COMPANY RESEARCH AND ANALYSIS REPORT

USEN-NEXT HOLDINGS Co., Ltd.

9418

Tokyo Stock Exchange First Section

12-Jun.-2020

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Index

Summary

The strengthened income base is a factor behind the major increase in profits, while it is also effective for the novel coronavirus

1. Is coordinating the strengths of each business to create Group synergies

USEN-NEXT HOLDINGS Co., Ltd. <9418> (referred to below as "the Company") carries out a music distribution service for stores and other facilities as its core business and provides a full range of solutions including peripheral services required for running stores and other facilities. The Company also provides "U-NEXT", a flat-rate video distribution service to consumers. USEN CORPORATION and U-NEXT Co., Ltd. reintegrated in December 2017, and the integration aimed to direct cash from the cash-cow music distribution business to businesses with high growth potential 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.

2. Is diversifying each business on the main axis of the music distribution business

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 for operating stores. The energy and media businesses target such customers with sales of electricity and gas, as well as services 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, it has a support system that carefully and precisely responds to changes in market conditions as well as customers' needs.

3. In the 1H FY8/20, profits increased significantly against the backdrop of the strengthened income base

In the 1H FY8/20 results, net sales were ¥95,330mn (up 14.1% year-on-year (YoY)) and operating profit was ¥5,944mn (up 50.8%). The Group is starting to leverage the synergies generated from the integration in 2017, and the main factor behind the substantial increase in profits was that profits grew greatly in the businesses other than the media business. Moreover, it can be said to have established an income base. By business, in store services, sales of "U Regi" increased greatly; in business systems, sales were strong of automated payment machines for medical institutions; and in communications, the products handled expanded against the backdrop of the spread of SaaS (Software as a Service) and the shift to IoT by stores. Therefore, it would seem that these businesses covered for the slumps in the energy and media businesses, and profits grew more than forecast. Incidentally, it can be said that the results of the content distribution business, which invested in TV commercials, were stronger than would seem at first glance.

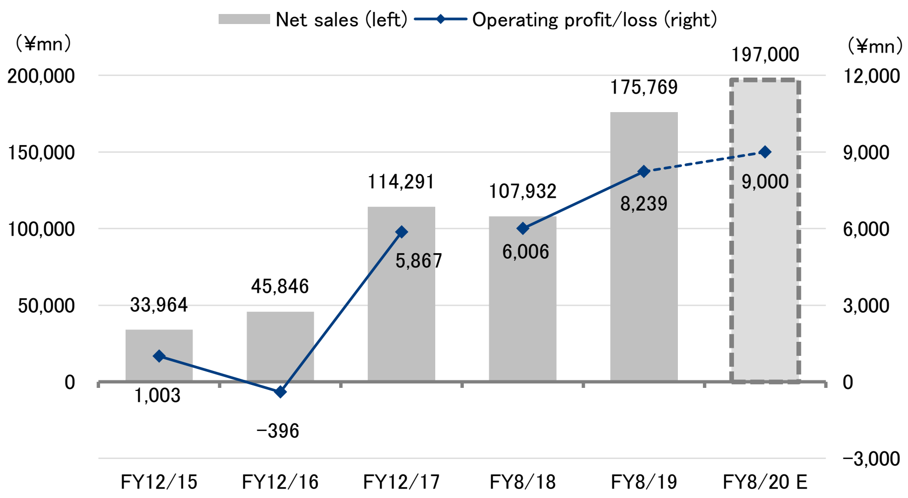
4. Is keeping down the impact of the novel coronavirus by strengthening the income base and the business portfolio

The forecasts for the Company's FY8/20 results are for net sales of ¥197,000mn (up 12.1%YoY) and operating profit of ¥9,000mn (up 9.2%). As the 1H results were extremely strong, if this were a normal year, it would not be strange if the Company upwardly revised the full fiscal year results forecasts. But limited to this year, the impact of the spread of the novel coronavirus cannot be avoided, and fundamentally, the previously assumed values are no longer applicable. Therefore, the Company has left its results forecasts unchanged. In fact, it would seem that since February 2020, the impact of the virus is being actualized for some businesses and customers. On the other hand, the content distribution business actually benefits from the requirements for self-restraint, so the virus can be said to be an opportunity for business expansion. Whatever the case, the Company is being affected by the novel coronavirus, the same as the world in general, so it may be forced to review the targets in the medium-term management plan. However, from the effects of strengthening the income base and the business portfolio, it is considered that it will be able to somewhat keep down the impact of the novel coronavirus compared to companies in general. It is thought that this benefit will extend not only to the Group companies, but to customers as well.

Key Points

- Has strengthened the income base through the synergies from the management integration
- Achieved a major increase in profits in 1H FY8/20
- Is keeping down the impact of the novel coronavirus through portfolio effects, etc.

Results trends



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

Company profile

A corporate integration aiming for Group synergies

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 in 2017 through the reintegration of the former U-NEXT and the former USEN. The integration aims to maximize the customer base, which includes some 750,000 stores and commercial facilities, and which is the group's greatest asset. In addition to the 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.

On entering 2020, the novel coronavirus has been dealing a blow to societies and economies on a global scale. Companies in Japan have also been fully affected, and the Company's customers, many of which are SMEs, are no exception to this. However, in the Company's case, on the one hand it has businesses for which there are concerns about the negative impact, but on the other hand it has businesses for which a positive impact can be expected. In other words, in the Company's Group structure, it is able to distribute risk from portfolio effects. In addition, it has made progress in constructing an income base, and the impact of the novel coronavirus is expected to be smaller on it compared to its impact on companies in general. Therefore, there is the aspect of the Company becoming an even more important cornerstone for its customers. There are more detailed discussions on the effects of the novel coronavirus in the results outlook and medium-term growth image sections.

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.

Every business is actively progressing management

3. 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. Each business is currently expanding their income models from one-shot income at the time of a sale to recurring income through collecting monthly usage fees.

Business description of consolidated subsidiaries

Business	Operating company	Business description
Store services business	USEN CORPORATION, CANSYSTEM. CO., LTD., U'S MUSIC Co., Ltd., USEN Techno-Service Co., Ltd.	Provides, sells, and implements store solutions, including for music distribution, and manages and develops music copyright, etc.
Communications business	USEN NETWORKS Co., Ltd., U-NEXT Co., Ltd., USEN ICT Solutions CORPORATION, USEN Smart Works CORPORATION, USEN-NEXT LIVING PARTNERS INC., U-MX co., LTD., Next Innovation Co., Ltd., Y.U-mobile Co., Ltd.	A sales agency for broadband Internet lines, and it proposes and sells office ICT environment builds, provides the U-mobile MVNO service, and also provides and sells broadband Internet lines for individuals
Business systems business	ALMEX INC.	Develops, manufactures, and sells business management systems and automated payment machines for hotels, hospitals, golf courses, etc.
Content distribution business	U-NEXT Co., Ltd., U-NEXT Marketing Co., Ltd. (name changed to TACT INC. in December 10, 2019)	Provides and sells "U-NEXT", a video distribution service
Energy	USEN CORPORATION	As part of the lineup of services for business sites and commercial facilities, sells energy-saving services, such as for high and low voltage electric power and gas
Media	USEN Media CORPORATION	Manages the "Hitosara" customer-attraction service for restaurants, and publishes online magazines, free magazines, etc.

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

(1) The store services business is increasing the breadth of its product lineup

The store services business provides solution services mainly related to the Group's music distribution business, which is the Company's original business, and to store management. The Company has more than 50 years of experience in the music distribution business, and it provides the USEN service that broadcasts music and information for stores and facilities throughout the country, ranging from specialist channels, such as for J-POP and Western music, through to request channels. The majority of its customers are business sites, and a particularly high percentage of them are restaurants, retailers, beauticians, and clinics, while there are also a wide variety of chain stores, ranging from nationwide chains to community-based chains. It offers more than 500 channels, so customers can search for a channel suited to their business category, whatever industry they are in. Naturally, all of the copyrights for the music it handles are treated appropriately.

The Group has a strong support network comprised of 170 bases, 1,100 sales personnel, and 900 engineers, and its approach is to handle everything, from installation and construction through to after-sales care. In addition, when considering that for a monthly fee of ¥4,000 to ¥5,000, customers can eliminate tasks such as installing CD players, continuous software purchases and song selections, and dealing with troublesome copyrights, the cost performance is extremely high, which is the reason for the service's long-lasting popularity. Therefore, presently the Company has a solid customer base of more than 750,0000 customers, and it has an overwhelming share of the background music (BGM) market for stores and facilities, of more than 90% (including the share of CANSYSTEM, which was made a wholly-owned subsidiary in October 2018 and which ranks second in the industry for music distribution services to business sites). It is a cash-cow business that supports the Group's strategy.

As services peripheral to the music distribution business, the Group provides various solutions services for store management, including products and services relating to stores, the installation and construction of equipment and interiors, music copyright management, support to acquire human resources, development support, building business environments, and sales promotions. In recent years, progress has been made in introducing IT into the retail and services industries also, but as the hurdles are high for SMEs to introduce cutting-edge equipment and systems by themselves, the Company provides its customers with a one-stop service so they don't have to do it by themselves. Even among these services, growth has been particularly high for the "U Regi" tablet POS register service and the "U Pay" cashless payment service. In addition, the IP Camera service, which makes possible various functions, from crime prevention through to improved operations efficiency and sales analysis, has been well received. Other than these, the Company has many other services that can be said to be necessities, including "Omise-no-Anshin Hoken", a comprehensive tenant insurance for businesses; "UPLink", a store app creation service; and "U-SPOT", a Wi-Fi service for business sites, and moreover it is currently expanded these services.

Tablet POS "U Regi"

"U Pay" reader

Source: The Company's press release

(2) The communications business is steadily accumulating results

The communications business provides "USEN GATE 02", an ICT solution, and "USEN Hikari", a broadband Internet line, for businesses, and also "U-mobile", an MVNO service, and "U-NEXT Hikari 01", a broadband Internet line, for individuals. Competition is intensifying in services for individuals, and in the situation, this business is steadily accumulating results for businesses by providing ICT products and services that coordinate with SaaS, including Cloud, mobile and data center services for customers like Google and Cybozu, Inc. <4776>. The strengths of the Company, which provides services to more than 40,000 companies in the ICT industry that is constantly and continuously changing and developing, include its extensive lineup of services and its provision of high levels of convenience, in that it is able to respond to all customer needs relating to the network environment from a single contact point. These achievements have been highly evaluated, including that it won the New Customer Success Award in the LINE WORKS Partner Conference 2019 held by WORKS JAPAN Mobile Corp., a fellow subsidiary of LINE Corporation <3938>, and also the Sales Division Award and the Sales Advisory of the Year Award at the CYBOZU AWARDS 2019 held by Cybozu.

(3) The business systems business is achieving both increased efficiency for customers and convenience for users

Subsidiary ALMEX INC. solely handles the business systems business. This business supplies automated payment machines and lodging facility management systems to business hotels, city hotels, and leisure hotels, automated payment machines and automated patient check-in machines to general hospitals and other medical institutions, and automated payment machines and check-in machines to golf courses. It also sells ordering terminals and operating systems to restaurants. While 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 fabless manufacturer, it develops, sells, and provides maintenance for equipment and systems on its own, which is a strength, which makes it a unique presence within the group.

In addition, it is not only improving the efficiency of customers' operations, such as through labor saving, it has also established a strong reputation for developing products that target convenience for facility users, which is a significant differentiating factor. To give some recent examples, in the Sma-pa Series of total solutions for medical institutions, the Company has introduced to the market "Sma-pa CHECK OUT", a system that enables the use of a smartphone to pay hospital bills not at the cashier desk but later, and "Sma-pa TERMINAL-Z", which is a next-generation automated payment machine equipped with face authentication and insurance card verification functions that utilize artificial intelligence technologies. For the future, it is considering expanding fee income not only from products, but also from software services that are installed in devices. Moreover, it is also expanding its business domains, including introducing automated payment machines into Ixora hotels in Penang, Malaysia, and into all of the amusement facilities of ROUND ONE Corporation <4680>.

"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)

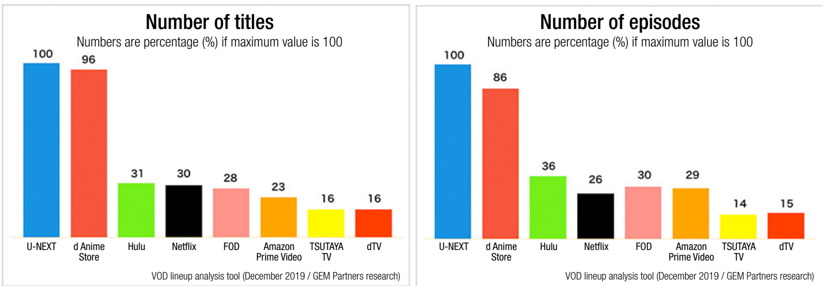
Source: The Company's press release

(4) The content distribution business has a well-regarded lineup, including the most unlimited viewing items in the industry

Through "U-NEXT", the Company provides Video on Demand, (VOD) services to individuals. For a monthly fee, users can watch video content, such as movies and TV programs, and also read e-books and listen to music, on devices such as their TVs, PCs, and smartphones via the Internet. The biggest feature of the service is the number of video contents that can be watched on an unlimited basis, which is said to be more than double that of its competitors. The Company is executing a strategy that aims to have the leading lineup of content in all genres, and according to a survey by GEM Partners Co., Ltd., in May 2019, "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 in 6 main genres (foreign movies, Japanese movies, overseas dramas, Korean and Asian dramas, Japanese dramas, and animation). It is a paid-for service, but it has an extensive lineup, including that the latest titles can be watched sooner than on competitors' services. It is also the only service that provides adult content, and the importance of carrying adult content as the key to growing demand to adults can be understood from the overwhelming victory by TSUTAYA Co., Ltd., over US-based major Blockbuster LLC during the growth years in rental videos.

The Company's monthly usage fee of ¥1,990 appears expensive at first glance, but it is actually fairly reasonable considering the extensive content with more than 180,000 titles (140,000 unlimited viewing titles and 30,000 rental titles), the support for four users per account, and the allocation of ¥1,200 of points each month that effectively enables free access to the latest paid-for titles within the points range. In addition, the remote control of Toshiba Corporation's <6502> TV Regza released in June 2019 is equipped with the U-NEXT button to launch "U-NEXT" programs directly, and the number of devices compatible with it has increased, including Apple TV and popIn Aladdin, a ceiling light with a projector, and in such ways, user convenience is being continuously improved. In December 2019, it acquired the No1. ranking for the number of unlimited viewing anime episodes, and then in February 2020, it concluded a comprehensive partnership agreement with BBC Studios of the UK, and it will distribute 600 of the BBC's popular titles and 3,000 episodes through an unlimited viewing service. From the above, it can be said that the Company is the only domestic VOD service provider able to compete with the industry giants such as Amazon<AMZN> Prime Video and Netflix<NFLX>.

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



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

(5) In the energy business, regional power companies are recovering

In the energy business, the Company sells high- and low-voltage electric power and city gas to stores and retail facilities located outside of the service areas of its partner, Tokyo Electric Power Company (TEPCO) Holdings, Inc. <9501>. It also offers consulting services, such as for energy conservation. Even though this business was only recently launched in September 2016, against the backdrop of the liberalization of electric power sales, although its profit ratio is low, it has become a stable business that always takes the spread, as it re-sells the electric power purchased from TEPCO Holdings. So far, from the appeal for inexpensive prices for the deep customer base of the Company, which has built a dedicated sales organization, the number of subscribers has rapidly increased, and expectations for growth are high, as it plays the role of a hook product for new-customer acquisitions and to spur cross sales. However, the various regional power companies are aiming to recover on the timing of contract renewals, and the situation is that the competitive environment is rapidly intensifying.

(6) The media business is being impacted by the decline in inbound demand, etc.

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. As a strategy targeting inbound tourism, although it is currently facing serious headwinds, the Company operates “SAVOR JAPAN”, a multi-lingual version of “Hitosara” that targets foreigners visiting Japan, and started working together with Japan Travel by NAVITIME in a restaurant reservation service. 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.

Financial results trends

Can sense an evolution of the business model from the 1H results

1. 1H FY8/20 results

In the 1H FY8/20 results, net sales were ¥95,330mn (up 14.1% YoY), operating profit was ¥5,944mn (up 50.8%), ordinary profit was ¥5,103mn (up 51.1%), and profit attributable to owners of parent was ¥2,428mn (up 36.8%), so profits increased significantly. As well as strengthening measures for the content distribution business, which the Company has positioned as a high growth business, in existing businesses for stores, it has enhanced the services lineup and expanded the lineup of products in response to various issues, such as for cashless payments using POS registers, and for labor saving. In the business systems business, it has market launched products that utilize cutting-edge technologies. CANSYSTEM, which was made a consolidated subsidiary on October 1, 2018 (deemed acquisition date, November 30, 2018), has also had an effect in terms of pushing-up results, and as a result of the above, the progress rates in the 1H for the full-fiscal year results forecasts were above 60% for every profit item. A feature of the Company’s income is that it accumulates with each passing month against the backdrop of its sales capabilities, so normally, the 1H operating profit forecast is set at less than half of the full fiscal year forecast. It seems that in the 1H FY8/20, operating profit was more than ¥1.5bn above the in-Company forecast, so these results can be said to be extremely strong. This point demonstrates that the synergies from the 2017 integration are being actualized for the Company Group a whole, and also that it has an income base is place and the business portfolio has started to function, so it would be no exaggeration to say that it has further evolved its business model.

1H FY8/20 results

	1H FY8/19 (¥mn)	% of net sales	1H FY8/20 (¥mn)	% of net sales	% of change	Progress rate
Net sales	83,574	100.0%	95,330	100.0%	14.1%	48.4%
Gross profit	33,505	40.1%	38,605	40.5%	15.2%	-
SG&A expenses	29,562	35.4%	32,660	34.3%	10.5%	-
Operating profit	3,942	4.7%	5,944	6.2%	50.8%	66.0%
Ordinary profit	3,378	4.0%	5,103	5.4%	51.1%	66.3%
Profit attributable to owners of parent	1,775	2.1%	2,428	2.5%	36.8%	73.6%

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

Double-digit increases in profits in all the mainstay businesses

2. 1H FY8/20 results by segment

Against the backdrop of the Company building a consolidated income base, it has also progressed the building of income bases for each individual business. However, there are differences in the progress made between these individual businesses, and it is anticipated that this will lead to reviews of the strategy and the business portfolio in the future. In this situation, it seems that the main reasons why profits were above forecast were the strong performances of “U Regi” in the store services business and of automated payment machines for medical institutions in the business systems business, and also the spread of SaaS and the acceleration of the shift to IoT, such as in business offices, in the communications business. The scale of profits in the content distribution business is small, and the Company is currently in a phase of investing in upfront costs to release TV commercials to expand share in a growth market, but it has started to receive so-called nester demand (demand from those shopping from home due to measures against COVID-19), which is an extremely positive development. On the other hand, rapid growth was expected for energy sales, but growth has been sluggish, while the media business has been impacted by the decline in inbound demand. The details of the income conditions in each business are shown below.

1H FY8/20 results by segment (before adjustment)

	1H FY8/19 (¥mn)	% of net sales	1H FY8/20 (¥mn)	% of net sales	% of change
Store services business	23,029	27.2%	26,516	27.4%	15.1%
Communications business	19,549	23.1%	20,818	21.5%	6.5%
Business systems business	9,529	11.2%	10,839	11.2%	13.7%
Content distribution business	15,736	18.6%	20,598	21.3%	30.9%
Energy business	14,098	16.6%	15,331	15.9%	8.7%
Media business	2,661	3.1%	2,521	2.6%	-5.3%

	1H FY8/19 (¥mn)	Profit ratio	1H FY8/20 (¥mn)	Profit ratio	% of change
Store services business	4,279	18.6%	4,786	18.0%	11.8%
Communications business	1,440	7.4%	1,845	8.9%	28.1%
Business systems business	1,591	16.7%	2,024	18.7%	27.2%
Content distribution business	10	0.1%	329	1.6%	3190.0%
Energy business	-306	-2.2%	39	0.3%	Became profitable
Media business	136	5.1%	119	4.7%	-12.5%

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

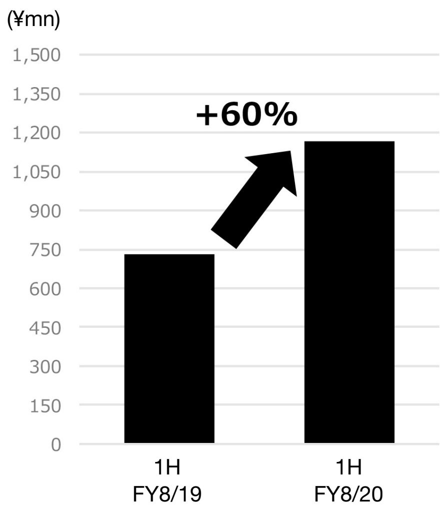
(1) The store services business is capturing demand to update registers, such as from the shift to cashless payments

In the store services business in the 1H, net sales were ¥26,516mn (up 15.1% YoY) and operating profit was ¥4,786mn (up 11.8%). Against the backdrop of the stable income base for music distribution, the Company worked to maintain and expand transactions with existing customers, to acquire new customers, and to improve brand power. Specifically, it aimed to actively respond to the shift to IoT in stores, for which needs are strong among SMEs as well, and to enhance the services lineup, and it is providing total solutions, from supporting business start-ups and building business environments through to attracting customers and conducting sales promotions. For facilities, the Company provides public wireless LAN access services to public spaces, and offers the "USEN Omotenashi Cast" service that accurately delivers facility announcements in four languages – Japanese, English, Chinese, and Korean.

Ahead of the revision to the consumption tax rate on October, 2019, demand to respond to reduced tax rates and cashless payments rose, so sales of "U Regi", a tablet POS cash register, and the "U Pay" payment service increased. There were concerns about a decline as a rebound to these increases from October onwards, but sales continued to be maintained at a high level amid the shift to IoT. In particular, sales of "U Regi" grew significantly, up 60% YoY, as users were drawn to its many functions and low cost, its smart design and intuitive operability, as well as its helpful support service that can be accessed 365 days a year at the Company's 170 offices and dedicated help desks. At CANSYSTEM, which became a consolidated subsidiary in November 2018, sales were significantly boosted by the favorable reception for its Cloud camera. However, CANSYSTEM's profits were basically cancelled-out by the amortization of goodwill, while for "U Regi", for which the number of installations is increasing, it records low-profit equipment sales ahead of the recording of fees in the future. Therefore, its operating profit growth was less than its net sales growth.

In January 2020, the Company established USEN-NEXT Financial Co., Ltd., as a joint venture with Shinsei Bank, Limited, and entered a new field, the financial field. For the service content, it will provide financial services such as business credit (installment payments) and vendor leasing, business-use credit cards, and lending for SMEs, including business sites. However, it would seem to correspond to starting a large-scale new business, rather than creating a menu of new services.

"U-Regi" Sales

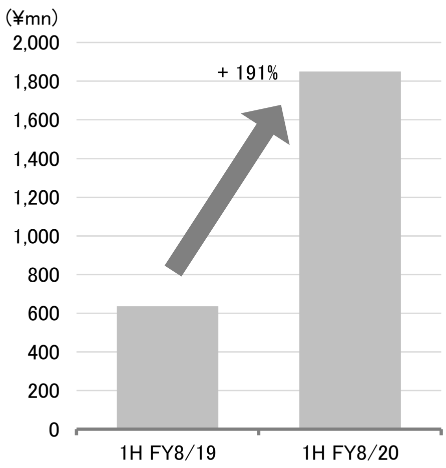


Note: Only recurring sales, not including initial sales for equipment, etc.
Source: The Company's results briefing materials

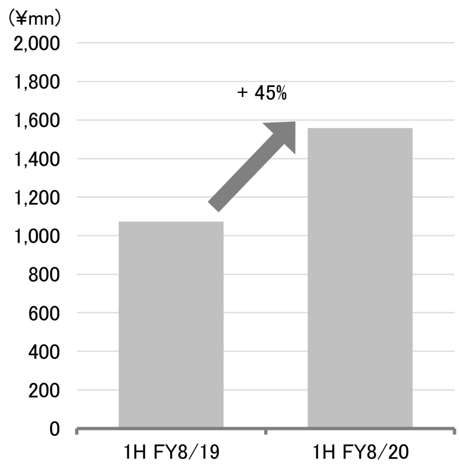
(2) The communications business continues to expand its business scope for businesses

In the communications business, net sales were ¥20,818mn (up 6.5% YoY) and operating profit was ¥1,845mn (up 28.1%). The Company did not actively develop the business for individuals, in which competition is intensifying and for which it continues to operate while controlling costs at the minimum level of operations. But for businesses, it has strengthened its provision of a one-stop service for solutions to improve business environments that are matched to customer needs specialized to each office, including network-related services and Cloud services in builds of ICT environments for offices, data center services, SaaS, and “Sound Design for OFFICE”, which is a service to broadcast music in offices. It has also added a video interpretation function to its interpretation support service for businesses. As a result, acquisitions of new small-scale businesses in broadband Internet access sales agencies continued to trend strongly, while progress was also made in shifting from agencies, which provide one shot-type commission income, to the Company’s own highly profitable services that provide recurring income, so profitability to businesses improved. Therefore, although net sales grew by a single digit, profits grew by double digits.

Trend in optical line net sales to business sites



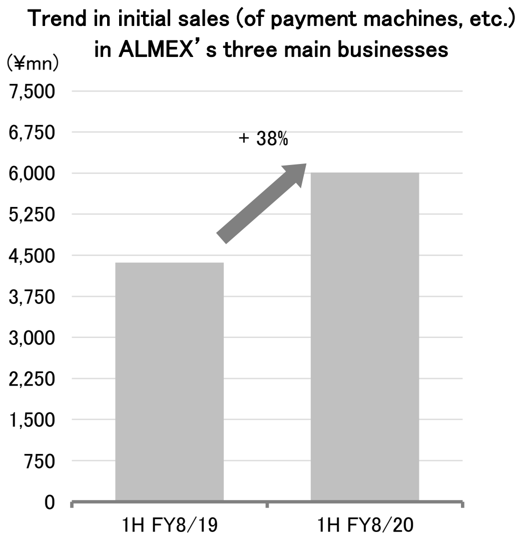
Trend in SaaS sales



Source: Prepared by FISCO from interviews

(3) The business systems business performed well for both hotels and hospitals

In the business systems business, net sales were ¥10,839mn (up 13.7% YoY) and operating profit was ¥2,024mn (up 27.2%). In the hotels market, responding to the increase in the number of hotels and to the effects of the labor shortage have become urgent tasks, so demand is strong to introduce IT solutions into hotels. Demand is also strong to replace terminals on the shift to 100% IC credit cards following the revision to the Installment Sales Act (the deadline for this was the end of March 2020). Therefore, the Company has been continuously working to increase its market share by launching new products and strengthening proposal-based sales. For hospitals, demand has been strong to address the labor shortage and to eliminate waiting times, and this demand has also now spread from large-scale general hospitals to small-scale hospitals, such as clinics and dental surgeries. Therefore, sales are growing of reception equipment installed with face authentication and insurance card verification functions for general hospitals, and of automated payment machines for clinics. For amusement facilities, a round of deliveries of automated payment machines to major customers has been completed. But the Company has strengthened aspects such as sales, customization that incorporates customer needs, and after-sales services, and even after the revision to the consumption tax rate, demand continued to be strong for management systems and automated payment machines for hotels, reception equipment for general hospitals, and automated payment machines for clinics. Therefore, both sales and profits grew greatly.



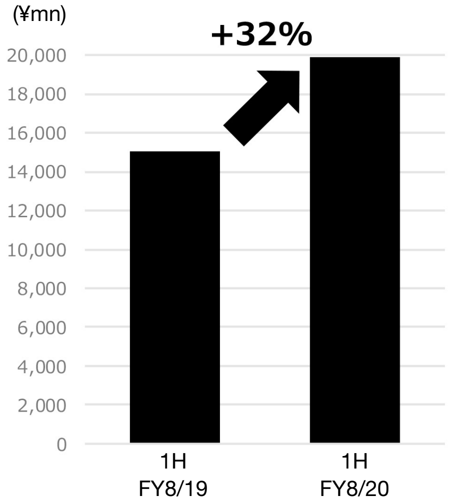
Source: Prepared by FISCO from interviews

(4) The content distribution business is growing more than the growth market

In the content distribution business, net sales were ¥20,598mn (up 30.9% YoY) and operating profit was ¥329mn (up 3,190.0%). The Company is working to improve the user experience, enhance content, and open-up the market, and in December 2019, it broadcast nationwide TV commercials with the aim of achieving more than 2 million subscribers. This also served to improve name awareness, and it seems that the number of subscribers increased by more than 30%. The Company also focused on improving convenience, equipping a U-NEXT Button on the remote controls of Toshiba's Regza and Hisense's S6E, and enabling "U-NEXT" to be used from Google's smart speaker and smart display. It is also focusing on improving image quality and sound quality, including that it is distributing major Hollywood studio titles in 4K UHD, Dolby Vision®, and Dolby Atmos® for the first time in a video distribution service in Japan.

The video distribution market continues to grow due to the spread of smartphones and the rising need for VOD that enables time to be used efficiently, and it would seem that this market grew by more than 20% in 2019 also. The two major overseas companies that are driving this growth in demand are Amazon Prime Video and Netflix. It can be said that companies in Japan have been unable to stand-up to these two giants, but the Company, which has a competitive advantage in terms of lineup, has been the exception to this and is continuing to perform strongly. In the video distribution services market, which is becoming concentrated on the top-ranking companies and diversifying, it is considered that the main factors behind the Company's strong sales are its basic policy of enhancing the product lineup and its focus on improving convenience for viewers. Separate to fixed-price video distribution, in January 2020 it started providing "AI Concierge for Chatbot", which is a chatbot service that uses AI to appropriately answer inquiries from users in high-quality conversations.

"U-NEXT" Sales



Source: The Company's results briefing materials

(5) Competition has intensified in the energy business

In the energy business, net sales were ¥15,331mn (up 8.7% YoY) and operating profit was ¥39mn (up ¥345mn). The Company has positioned it as a high growth business and has actively invested in it, including to establish a dedicated sales department and to progress sales activities, and it has finally become profitable. However, this business uses the electric power purchased inexpensively from TEPCO Holdings as a hook product, with the aims of increasing sales to existing customers and to acquire new customers in areas outside of TEPCO's jurisdiction. But the local power companies are aiming to recover on the timing of the contract renewals (every 1 or 2 years), so recently competition has intensified. It would seem possible for the Company to compete further in this area from its stable profits from purchases from TEPCO Holdings. But if severe price competition is spurred-on in an industry that originally was comprised of regional monopolies, friction may occur in those regions in which the Company needs to become deeply established. Therefore, as it has many other businesses performing well, including the content distribution business, which is one more high growth business, it is possible that it will review its allocation of management resources in terms of the relative weights applied to the respective businesses, while observing the situation.

(6) In the media business, the business environment is changing rapidly

In the media business, net sales were ¥2,521mn (down 5.3% YoY) and operating profit was ¥119mn (down 12.5%). Its main business is "Hitosara", a gourmet restaurant information website that focuses on chefs (Hito) and food (Sara). This business differentiates itself including by publishing related books, it has been in pursuit of the "three major gourmet websites", of Tabelog, Gurunavi, and Hot Pepper Gourmet. However, the industry environment for gourmet websites is changing rapidly, including due to the posting of unfair word-of-mouth reviews on gourmet sites, the problem of "staged businesses", (involving postings to manipulate website rankings), the increase in store-search channels such as Google and SNS, and the dramatic decrease in inbound demand. For the Company, it may be necessary to transform the business model once again, for example repositioning it as one store services business. It manages the "SAVOR JAPAN" gourmet website for visitors to Japan, but this business has only just started, so it seems that even it if were to be put on hold, the impact of this on results would be small.

Results in the current 2H will depend on the novel coronavirus

3. FY8/20 outlook

The forecasts for the Company's FY8/20 results are for net sales of ¥197,000mn (up 12.1% YoY), operating profit of ¥9,000mn (up 9.2%), ordinary profit of ¥7,700mn (up 14.9%), and profit attributable to owners of parent of ¥3,300mn (down 45.6%). Profit attributable to owners of parent is forecast to decrease due to the end of the recording of deferred tax assets associated with the sale of real estate in FY8/19. But otherwise, the forecasts are for higher sales and profits, with operating profit and ordinary profit to grow by more or less double digits. As previously stated, in the 1H results, the rates of progress toward achieving the full fiscal year forecasts were more than 60% for every profit item, so the results were extremely strong. It would seem that sales are basically in line with the full fiscal year forecast, which is as the Company has also stated, but it is possible that profits exceeded the in-Company forecasts by more than ¥1.5bn. Accordingly, this would normally result in the forecasts being significantly upwardly revised. But limited to this year, the spread of the novel coronavirus is affecting not just Japan, but the global economy, and the Company will also not escape from its impact. Therefore, it is unable to quantitatively estimate profit forecasts at the present time, so it has left the results forecasts unchanged.

FY8/20 outlook

	FY8/19 (¥mn)	% of net sales	FY8/20 E (¥mn)	% of net sales	% of change
Net sales	175,769	100.0%	197,000	100.0%	12.1%
Gross profit	69,753	39.7%	-	-	-
SG&A expenses	61,513	35.0%	-	-	-
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%

Note: the values exclude the effects of the novel coronavirus
Source: Prepared by FISCO from the Company's financial results

Even it is not possible to quantitatively estimate the effects of the novel coronavirus, we can imagine its impact on results from 3Q onwards. It would seem that its impact was already starting to appear on some customers from February, which was the second half of the 1H. But due to the time lag from a sale being completed to it being recorded in net sales, the Company's February results were unaffected by the novel coronavirus, and it is considered that its impact on results will appear from March onwards.

On broadly categorizing the Company's main customers, they are business sites and facilities like restaurants and retail stores to which it provides music distribution and other store services; individuals to who it provides video distribution services; small-, medium-, and large-size companies and school corporations to which it sells Internet lines and ICT environments; and hotels and general hospitals to which it provides automated payment machines and business management systems. None of these customers will escape the impact of the novel coronavirus, but in particular, many of them are business sites for which foot traffic has decreased or which have temporarily had to close due to consumers' self-restraint following the declaration of a State of Emergency issued for Tokyo on April 7. The situation is especially severe for small- and medium-sized restaurants and retail stores, and hotels, while conversely, the impact on hospitals and general business sites is considered to be relatively small. As this period of self-restraint has become prolonged, the situation would rather seem to be that individuals have a lot of free time.

The Company is affected by the coronavirus via its impact on its customers. For businesses such as video distribution, it might actually be an opportunity for business expansion, and in April, the Company continued to broadcast the TV commercials it started broadcasting in March. Even when the self-restraint period ends, it is considered that the sales promotion effects from the TV commercials and other measures will endure. Conversely, conditions for customers other than individuals have become severe to a greater or lesser extent, and the Company has been disseminating warnings about the novel coronavirus in its music distribution services and posting financial institutions' backup information on its website to support business start-ups. Also, although this is in hindsight, the Company's entry into the financial services industry will make it easier for it to provide support, including financing for equipment-installation costs, short-term loans, and financing for customers' business restarts after the end of the novel coronavirus pandemic, and this is likely to be very reassuring for its customers. However, it seems that it will launch services around July at the soonest, and it may be necessary to cover some customers separately.

Although the income structure is being strengthened and recurring fees are increasing, if the self-restraint period becomes prolonged, it will be difficult to conclude new contracts, and we have to assume the risk of the possibility of a reduction in contracts and cancellations. In such cases, the conditions for the Company's results can be expected to become more severe. But as it has diversified its customers and businesses, it is considered that, compared to companies in general throughout the world, its slowdown in results will be only moderate due to portfolio effects. Also, from the savings accumulated in the 1H, if the economy heads for a recovery before the 4Q, it is possible that it will be able to maintain its full fiscal year results in line with the initial forecasts. However, if the impact of the virus remains strong even after the summer, problems will not be able to be resolved by individual companies, so it may have to downwardly revise the full fiscal year results forecasts.

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 started 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. By dividing the businesses into three portfolios*, it intends to carry out a well-balanced strategy. While developing this sort of growth strategy, the Company's policy is to set as benchmarks ROE (Return on Equity), which is considered to be most important management indicator, and its constituent factors (shareholders' equity and profit attributable to owners of parent). Through this, in FY8/24 it is aiming to realize net sales of ¥270bn, operating profit of ¥13bn, and a high-quality financial balance. In addition, if it achieves these targets, it intends to raise-up the dividend payout ratio to 30%.

* Business portfolio: the cash cow business with a solid customer base and stably high income (music distribution business), the stable growth businesses in which stable demand continues to grow (business systems business, SaaS/line business, and media business), and the high growth businesses that are expected to be sources of income in the future (content distribution business, energy business, and IoT business for stores).

Numerical goals in NEXT for 2024

(¥100mn, %)

	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	-

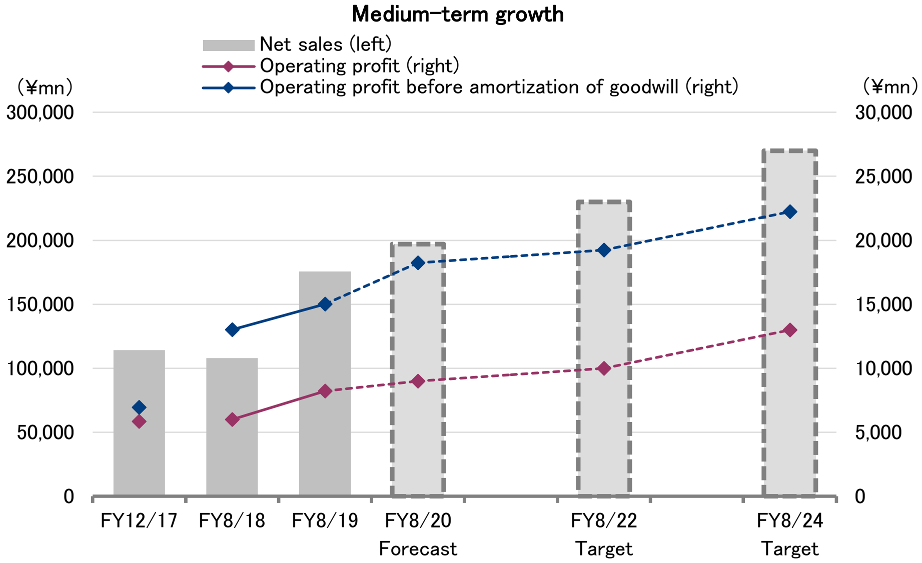
Source: Prepared by FISCO from the Company's medium-term management plan briefing materials

Evolving the business model to overcome the novel coronavirus

2. Medium-term growth

In NEXT for 2024, the medium-term management plan, the interim target for FY8/22 is operating profit of ¥10bn, while the target for the plan's final fiscal year of FY8/24 is operating profit of ¥13bn. When considering the strong results in the 1H, it was thought fully possible that the Company could achieve them ahead of schedule. However, discrepancies have appeared between the individual business in terms of the progress made in building an income base, and moreover the environment is changing, including that the novel coronavirus is spreading throughout the world causing a prolonged economic stagnation. Therefore, it has come to be considered necessary for the Company to review aspects such as its long-term vision, basic strategy, and business portfolio. The internal environmental changes of the former will be reviewed with positive implications, but the external environmental changes of the latter are likely to be reviewed with negative implications. At the present time, it is impossible to anticipate the scale and the scope of the impact of the novel coronavirus, but in addition to the evolution of the business model in the 1H due to the internal environmental changes, the situation is expected to be advantageous for some businesses, such as the content distribution business, regardless of the external environment changes. Therefore, it is considered highly possible that on the end of the novel coronavirus pandemic, the Company will be able to recover at an early stage compared to other Japanese companies.

From the above, while the timing to achieve the targets in the medium-term management plan may be pushed back, the Company can still achieve them. Also, when considering the fact that strongly performing products and services are increasing, the rebound from the upfront costs incurred in the previous fiscal period, the structural reforms in CANSYSTEM, the business transformation of the communications business, and the slowdown of the energy business, which was expected to be high growth but low profitability, the operating profit ratio may exceed the target in the medium-term management plan of 4% to 5%. In addition, the Company incurs amortization of goodwill of ¥3bn in each fiscal period, and the operating profit ratio before amortization, which shows the actual ability to generate cash, is likely to be an even higher figure. Alongside this, the amount of net profit before amortization (the crude cash flow) is also higher, so the Company has a comparatively ample cash flow, which can be considered to be a factor that will support it after the end of the novel coronavirus pandemic. These benefits, of the possibility of an early recovery and an ample cash flow, are expected to extend not only to each Group company, but to customers as well.



Note: the values are excluding the impact of the novel coronavirus
Source: Prepared by FISCO from the Company's financial results and medium-term management plan briefing materials

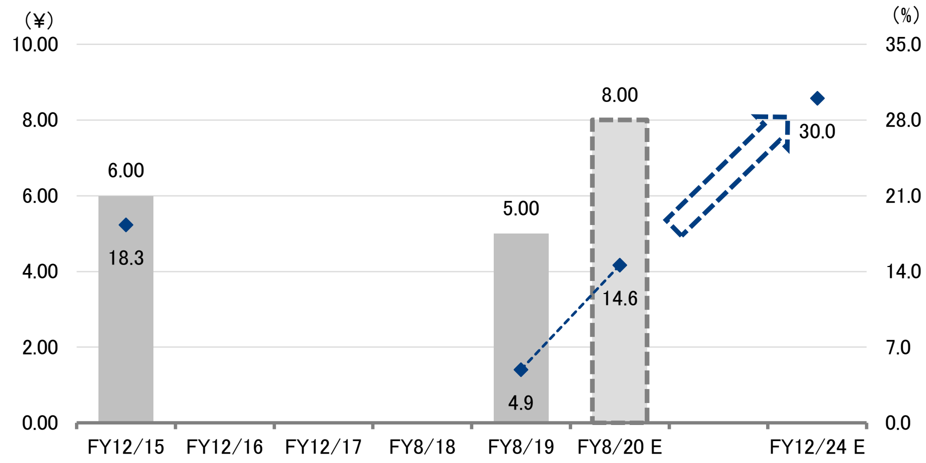
Shareholder return policy

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

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%. If saying a dividend payout ratio of 30%, there might be an image of a fairly considerable increase that would raise concerns about cash flow. But in the case of the Company, as we saw in the medium-term growth image section, it has considerable profits before amortization that are the source of funds for investment and dividends, so it can be said that it has ample funds for returns to shareholders, even while continuing to maintain a certain level of investment in growth.

Trends in dividend per share and payout ratio



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

Has significantly upgraded the shareholder benefit program

2. Shareholder benefit program

On November 21 and December 18, 2019, the Company released in rapid succession two upgrades to its shareholder benefit program, with the aims of further increasing the appeal of investing in its shares and retaining shareholders in the medium- to long-term.

As the first upgrade to the shareholder benefit program, the Company newly added a preferential treatment category for shareholders holding at least 1,000 shares. For shareholders holding from 100 to 999 shares, they receive 90 days of free use of the “U-NEXT” video distribution service and ¥1,000 worth of points, which is unchanged from previously (Shareholders who are already “U-NEXT” subscribers receive points only). However, shareholders with at least 1,000 shares will now receive one year’s worth of usage fees for the “U-NEXT” service and ¥1,800 worth of points each month.

Table Comparing New and Previous Shareholder Benefit Programs

Previous Shareholder Benefit Program		New Shareholder Benefit Program	
-	-	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	100-999 shares	No change
	“U-Mobile” Talk Plus plan initial fee waived, ¥5,000 cash back via postal money order		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

For the second upgrade, shareholders holding at least 500 shares at the end of February in each year will receive shareholder benefit points according to the number of shares they hold, while in the "USEN-NEXT HOLDINGS Premium Benefits Club", which is a newly established special website only for shareholders, they can exchange their points for more than 2,000 products and services, including food and electronic products, gift cards, travel, and experiences. 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. Also, by exchanging the points for WILLsCoin, shareholders can total their points with the shareholder benefit points of other companies that have introduced the Premium Benefits Club and extend their period of validity.

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

Source: The Company's results briefing materials

Shareholders registered in the shareholder registry at the end of August 2019 were eligible for the Company's first upgrade to the shareholder benefit program, and shareholders registered at the end of February 2020 were eligible for the second upgrade, while shareholders eligible for both upgrades received both benefits. The first and second upgrades establish a system in which the longer that shares are held, the more generous the benefits received. If shareholders hold at least 1,000 shares for a long time, from the first upgrade, they will have waived the "U-NEXT" monthly usage fee of ¥1,990 and separately receive ¥1,800 worth of points each month, while in addition, from the second upgrade, they will receive 27,500 points (1.1 times the points in the first year: 1 point = ¥1).

On March 16, 2020, President Uno sold his holding of shares in order to maintain the Company's listing on the 1st Section of the Tokyo Stock Exchange. But the Company's new shareholder benefit program is proving popular, especially with individual investors, and it is considered to be the driving force behind the significant increase in the number of investors, from 5,000 people to 15,000 people.

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.

FISCO

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