is to realize dynamic growth strategies as a corporate group possessing abilities in IoT, AI, and other next-generation technologies. Furthermore, the reintegration is expected to result in higher operational efficiency by reducing overlapping costs incurred by individual group companies through the consolidation of common group functions.

Promoting digitalization and diversification from the founding business of music distribution

2. History

Mototada Uno founded USEN in 1961 as Osaka Yusen Broadcasting and subsequently built a wired broadcast network nationwide. When Yasuhide Uno took over as President in 1998, he promoted store assistance services and broadband service using the Company's existing customer base and infrastructure, and pursued diversification and digitalization, including video distribution, electronic books, and other content provision services. U's Broad Communications (now, U-NEXT), a broadband service provider, a USEN subsidiary, took over the TV paid video distribution service and sales agent business for personal optical lines and other communication lines and spun off from USEN in December 2010. However, in December 2017, the Company decided to reintegrate USEN and U-NEXT in order to leverage the group's strengths, such as the customer base, sales channels, and store assistance know-how of both companies respectively.

Business overview

The Company has six business segments: store services, communications, business systems, content distribution, energy, and media. It mainly uses a B-to-B format. The store services business provides music distribution services to restaurants and other stores, engages in sales and installation of distribution equipment, manages music copyrights, and provides store IoT and other store operation solution services. The energy and media businesses provide such customers with sales of electricity and gas, as well as services like “Hitosara” that use media to help attract customers. The communications business sells broadband Internet line for businesses and MVNO services to individuals. The business systems business provides automated payment machines and front desk management systems to hotels, hospitals, and other customers. The content distribution business distributes video, e-books, and other digital content to individuals. The Company is expanding a recurring income model of collecting monthly fees.

Enhancement of store services

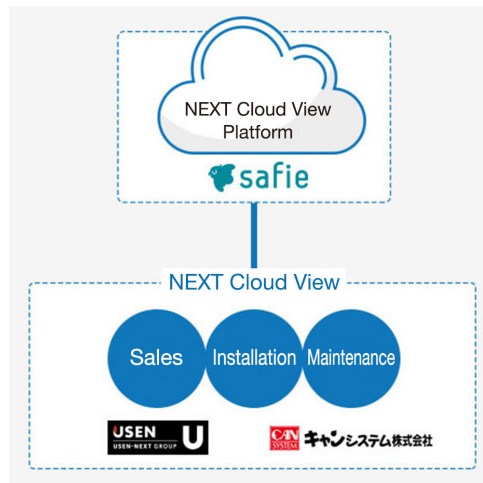
1. Store services

The store services business is centered on music distribution, which is the group’s core and founding business, where it provides, sells, and installs various store-related products and services, and manages and develops music copyrights, along with other services. The music distribution service has been operating for more than 50 years, and it provides the “USEN” service for broadcasting music and information to stores and facilities nationwide with a content range of specialty channels (such as J-POP and Western music). Stores comprise the vast majority of customers, with restaurants, retailers, beauty salons, and health clinics accounting for a high percentage of users. Chain store users range from national chains to chains focused on local areas. Users rent service tuners from the Company, and the tuners utilize a dedicated coaxial cable, communications satellite, or Internet line as infrastructure. Naturally, the Company properly handles copyright issues for all of the music it supplies. The group has extensive support operations with 170 branches, 1,100 salespeople, and 900 engineers nationwide. This gives it the ability to cover services from installations to aftercare. We think the deep-rooted popularity of this service makes sense given its robust music lineup, the high quality, and support system, along with its high cost performance based on the fact that for a monthly fee of ¥4,000-¥5,000 users don’t need to have CD players and other hardware, buy software on an ongoing basis, select songs, or deal with cumbersome copyright issues. This business holds a dominant market share with a strong customer base of over 750,000 users, and supplies more than 90% of in-store and facility background music (including CANSYSTEM, the No.2 company in music distribution service to business sites which was converted into a wholly-owned subsidiary in October 2018). Indeed, it is a cash-cow business that supports the group’s strategy.

Business overview

The Company provides a solutions service related to store operations to business sites, ranging from business launch assistance to business environment building and promoting sales. The shift to IT has progressed in the retail and service sectors in recent years, and this trend has made the business environment even more challenging for smaller and very-small stores. To help such stores, the Company provides one-stop delivery of cutting-edge equipment and systems, and this service has been well received. There are a variety of offerings, including tablet POS register “U Regi,” tenant comprehensive insurance for business operators “Omise-no-Anshin Hoken,” store app creation service “UPLink,” facility Wi-Fi service “U-SPOT,” and “REACH STOCK,” a food ingredients buying service that connects producers and restaurants. The service offerings are in the process of being further expanded. One service particularly worthy of attention is the IP camera service. “NEXT Cloud View” is a high-resolution cloud-based camera service provided by USEN and CANSYSTEM in collaboration with Safie Inc. which excels in cloud recording services, and adds rush support service by USEN. In addition to offering crime prevention for offices and stores through video, it also offers cutting-edge analytical services to boost operating efficiency and aid with marketing.

NEXT Cloud View

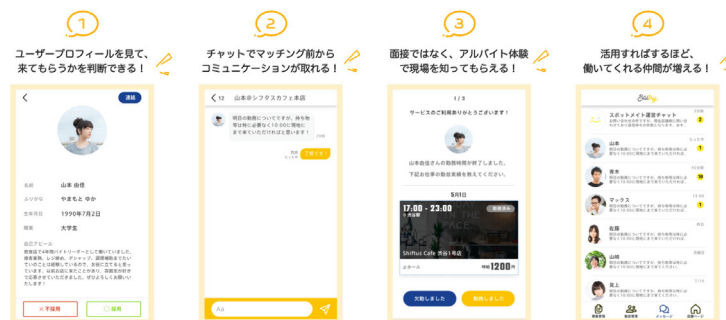


Source: The Company's press release

Business overview

The biggest problem for businesses right now is securing human resources. Nothing can be done about rising personnel costs, but not being able to find workers creates real problems. In response, the Company started offering personnel support solution services to resolve labor shortages, including for both hiring part-time workers and hiring foreign workers who have obtained a visa based on having specified skills as regular employees. The first initiative is a capital and business alliance with Spotmate inc., which operates the part-time job matching app “Baitry.” Through “Baitry,” people can experience part-time jobs on the spot, allowing stores to check compatibility with employees, and employees to check the workplace atmosphere and the work they will do in a specific job. The app is expected to prevent mismatches between stores and employees and lead to long-term employment. The second initiative is through subsidiary Next Innovation Co., Ltd. Next Innovation has started offering “Stay Worker,” a foreign worker recruitment support service that provides services from introduction to support requirements that must be done by the host company after hiring for stores with foreign worker hiring needs, all in a one-stop manner. Based on the fact that guidelines have been released stating that Japan will accept up to 350,000 foreign workers over the next five years based on the amended Immigration Control and Refugee Recognition Act that went into effect in April 2019, this goes beyond the bounds of the store services business and is highly beneficial for society as a whole. Speaking of being highly beneficial for the public, the “U-SPOT” Wi-Fi service for business sites has been registered for the telecommunications business by the Ministry of Internal Affairs and Communications, and it will start providing public wireless LAN access service in public spaces including shopping districts, building entrances, parks, train stations, and parking lots. By contributing to the enhancement of social infrastructure through the shift to public Wi-Fi, and offering high-speed, large-capacity IPv6 next-generation Internet connection service (provider) as a standard, stores will have higher-quality and more comfortable communication environments.

Part-time Job Matching App “Baitry” as Seen by Worker



Source: The Company's press release

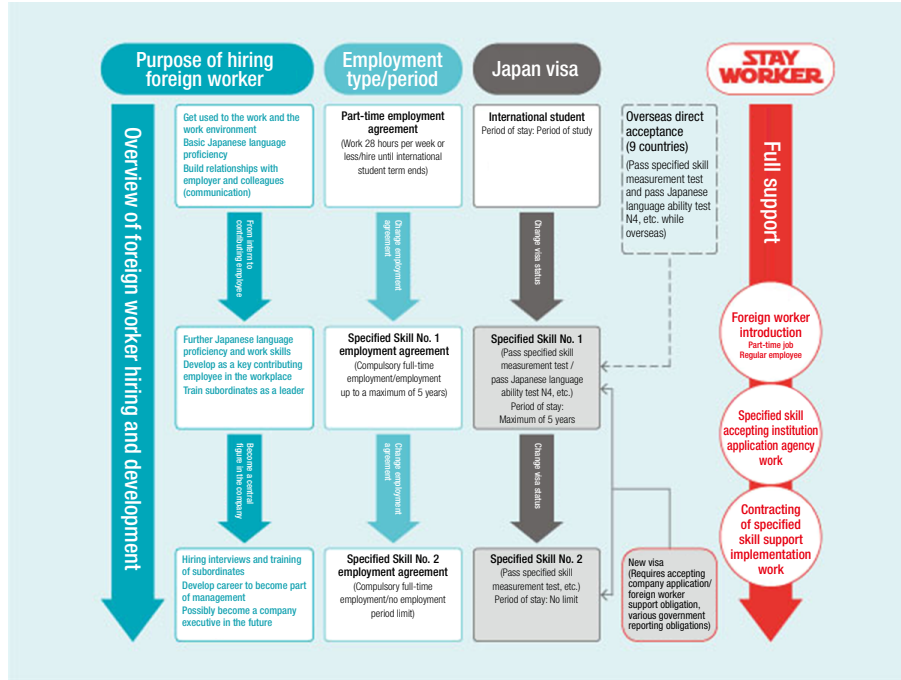
Part-time Job Matching App “Baitry” as Seen by Hiring Store



Source: The Company's press release

Business overview

Overview of Foreign Worker Support Service “Stay Worker” Service



Source: “Stay Worker” website

Steadily built up track record is highly regarded

2. Communications

The communications business provides “USEN GATE 02,” an ICT solution for businesses, “USEN Hikari,” a broadband Internet line for businesses, “U-mobile,” an MVNO service for individuals, and “U-NEXT Hikari 01,” a broadband Internet line for individuals. The ICT business sells a variety of ICT products and services, including “USEN GATE 02” Internet line, dedicated lines, and other corporate network services, cloud services from Google, Cybozu Inc. <4776> and others, data communications and mobile device management (MDM) services, and data center services. The Company was the first provider worldwide to offer Internet connection service from optical fiber and has provided services to more than 40,000 companies in the constantly changing and advancing ICT industry. We think the breadth of the service lineup is an important strength in this business. The business handles all network environment-related needs while offering an integrated contact point that provides a high level of convenience. Recognizing this track record, the Company’s subsidiary USEN ICT Solutions won the “New Customer Success” award at the LINE WORKS Partner Conference 2019 held by WORKS JAPAN Mobile Corp., a fellow subsidiary of LINE Corporation <3938>, and won the “Sales Division Award” and the “Sales Advisory of the Year” award at the CYBOZU AWARD 2019 held by Cybozu, Inc.

Boosting customers' efficiency and providing convenience for users

3. Business systems

Subsidiary ALMEX INC. 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 automated payment machines might seem like a market segment that would be dominated by large electric equipment manufacturers, ALMEX holds very high market shares in Japan, at 85% for leisure hotels, 65% for business hotels, 65% for large medical institutions, and 70% for golf courses. As a fables manufacturer, it develops, sells, and provides maintenance for equipment and systems on its own, which is a strength, which makes it a unique presence within the group. Also, in addition to helping customers increase the efficiency of their operations, including labor-saving measures, ALMEX uses a product development method that takes convenience for facility users into consideration as well, and this is an important differentiating factor. In terms of recent examples, ALMEX has launched “Sma-pa CHECK OUT,” which allows users to pay their hospital bills without worrying about waiting time by paying later, and “Sma-pa TERMINAL-Z,” a next-generation automated payment machine equipped with facial recognition and insurance card confirmation functions using artificial intelligence technology, which is also compatible with cashless transactions. In this way, ALMEX is implementing an expansion strategy by introducing products that improve customer operation efficiency and user convenience, but going forward it is also planning to increase fee income for software services installed in terminals. In addition, ALMEX is expanding its domains beyond existing geographic and sector targets, by introducing automated payment machines in the IXORA hotel in Penang, Malaysia and at all ROUND ONE Corporation <4680> amusement facilities.

“Sma-pa TERMINAL” next-generation reception machine equipped with facial recognition capability (left) and “Sma-pa TERMINAL-Z” next-generation medical fee automated payment machine (right)



Source: The Company's press release

Well regarded lineup, including the most unlimited on-demand items in the industry

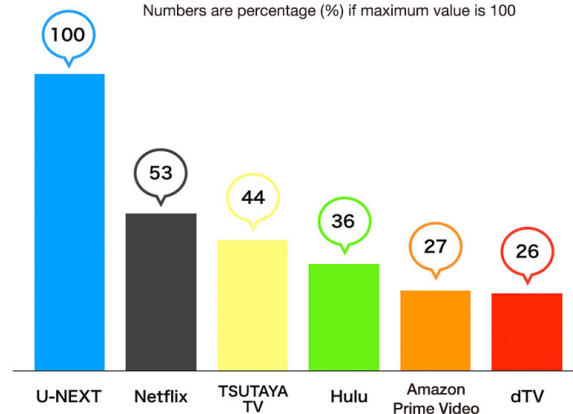
4. Content distribution

U-NEXT provides video distribution (video-on-demand; VOD) service. This service charges a monthly fee to individuals for viewing access by television, PC, smartphone, or other devices of video content and television, electronic book content, and music content. The biggest feature of the service is the number of videos that can be watched on an unlimited basis, which is said to be more than double that of competitors. The Company is executing a strategy that aims to have the leading lineup of content in all genres, and according to data compiled by an independent company, U-NEXT has been No. 1 in terms of the number of videos that can be viewed on an unlimited basis for 15 consecutive months. While it is a pay service, more new works can be viewed faster than its competitors. U-NEXT is the only service that carries adult content, and the importance of carrying adult content is understood when one considers the overwhelming victory by TSUTAYA Co., Ltd. over US-based major Blockbuster LLC during the growth years in rental videos. The Company charges ¥1,990 per month. While this may seem expensive at first glance, it is actually fairly reasonable considering the robust content with more than 160,000 items, support for four users per account, and an allocation of ¥1,200 in points each month that effectively enables free access to the latest pay items within the point range. In addition, the remote control of the Toshiba Corporation <6502> TV "Regza" released in June 2019 is equipped with the U-NEXT button to launch U-NEXT programs directly, and the range of compatible devices have been increased, including Apple TV and "popIn Aladdin," a ceiling light with a projector. These and other initiatives have been boosting the level of convenience for users. Consequently, the Company's growth potential is particularly strong, despite the intensification of competition with massive service firms Amazon <AMZN> Prime Video, Netflix <NFLX>, and others.

U-NEXT Service Content Lineup

Six Main Genres

Numbers are percentage (%) if maximum value is 100

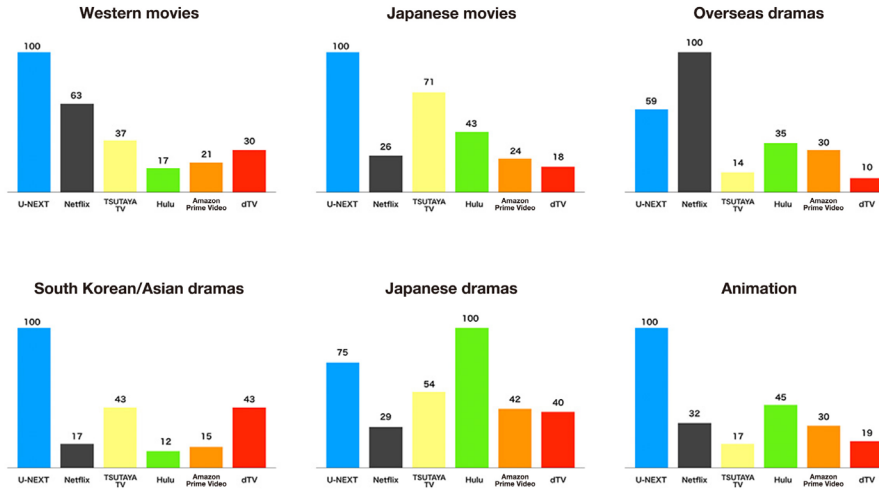


VOD lineup analysis tool (May 2019 / GEM Partners research)

Source: The Company's press release

Business overview

Market share by genre



VOD lineup analysis tool (May 2019 / GEM Partners research)

Source: The Company's press release

Rapidly growing hook product

5. Energy

In the energy business, the Company sells high- and low-voltage electricity and city gas to stores and retail facilities located outside of partner Tokyo Electric Power Company Holdings, Inc.'s <9501> service territory, and also offers consulting services such as proposals of energy-conservation measures. Even though this business was just recently launched in September 2016 following the liberalization of electricity sales, the Company has attracted strong interest and is rapidly increasing the number of subscribers by promoting low prices to its deep customer base, as will be discussed below. There are high hopes for it as a hook product that leads to cross-sales of other products, and the Company sees this as an important product and has thus built up a dedicated sales platform and is bolstering sales. Unlike new electricity, which may be subject to the risk of negative spreads due to temporary risks such as seasonal fluctuations due to differences in power supply systems, the Company's energy business involves the resale of electric power wholesaled from TEPCO Holdings. Although the profit margin is low, the Company is always able to earn a spread in this business.

Disseminating information on gourmet restaurants inside Japan and overseas

6. Media

The core product in the media business is “Hitosara,” a gourmet restaurant information website that helps restaurants attract customers. The site focuses on chefs (Hito) and food (Sara). By narrowing its scope to relatively high-end restaurants, it differentiates itself from rival sites. “Hitosara” has established a solid market position. In income, it added transaction fees for on-the-spot reservations to the existing advertising revenue business model. It operates “SAVOR JAPAN,” a multi-lingual version of “Hitosara” that targets foreigners visiting Japan, as an inbound strategy. The media business also offers “WeColle,” a wedding media that targets women who are beginning to think about marriage using a four-pronged strategy (free magazine, Internet, events, and salons) and as well as “bangs,” a web magazine for finding hair and other stylists.

Medium-term management plan

Aiming for ¥13bn in FY8/24 operating profit

1. “NEXT for 2024” medium-term management plan

The Company formulated “NEXT for 2024,” a medium-term management plan with “Brighten the future” as its group brand slogan in June 2019. It is a five-year plan starting in FY8/20, and its five core strategies are 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. Based on these efforts, it hopes to reach ¥270bn in net sales, ¥13bn in operating profit, and high-quality balanced finances by FY8/24. It also wants to raise the dividend payout ratio to 30% at some point. To this end, the Company aims carry out its growth strategy in accordance with “NEXT for 2024,” and focus on ROE, which is considered the most important management indicator, and its component factors (equity and profit attributable to owners of parent) as benchmarks.

Numerical goals in NEXT for 2024

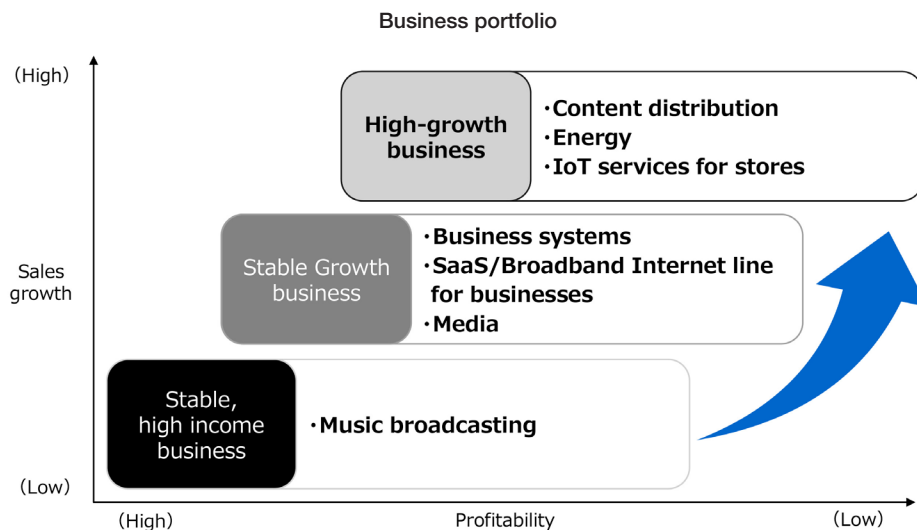
	FY8/19	FY8/22	Growth ratio (vs. FY8/19)	FY8/24	Growth ratio (vs. FY8/19)
Net sales	1,758	2,300	30.9	2,700	53.6
Operating profit	82	100	22.0	130	58.5
Ordinary profit	67	90	34.3	120	79.1
Profit attributable to owners of parent	61	45	-26.2	65	6.6
EBITDA	175	200	14.4	235	34.4
EBITDA-CAPEX	106	100	-5.7	135	27.4
ROE	33.6	15	-18.6pt	15	-18.6pt
Equity ratio	14.9	20	5.1pt	30	15.1pt
Leverage ratio	4.2	3.0	-1.2pt	2.5	-1.7pt
Debt equity ratio	3.5	2.0	-1.5pt	1.5	-2.0pt
Payout ratio	4.9	10~30	-	10~30	-

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

Leverage cash from stably high profits to achieve growth

2. Group medium-term management vision

Looking at the integration aim more closely, the Company hopes to utilize cash from the music distribution business, which is the founding business, which lacks significant growth potential on its own but is an excellent cash cow, to develop other growth businesses. Also, based on the strong customer base of 750,000 users (including for CANSYSTEM which joined the group), the Company wants to integrate sales, technological assistance, and services, which have been scattered among companies and businesses thus far, thereby enhancing cross-sales and upselling for individual customers (increasing the average customer sales price), and thus maximize sales per customer. The Company also plans help users address issues like the aging of society, the shift to cashless payments, and the increase in inbound activity. To do so, the Company regrouped the business portfolio into three categories at the time of the integration –cash-cow, stable high-income businesses with a robust customer base (music distribution business); stable growth businesses that will continue to grow based on consistent needs (business systems business, SaaS/line business, media business); and high-growth businesses expected to be sources of future earnings (content distribution business, energy business, store IoT business). Also, the Company needs to evolve its management framework from a top-down approach to a bottom-up approach in order to build an environment for creating new services and products. Work style reforms occupy an important position in the strategy for achieving this, and the Company is introducing super-flex time and telecommuting programs, as well as allowing employees to work at whatever desk they choose along with establishing open spaces in the office to foster better communication and otherwise create an environment that helps people work more productively. In addition, the Company plans to raise the mandatory retirement age from 60 to 70 as a means of preventing know-how and skill from declining or altogether leaving the Company, as a part of efforts to amass group knowledge.



Financial results trends

Strong FY8/19 results

1. FY8/19 results

In FY8/19, the Company reported ¥175,769mn in net sales, ¥8,239mn in operating profit, ¥6,702mn in ordinary profit, and ¥6,069mn in profit attributable to owners of parent. It did not provide YoY comparisons because FY8/18 was an eight-month period to alter the fiscal year, but we believe the Company's results were strong. In addition to strengthening the existing businesses for stores, the Company bolstered its initiatives in the energy business and the content distribution business, both of which are positioned as high-growth businesses, and in the stable-growth business systems business it provided products using cutting-edge technologies, and expanded sales of labor-saving products such as tablet POS registers to stores which are suddenly facing various challenges, including the shift to cashless payments. Also, the Company made CANSYSTEM a consolidated subsidiary effective October 1, 2018 (deemed acquisition date of November 30, 2018). FY8/19 net sales exceeded the initial guidance by more than ¥5,000mn, while operating profit likewise exceeded the initial forecast by more than ¥200mn. The over-achievement in net sales was largely due to the fact that CANSYSTEM's sales were not included in the initial guidance, while the excess profit was primarily due to the upturn in profit in the business systems business.

FY8/19 results

	(¥mn, %)			
	FY8/18	% of net sales	FY8/19	% of net sales
Net sales	107,932	100.0	175,769	100.0
Gross profit	45,948	42.6	69,753	39.7
SG&A expenses	39,941	37.0	61,513	35.0
Operating profit	6,006	5.6	8,239	4.7
Ordinary profit	5,012	4.6	6,702	3.8
Profit attributable to owners of parent	3,169	2.9	6,069	3.5

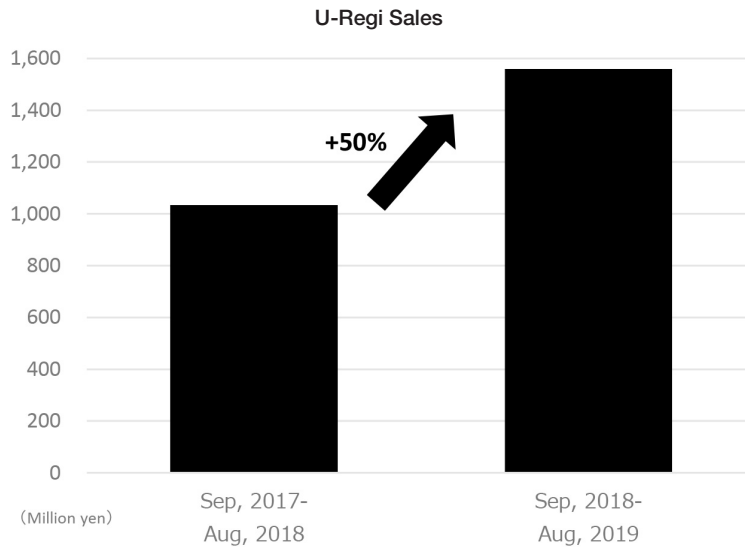
Note: FY8/18 is an irregular eight-month fiscal period
 Source: Prepared by FISCO from the Company's financial results

The energy business turned profitable in FY8/19 4Q

2. FY8/19 results by segment

In the store services business, the Company expanded the lineup of services for stores and commercial facilities, and provided total solutions including store opening support centering on music distribution services and IoT services, as well as solutions for building store environments, attracting customers, and promoting sales. In addition, ahead of the consumption tax rate revision on October 1, 2019, demand for reduced tax rates and cashless payments increased, so inquiries about tablet POS cash register "U Regi" and payment service "U Pay" increased. In particular, sales of "U Regi" grew significantly by 50% (effective fiscal year comparison), as users were drawn to its many functions and low cost, its slick design and intuitive operability, as well as its helpful support service which can be accessed 365 days a year at the Company's 170 offices and dedicated help desks. In addition, to address inbound demand, the Company provides public wireless LAN access services to public spaces such as shopping districts, large commercial facilities, building entrances, parks, train stations, and parking lots, and offers the "USEN Omotenashi Cast" service that accurately delivers facility announcements in four languages – Japanese, English, Chinese, and Korean.

Financial results trends



Note: Only recurring sales, not including initial sales for equipment, etc.
 Source: The Company's results briefing materials

In the communications business, the broadband Internet line sales agency sector continued robust new user acquisition mainly targeting smaller businesses, and the Company shifted from one-shot agency commissions to providing running services delivered by the Company. In office ICT environment construction, the Company proposed "USEN GATE 02" brand network-related services, cloud services, and data center services according to customers' office environments, and made progress in building a platform to propose ICT environment construction in a one-stop manner. In March 2019, a new company was established in order to focus on the SaaS business which is expected to grow going forward.

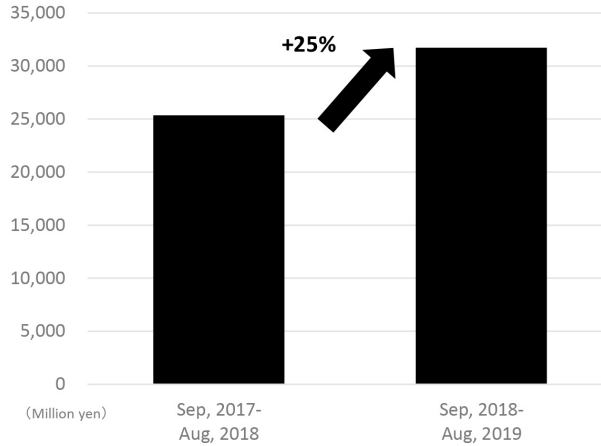
In the business systems business, the number of foreign visitors to Japan is expected to further increase ahead of the 2020 Tokyo Olympics, so the Company continued to promote the introduction of hotel management systems and automated payment machines, and responded to hotels' labor-saving needs. The Company also worked on launching new products, strengthening proposal-based sales, increasing market penetration, and expanding its market share. In the hospital market, aiming to improve hospital management efficiency and user convenience, the Company introduced "Sma-pa TERMINAL," a next-generation reception machine equipped with a facial recognition system, and "Sma-pa TERMINAL-Z," a next-generation medical expense automated payment machine. The Company boosted the relationship of trust with customers by providing efficient and consistent services, including maintenance and repair services after installing these machines.

In the content distribution business, the Company continued to expand content and develop the market as the video distribution market surges. As a result, the number of subscribers grew steadily, and "U-NEXT" sales grew significantly by 25% (effective fiscal year comparison). In terms of enhancing content, the lineup was expanded across all genres, and U-NEXT has been No. 1 in terms of the number of videos that can be viewed on an unlimited basis for 15 consecutive months, and the service is also No. 1 in the number of titles for Western movies, Japanese movies, Korean/Asian dramas, and animated shows (based on May 2019 data from GEM Partners Inc.). The video distribution market is simultaneously expanding, becoming accessible to more people, and becoming more diverse. Given these trends, the Company's strategy of expanding the product lineup has been an intelligent one. In terms of cultivating the market, the focus on increasing viewer convenience, including increasing TV remote controls equipped with the "U-NEXT" button and having more devices compatible with "U-NEXT," has been a major factor behind the strong sales.

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

Financial results trends

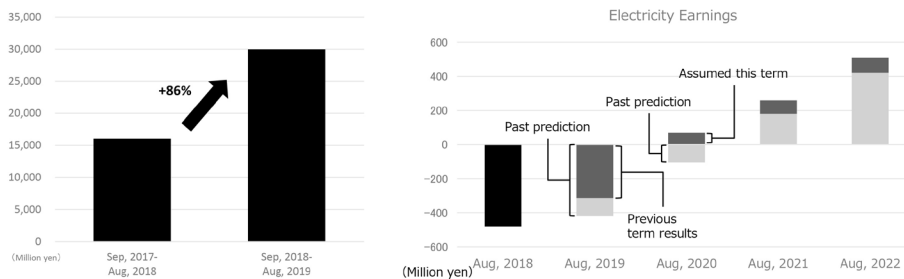
“U-NEXT” Sales



Source: The Company's results briefing materials

The energy business is part of the Company's lineup of services for business sites and commercial facilities, and it involves mainly sales of high-voltage and low-voltage electricity. It has positioned the energy business as a high-growth business, and promoted aggressive investment and sales activities, including the formation of a dedicated sales division, as a means for further growth as a future mainstay business. Electricity sales have been received well since the September 2016 launch, with sales soaring 86% (effective fiscal year comparison). In FY8/19 4Q, the business realized profitability in electricity sales faster than expected, and it seems to have already started recovering up-front investment (fixed costs). As a result, electricity sales on a fiscal year basis are also expected to turn profitable a year earlier than the Company initially forecasted. Also, in 2018 the Company began selling “USEN GAS” in the area that Tokyo Gas Co., Ltd. <9531> supplies city gas, and sales have been well received. Currently, the Company is providing this service in the areas supplied by Osaka Gas Co., Ltd. <9532> and TOHO GAS Co., Ltd. <9533>.

“USEN Denki” Sales (left) and Plan for Achieving Profitability in Electricity Sales



Source: The Company's results briefing materials

In the gourmet restaurant information media (“Hitosara”) business, the Company worked to differentiate itself from rivals by strengthening its media capabilities, including publishing related books. Also, the Company launched “AI Concierge,” which uses artificial intelligence in support desk operations for member restaurants, and provides automated inquiry responses 24 hours a day, 365 days a year, thereby increasing convenience for member restaurants (a switch with manned service). “SAVOR JAPAN,” a gourmet site for overseas visitors, worked with online media “tsunaguJapan” (which targets inbound tourists) to draw customers, announced 50 selected restaurants with luggage check-in services, and otherwise launched initiatives to secure new customers using restaurants’ open spaces and to secure sources of profits.

Financial results trends

FY8/19 results by segment

	(¥mn, %)			
	FY8/18	% of net sales	FY8/19	% of net sales
Store services business	32,600	29.9	48,699	27.3
Communications business	27,955	25.6	40,027	22.5
Business systems business	13,911	12.7	20,434	11.5
Content distribution business	17,390	15.9	33,667	18.9
Energy	13,743	12.6	30,022	16.9
Media	3,600	3.3	5,256	3.0

	FY8/18	Profit ratio	FY8/19	Profit ratio
Store services business	6,063	18.6	7,703	15.8
Communications business	2,390	8.5	2,643	6.6
Business systems business	2,506	18.0	3,512	17.2
Content distribution business	125	0.7	431	1.3
Energy	-482	-3.5	-368	-1.2
Media	245	6.8	355	6.8

Note: FY8/18 is an irregular eight-month fiscal period
 Source: Prepared by FISCO from the Company's financial results

Excess profits again possible in FY8/20

3. FY8/20 outlook

The Company's FY8/20 guidance calls for ¥197,000mn in net sales (+12.1% YoY), ¥9,000mn in operating profit (+9.2%), ¥7,700mn in ordinary profit (+14.9%), and ¥3,300mn in profit attributable to owners of parent (-45.6%). Profit attributable to owners of parent is expected to decline due to the non-recurrence of the deferred tax assets in conjunction with sales of real estate booked in FY8/19, but sales and profits are otherwise forecast to increase. FY8/20 forecasts are projections in accordance with the medium-term management plan. However, with respect to dealing with the shortage of labor that is attracting attention as an urgent issue in FY8/20, the part-time job matching app "Baitry" and foreign worker recruitment support service "Stay Worker" are likely to benefit the store service business and the business systems business. Electricity sales in the energy business, which is expected to become profitable a year ahead of schedule, is also a point of focus. If steady progress is made on these initiatives, sales and profits may exceed FY8/20 guidance.

FY8/20 outlook

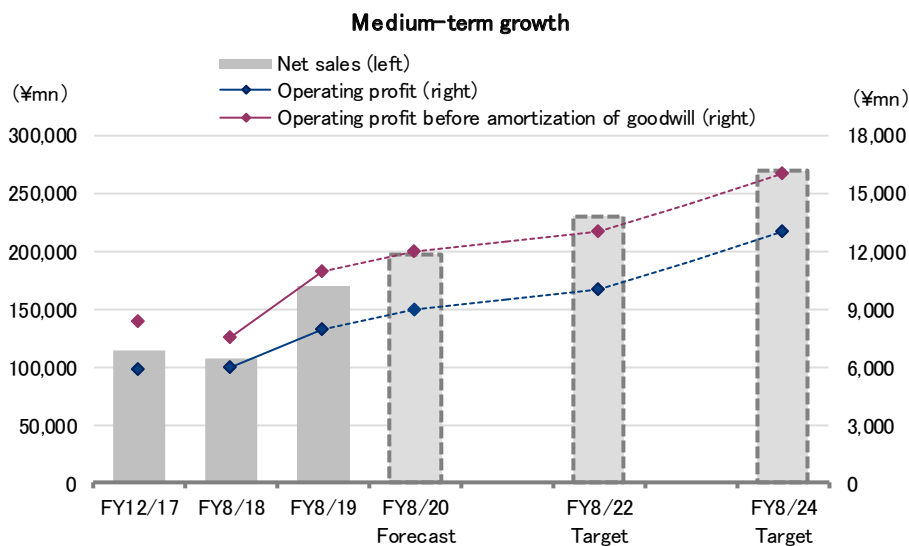
	(¥mn, %)				
	FY8/19	% of net sales	FY8/20 E	% of net sales	% of change
Net sales	175,769	100.0	197,000	100.0	12.1
Operating profit	8,239	4.7	9,000	4.6	9.2
Ordinary profit	6,702	3.8	7,700	3.9	14.9
Profit attributable to owners of parent	6,069	3.5	3,300	1.7	-45.6

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

Medium-term management plan might be achieved a year ahead of schedule

4. Medium-term growth

We think the Company is sufficiently capable of attaining the operating profit targets of ¥10bn in FY8/22 and ¥13bn in FY8/24 set in the medium-term management plan “NEXT for 2024.” The Company needs double-digit annual average profit growth (the benchmark of high growth) to reach these goals. However, in the medium-term management plan, the Company expects the operating margin to be in the 4% range, due to negative factors including roughly ¥3bn in annual goodwill amortization costs and the expansion of the high-growth, low-margin energy business, despite positive factors such as the recoil decline from the previous fiscal year in upfront costs, structural reforms in CANSYSTEM, and a business model shift in the communications business. The new, growing energy business has low profit margin due to its electricity wholesale business, and its downward pressure on overall profitability reduces asset turnover, too. Accordingly, we expect the Company to generate a roughly 6% high operating margin (excluding the energy business) over the medium term, and also a robust operating margin prior to goodwill amortization costs, a key indicator of a company’s ability to earn cash, of about 8%. Given these points, if “NEXT for 2024” progresses smoothly, we think the Company will be a cash-generating company with high profits and strong growth. Of course, the Company plans to repay borrowings as set forth in the medium-term management plan. Furthermore, if FY8/20 results exceed guidance, this will be understood to mean that earnings momentum has strengthened, and we think that this will indicate that the possibility for attaining the medium-term management plan’s targets a year ahead of schedule has increased. We have high expectations for the Company’s ability to realize its potential for growth.



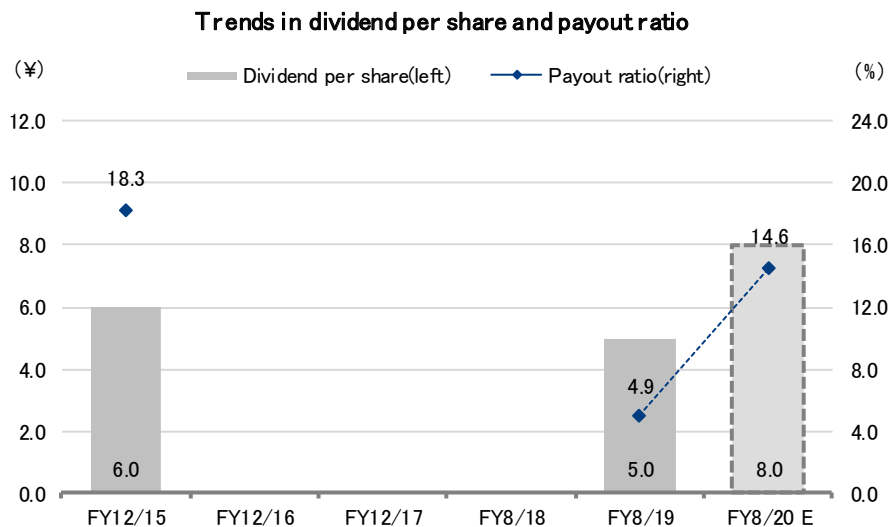
Source: Prepared by FISCO from the Company’s financial results and medium-term management plan briefing materials

Shareholder return policy

Enhancing shareholder returns

1. Dividend policy

The Company views returning profits to shareholders as an important management policy and has adopted a basic policy of continuing stable dividends over the long term. The Company paid a FY8/19 fiscal year-end dividend of ¥5 per share, thus restoring a dividend for the first time in four years. With respect to the annual dividend for FY8/20, the Company plans to pay a dividend of ¥8 per share. The medium-term management plan “NEXT for 2024” sets forth a policy of paying dividends with a payout ratio of 10-30%.



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

Expanding benefit program that enables U-NEXT services to be used under favorable conditions

2. Shareholder benefit program

On November 21, 2019, the Company released an upgraded shareholder benefit program. For shareholders who own at least one trading unit (100 shares) of its shares, the Company has been providing a benefit program that consists of waiving the initial fee and first 90 days of usage fees for the “U-NEXT” video distribution service, and also gives them 1,000 points that can be used for the “U-NEXT” service (shareholders who are already members only receive the points). With the change, the Company added even more special perks for shareholders who own at least 10 trading units (1,000 shares). Specifically, the Company will provide one year’s worth of usage fees for free and ¥1,800 worth of points each month. Converted into monetary amount, this comes to approximately ¥50,000 per year in benefits. The shareholder benefit program related to the mobile data communication service U-mobile was also abolished.

Shareholder return policy

Table Comparing New and Old Shareholder Benefit Programs

Current		After change	
-	-	At least 1,000 shares	One year worth of usage fees for "U-NEXT" service and ¥1,800 worth of points each month
At least 100 shares	"U-NEXT" service initial fee waived, 90 days of free use, ¥1,000 worth of points provided		No change
	"U-Mobile" Talk Plus plan initial fee waived, ¥5,000 cash back via postal money order	100-999 shares	Abolished

Note: Shareholders who are already "U-NEXT" subscribers receive points only. Points received can be used to pay for the fixed-price music streaming service (app) "SMART USEN."

Source: Prepared by FISCO from the Company's press release

Information security

Carefully managing security for work-style reforms

The Company is strengthening personal information protection capabilities and continues to implement educational programs. However, it cannot give a guarantee of complete protection and there is always risk of personal information leaks due to improper access from an external source, system trouble, insider crime, human mistakes, and management mistakes at outsourcing and service provision partners. Given these challenges, the Company manages the information system at a data center, employs a firewall, and continually assesses vulnerability in web applications as a more proactive information security effort. The Company allocates notebook PCs and smartphones to individuals as part of work-style reforms. It greatly reduces security risk by equipping notebook PCs with a security chip (TPM) and utilizing MDM in smartphones.



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