COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

Tokyo Stock Exchange Prime Market

8-Dec.-2022

FISCO Ltd. Analyst
Ikuo Shibata

FISCO Ltd.
https://www.fisco.co.jp

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Summary

In 1H FY3/23, sales increased while profits decreased. The Branded Business experienced a steeper slow-down than expected, mainly due to cooling consumer sentiment and a decline of special demand related to COVID-19. Full-year forecasts have been revised downward, mainly reflecting a review of sales forecasts

Wacom Co., Ltd. <6727> (hereafter, also "the Company") is the global leading manufacturer aiming to create value for customers based on technologies in the field of digital pen and ink. It dominates in brand clout and market share, supported by professional creators such as designers and animators who work in studios for movie production or industrial design studios. Its two business segments are the Branded Business, in which it sells its proprietary Displays (LCD pen tablets) and Pen Tablets and other products, and the Technology Solution Business, in which it supplies proprietary digital pen technology as a component to manufacturers of finished products, including smartphones and tablet PCs.

1. 1H FY3/23 results

For 1H FY3/23, sales increased while profits decreased, with net sales increasing 7.7% YoY to ¥54,138mn and operating profit decreasing 69.8% to ¥2,284mn. Overall sales increased, as the positive effect of the yen's depreciation and growth in the Technology Solution Business covered a decrease in sales in the Branded Business (mid- and low-priced models), mainly due to a rapid cooling of consumer sentiment with the deterioration of the economic environment and a decline of special demand related to COVID-19 (online education and stay-at-home demand, etc.). On the earnings front, operating profit decreased, mainly due to a decrease in the gross profit margin in the Branded Business (deterioration in the sales mix and increase in US-dollar purchasing prices due to foreign exchange fluctuations while non-US-dollar sales revenues were negatively impacted by foreign exchange fluctuations) and an increase in selling, general and administrative expenses, despite a boost to profits from the yen's depreciation and the Technology Solution Business. Looking at the Company's activities, the Company formed a capital and business alliance with CELSYS, Inc. <3663> (Former ArtSpark Holdings Inc. It merged with its subsidiary CELSYS, Inc. on September 1, 2022 and changed its name to CELSYS. Hereinafter "CELSYS") for joint development of created experiences, etc. for special purposes such as education through "CLIP STUDIO PAINT." The Company's successful initiatives include having its "S Pen" featured in the "Galaxy Z Fold4" made by Samsung Electronics Co., Ltd. <KRX:005930> and the announcement of its flagship model, "Wacom Cintiq Pro 27."

2. FY3/23 results outlook

For the FY3/23 consolidated results outlook, based on 1H results and the outlook going forward, the Company announced a downward revision on October 14, 2022. The Company now expects an increase in sales and a decrease in profits, with net sales expected to increase 9.4% YoY to ¥119,000mn and operating profit to decrease 53.9% to ¥6,000mn. The reason for the downward revision in the net sales forecast is mainly in the Branded Business, where, in light of changes in the market environment, the Company 1) revised sales forecasts for mid- to low-priced models in the Pen Tablets and Displays categories and 2) postponed the timing of market launch for certain products. As a result, the Company expects to secure a significant increase in sales over the full year, due to the positive effect of the yen's depreciation and the maintaining of strong relationships with OEM partner manufacturers, despite a YoY decrease in sales in the Branded Business. On the earnings front, operating profit is expected to decrease significantly on a consolidated basis, mainly reflecting the decrease in sales and deterioration of the product mix in the Branded Business, as well as the negative impact of the continued appreciation of the US dollar and a declined in the gross profit margin, despite growth in the Technology Solutions business and the positive impact overall on a consolidated basis of the yen's depreciation.

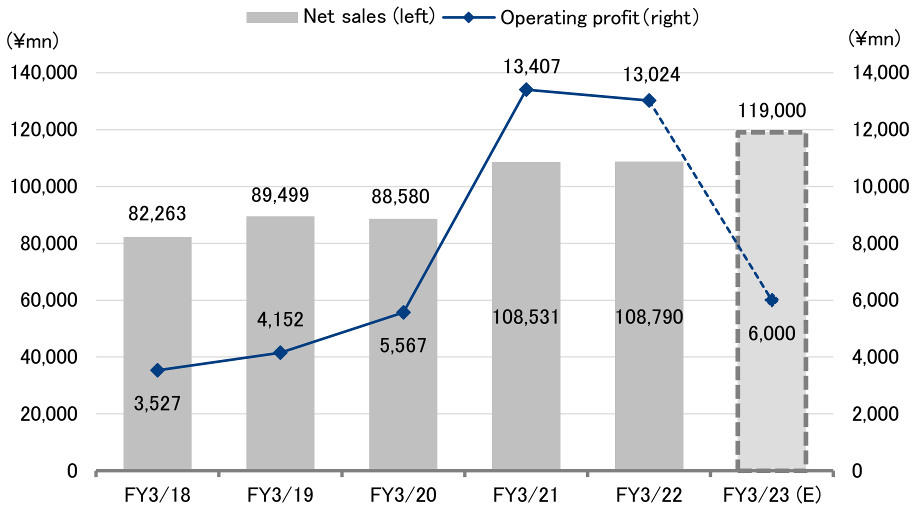
3. Growth strategy

The Company is promoting initiatives under "Wacom Chapter 3" (FY3/22 to FY3/25) its four-year medium-term business direction. Despite a delay in the envisioned growth trajectory due to the current decrease in earnings following a deterioration of the economic environment, the Company's strategic direction remains the same. The new direction will promote the specific value propositions and sustainable growth, inheriting the vision of "lifelong ink," and redefining "five key strategic initiatives" as well as "six main streams for technology innovation" to implement the policy. In particular, the Company's leading strategy is to select three fields that have a high affinity with its existing technologies–AI, XR, and Security–and realize new value propositions in these fields using new technologies and business models. Taking the growth of existing businesses as a baseline and adding the impact of new core technologies and business models, the policy aims for double-digit growth.

Key Points

- 1H FY3/23 results were an increase in sales with a decrease in profit, mainly due to a steeper than expected slowdown in the Branded Business (mid- to low-priced models)
- Significant impact from cooling of consumer sentiment with the deterioration of the economic environment and the decline of special demand related to COVID-19
- Based on 1H results and future forecast, the earnings forecast for FY3/23 was revised downward, with projection for an increase in sales and a decrease in profit for the full year
- Promoted the new medium-term business direction Wacom Chapter 3 started from FY3/22. No change to its direction in pursuit of growth acceleration with the establishment of new core technologies and new business models

Results trends



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

Business overview

Global leader aiming to create value for customers based on technologies in the field of digital pen and ink

The Company is a global leader aiming to create value for customers based on technologies in the field of digital pen and ink. It sells products in more than 150 countries worldwide and dominates in brand clout and market share, supported by professional creators such as designers and animators who work in studios for movie production or industrial design studios. Furthermore, as a Technology Leadership Company, it broadly supplies the latest digital pen technology to partner companies manufacturing smartphones, tablet PCs, digital stationery, and other products and is fostering a business field that specializes in education with partners from the educational industry.

The Company is also striving to create new growth opportunities by rebuilding product line-ups and further evolving the business model amid major changes in the market environment, including tougher competition in mid- and low-priced product categories and evolution of user needs and workflow, as well as the spread of online education and teleworking accompanying advances in digital technologies (IoT, XR, AI, and others) and the communications environment (mobile, cloud, 5G, and others).

Its two business segments are the Branded Business, which sells the Company's proprietary Displays, Pen Tablets and other products, and the Technology Solution Business, which supplies proprietary digital pen technology as a component to manufacturers of finished products, including smartphones and tablet PCs. The two businesses have formed a more or less balanced business composition in terms of net sales and operating profit.

With the overseas sales ratio (overseas local entity sales ratio excluding the Technology Solution Business) at about 86%*, careful attention should be given to the impact of foreign exchange market fluctuations on earnings (in particular, fluctuations in the euro-yen rate have a major impact on operating profit).

* According to 1H FY3/23 consolidated results, the US accounts for 29.7% of the total, Asia and Oceania 33.2%, and Europe (Germany) 22.9%.

Additionally, while development sites are practically all concentrated in Japan, excluding developments of digital ink and security-related software (which are mainly in Europe) and driver software (which is mainly in the US), the Company consigns production to multiple overseas partners (which are mostly major electronics manufacturing service companies owned by either Japanese or Taiwanese with production bases in mainland China). However, from a perspective of mitigating regional concentration risk in the supply chain, the Company is proceeding to disperse its production sites into the surrounding Southeast Asia region*.

* As a result, in FY3/22, the Company recorded temporary cost of sales improvement effects equivalent to approximately ¥0.9bn, including the impact of the avoidance of additional tariffs on Chinese imports to the US, which were incurred in the preceding years.

Business and major product features

Promoting updates in the product portfolio that address changes in the business environment and de facto standardization of proprietary technologies

1. Branded Business

The Company has a broad lineup for target customers and product types. It sorts products into two categories: (1) Creative Solution and (2) Business Solution.

(1) Creative Solution

This is the core business since the Company's founding and possesses strong brand clout and market share with professional creators. Product types include Displays, Pen Tablets and Mobiles, and understanding their differences is important in assessing the competition environment and growth potential.

a) Displays

This category covers products that use an LCD panel as the tablet* and are similar to Mobiles, which are explained below, in terms of directly writing on an LCD screen with a digital pen. Meanwhile, they also known as PC peripherals, similar to Pen Tablets as an input device that does not have an OS or storage feature. Prices for larger products range from around ¥300,000 to ¥500,000. Users are mainly professionals and advanced amateurs, and the Company holds an overwhelming share in this market. In response to market changes (such as expanded scope in digital handwriting (drawing) users and demand shift from Pen Tablets), it released multiple new models including a 16-inch entry model with an actual sales price in the ¥60,000 to ¥70,000 range (tax exclusive; same below) in January 2019, a 22-inch model (actual sales price in the ¥100,000 to ¥110,000 range) in July 2019, and a 13-inch model for beginners (actual sales price in the ¥30,000 to ¥40,000 range) in January 2020. The Company is gaining a stronger presence even in the entry model segment where it faces tough price competition from other companies (Chinese manufacturers, etc.). In the domain for professional creators, where there is a growing need for the ability to use cloud-based workflows, in September 2022, the Company announced a 27-inch sized flagship model (sold at the ¥500,000 to ¥600,000 level together with a specialized stand).

* Sometimes referred to as “LCD pen tablets” as well.

b) Pen Tablets

The most basic device* consists of a digital pen and tablet (blackboard type) and has ever contributed to the Company’s results as a mainstay product. It is a PC peripheral used over a connection to a PC, similar to a mouse or keyboard. The Company offers a broad lineup that ranges from professional to beginner products thanks to a simple configuration. While it is sustaining competitiveness in the professional high-end market, competition has intensified in the mid- and low-priced category where it is difficult to achieve differentiation. Furthermore, since the Company has strategically shifted management resources in response to a demand shift toward Displays with better operability and lower prices, sales were steadily trending downward in the few years prior to the COVID-19 pandemic.

* Sometimes referred to as “opaque pen tablets” as well.

c) Mobiles, others

The Mobiles category covers Displays for use as an input device that contain an OS and storage feature. From the standpoint of usability, they are the same as standard tablet PCs with general pen entry support (many of these products utilize the Company’s pen sensor system) and might even appear to have a competitive relationship (fostering competition with the Technology Solution Business in the Company’s case). However, the difference is obvious to users who place emphasis on input performance, and it makes more sense for general users who do not have this focus to select standard tablet PCs rather than the Company’s Mobiles that function focusing on input devices. These products hence have clear segmentation in performance and functionality. Also, in products other than Mobiles, it sells a group of products for general consumers that are used, for example, to create illustrations and notes on a digital device, such as the stylus pen for Windows tablet PCs and digital stationery.

(2) Business Solution

The Company sells business-use products that are capable of direct drawing and character entry on an LCD screen. Usage is increasing in digital signature (hotel check-in, credit card payments, opening bank accounts, concluding insurance policies, etc.) and medical (medical document management and electronic medical records, informed consent etc.) areas, as well as the public field (government administration services such as application forms at service desks, emergency assistance, electronic voting support, etc.).

2. Technology Solution Business

This business is divided into two segments, AES Technology Solution and EMR Technology Solution, others sales based on digital pen technologies*. It supplies pen sensor systems to smartphone and tablet and notebook PC manufacturers. In particular, the Company is expanding sales to Samsung Electronics (Galaxy series) in smartphone-related use, a growing market. Tablet and notebook PC manufacturers highly rate the Company's technology which includes implementing foldable devices (folding-type smartphones and PCs, etc.) and electronic paper technology and compatibility with new devices, and its deals with major manufacturers and the number of projects is steadily growing. The Company aims to expand business scale through promotion of its proprietary digital pen technology as a de facto standard, while expanding the scope of users.

* The Company's technologies consist of Active ES (proprietary electrostatic coupling, battery required for pen) format technology and EMR (electro-magnetic resonance) rapid, high-precision positioning sensors (battery not required).

Financial highlights

In 1H FY3/23, sales increased while profits decreased. The Branded Business experienced steeper slow-down than expected, mainly due to cooling consumer sentiment and a decline of special demand related to COVID-19

1. 1H FY3/23 results

In the Company's 1H FY3/23 consolidated results, sales increased while profits decreased, with net sales increasing 7.7% YoY to ¥54,138mn, operating profit decreasing 69.8% to ¥2,284mn ordinary profit decreasing 45.1% to ¥4,203mn, and profit attributable to owners of parent decreasing 44.0% to ¥3,231mn.

Overall sales increased, as the positive effect of the yen's depreciation* and growth in the Technology Solution Business covered a decrease in sales in the Branded Business (mid- and low-priced models), mainly due to a rapid cooling of consumer sentiment with the deterioration of the economic environment, and a decline of special demand related to COVID-19 (online education and stay-at-home demand, etc.).

* The factor increased net sales by approximately ¥8bn.

On the earnings front, despite a boost to profits from the effect of the yen's depreciation*1 and the Technology Solution Business, operating profit decreased, mainly due to a decrease in the gross profit margin in the Branded Business and an increase in selling, general and administrative expenses (including R&D expenses)*2. The main cause of the decrease in the gross profit margin is deterioration in the sales mix and increase in US-dollar purchasing prices due to foreign exchange fluctuations while non-US-dollar sales revenues were negatively impacted by foreign exchange fluctuations.

*1 This factor boosted overall operating profit by approximately ¥0.5bn. Looking at the effect by segment, however, it should be noted that the effect was different in each segment, with a negative impact of approximately ¥0.8bn in the Branded Business and a positive impact of approximately ¥1.5bn in the Technology Solution Business. Furthermore, in non-operating income, the Company recorded foreign exchange gains due to the yen's depreciation (approximately ¥1.9bn).

*2 Selling, general and administrative expenses increased by approximately ¥2.5bn, including an increase of approximately ¥0.9bn in R&D expenses (approximately ¥1.1bn of the increase was caused by the yen's depreciation).

Looking at the Company's financial position, total assets increased by 10.7% from the end of the previous period to ¥81,165mn, mainly reflecting an increase in inventories. On the other hand, equity remained at about the same level, increasing by 0.7% to ¥43,786mn as increases in retained earnings and foreign currency translation adjustment were mostly balanced out by a decrease in treasury stock following a cancellation of treasury shares. As a result, the equity ratio decreased slightly to 53.9% (59.3% at the end of the previous period).

1H FY3/23 financial results

(¥mn)

	1H FY3/22		1H FY3/23		Change	
	Results	% of sales	Results	% of sales	Amount	%
Net sales	50,259		54,138		3,879	7.7%
Branded Business	25,879	51.5%	20,425	37.7%	-5,454	-21.1%
Technology Solution Business	24,380	48.5%	33,713	62.3%	9,333	38.3%
Cost of sales	30,565	60.8%	37,251	68.8%	6,686	21.9%
SG&A expenses	12,134	24.1%	14,604	27.0%	2,470	20.4%
Operating profit	7,560	15.0%	2,284	4.2%	-5,276	-69.8%
Branded Business	5,494	21.2%	-1,852	-9.1%	-7,346	-
Technology Solution Business	4,217	17.3%	6,552	19.4%	2,335	55.4%
Adjusted amount	-2,151	-	-2,417	-	-265	-
Ordinary profit	7,661	15.2%	4,203	7.8%	-3,458	-45.1%
Profit attributable to owners of parent	5,766	11.5%	3,231	6.0%	-2,535	-44.0%

	End of March 31, 2022	End of September 30, 2022	Change	
			Amount	%
Total assets	73,332	81,165	7,833	10.7%
Shareholders' equity	43,503	43,786	283	0.7%
Equity ratio	59.3%	53.9%	-5.4pt	-

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

Breakdown of SG&A expenses

(¥mn)

	1H FY3/22	1H FY3/23	Change	
			Amount	%
Personnel expenses	4,832	5,620	788	16.3%
R&D expenses	2,279	3,156	877	38.5%
Sales promotion and advertising expenses	983	1,241	259	26.3%
Freight and packing expenses	668	796	128	19.1%
Outsourcing expenses	655	762	107	16.4%
Depreciation and amortization	236	206	-30	-12.6%
Other	2,482	2,822	341	13.7%
Total	12,134	14,604	2,470	20.4%
SG&A expenses ratio	24.1%	27.0%		2.9pt

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

2. Results overview by business

(1) Branded Business

Sales and profits decreased, and the Company recorded a segment loss, with net sales down 21.1% to ¥20,425mn and segment loss of ¥1,852mn (profit of ¥5,494mn in the same period of the previous fiscal year). Looking at net sales, sales decreased in Creative Solutions (particularly mid- to low-priced models) due to the impact of a rapid cooling of consumer sentiment with the deterioration of the economic environment and a decline in special demand related to COVID-19 (online education and stay-at-home demand, etc.), in addition to the impact of lockdowns in some regions of China, and other factors. Meanwhile, in Business Solutions, sales increased only slightly, mainly due to fluctuating changes in market conditions. On the earnings front, a significant deterioration in profit (recording of segment loss) was mainly due to a drop in sales of high profit Pen Tablets (deterioration in the product mix) and increase in US-dollar purchasing prices due to foreign exchange fluctuations while non-US-dollar sales revenues were negatively impacted by foreign exchange fluctuations, as well as restrictions on profits from aggressive R&D investments.

Earnings breakdown in the Branded Business

(¥mn)

	1H FY3/22	1H FY3/23	Change	
			Amount	%
Creative Solution	23,731	18,181	-5,550	-23.4%
Displays	11,262	10,029	-1,233	-11.0%
Pen Tablets	11,430	7,420	-4,010	-35.1%
Mobiles, others	1,039	732	-307	-29.6%
Business Solution	2,148	2,244	96	4.5%

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

a) Creative Solution sales

Net sales decreased 23.4% YoY to ¥18,181mn. By product, in Displays, sales of professional products grew, while sales of entry models in the mid- to low-price band decreased, mainly due to a cooling of consumer sentiment and a decline of demand associated with COVID-19. On the other hand, Pen Tablets saw a decrease in sales of professional products due to the impact of several years passing since the launch of sales, while mid- to low-priced model sales dropped sharply, as with Displays. In Mobiles & others, sales of mobile products and stylus pens both decreased.

b) Business Solution sales

Net sales grew, increasing 4.5% YoY to ¥2,244mn. Revenue increased slightly with the impacts of fluctuating changes in market conditions and progress on projects.

(2) Technology Solution Business

The segment recorded sharp increases in sales and profits, with net sales increasing 38.3% YoY to ¥33,713mn and segment profit increasing 55.4% to ¥6,552mn. In net sales, despite production supply chain restrictions and other effects of the COVID-19 pandemic, ASE Technology Solution and EMR Technology Solution sales both grew significantly. On the earnings front, profits increased significantly, reflecting a boost from increased sales and the positive impact of the yen's depreciation, despite accelerated R&D investment for purposes such as the development of next-generation products.

Earnings breakdown in the Technology Solution Business

(¥mn)

	1H FY3/22	1H FY3/23	Change	
			Amount	%
AES Technology	9,888	12,748	2,860	28.9%
EMR Technology, others	14,492	20,965	6,473	44.7%

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

a) AES Technology Solution sales

Net sales increased 28.9% YoY to ¥12,748mn as the solutions continue to be highly regarded by OEM partner manufacturers.

b) EMR Technology Solution, other sales

Net sales increased 44.7% YoY to ¥20,965mn, driven by successful portfolio changes by OEM partner manufacturers.

3. Business recovery direction and initiatives

With regard to the slump in sales in the Branded Business (mid- to low-priced models), the Company recognizes external factors, such as a decrease in purchase priority with the deterioration of the economic environment and the decline of special demand related to COVID-19, as well as room for improvement on internal factors, such as sales channel management and the product portfolio. In response, the Company is taking the following initiatives: 1) strengthen B2B and proprietary online stores, 2) redeveloping lost market demand (general education and creative education, DX, etc.), 3) continuing renewal of product portfolio, and 4) provision of new value/start of new business model (3 and 4 have been continually ongoing projects). However, there is no change to the strategic direction of the abovementioned medium-term business direction Wacom Chapter 3.

Moreover, following the recent downturn in performance, the Company plans to update the envisioned growth under Wacom Chapter 3. Specifically, since growth going forward is expected to be delayed due to the impact of a deterioration in the economic environment, the Company is now looking at a scenario that is delayed by around two years from the original scenario: it is aiming for a turnaround from FY3/24, and will also realize a business structure that will achieve and maintain a double-digit operating profit margin from FY3/26 onward, when the Company starts "Wacom Chapter 4." The revised plan is to be disclosed over two occasions with a first report and second report (when the announcement of financial results for the FY3/23 is made).

4. Key takeaways of 1H FY3/23 results

To summarize 1H FY3/23 from the above, the important thing would be how to evaluate the sharper-than-expected slowdown of the Branded Business (mid- to low-price models). Although the drop in demand related to COVID-19 had been expected to some degree, the impact of cooling consumer sentiment has been sharper and larger than expected, including moves to adjust distribution inventories. Considering the market characteristics for mid- to low-price models in particular, at the initial stage of inflation, consumer sentiment is increasingly susceptible at lower income levels, and purchase priority has a tendency to be lower as well. Taking this into account, some level of influence from economic cycles can be seen as inevitable. However, judging from the high regard for the Company among its business partners (OEM partner manufacturers), its track record of having products included in business partners' products, and its moves towards collaboration with partners, we do not see any need to change our evaluation of the sizable potential of digital pens and the Company's technology as such. Accordingly, it seems that the challenge for the Company going forward will be the degree to which it can develop markets for its brands that will not be affected by economic cycles. In terms of the Company's direction for business recovery, it has stated that its theme is to firmly develop use cases and an experience-based approach, including strengthening sales channels, with a view toward incorporating the large-scale markets for the fields of general education and creative education or widening its user-base. This shows the Company's commitment to creating and developing truly foundational markets, and we see the Company's determination to reconfirm what it needs to do going forward as a positive point.

Main results of activities

Successful initiatives including market launch of Wacom Cintiq Pro 27 flagship model and adoption of S Pen for Galaxy Z Fold4

1. Capital and business alliance with CELSYS

In April 2022, the Company concluded a capital and business alliance* with CELSYS, whose offerings include the illustration, manga, and animation production app CLIP STUDIO PAINT. The Company has collaborated with CELSYS for over 20 years to support the creative community, and this alliance is intended to further deepen the collaboration between the two companies. Specifically, they intended to promote the following kinds of initiatives, making this alliance truly one of the centerpieces of the new core technology/new business model promoted in the medium-term business direction Wacom Chapter 3 (details to follow).

* The Company acquired approximately ¥1.6bn worth of shares (approx. 5%) through a third-party allocation. It plans to make additional acquisitions going forward, not exceeding 10%.

1) Co-development of creative work/experience through combination of Wacom products and CLIP STUDIO PAINT, for education and other specific purposes
2) Co-development to deliver new values through a combination of KISEKI ART service* and CLIP STUDIO PAINT
3) Implementation of technologies for protection and management of rights and authorship of digital artwork into CLIP STUDIO PAINT, and consideration of related service operations
4) Collaboration and development to enable new creative workflows through combination of Wacom products, new features and CLIP STUDIO PAINT
5) Co-development and proposal for partner companies through combination of Wacom products and CLIP STUDIO PAINT

* A service for grasping the creation process of pen and brush strokes using digital technology (visualizing the traces of creation), inspired by the idea that "the data from the traces of creation by creators and animators has value comparable to the works themselves, and is an asset that should be attributable to the artist." This project will help artists to obtain insight and improve their skills, and enable support various activities such as proposing new value for enjoying art works.

2. Digital pen technology adopted in S Pen for Galaxy Z Fold4

The Company's digital pen technology continued to be used in the S Pen for the Galaxy Z Fold4 smartphone announced by Samsung Electronics on August 10, 2022. Galaxy Z Fold4 is the first to use Google's Android 12L OS, which is optimized for use on large screens and folding screens. The special feature of the phone is the ability to flexibly change the angle setting of the folding main display between 75 and 115 degrees while freely conducting advanced multi-tasking operations. During such operations, Samsung Electronics' S Pen featuring Wacom's EMR technology demonstrates its true potential. Specifically, since the pen is able to conduct precision operations in a finely detailed area easily and freely, users can easily draw pictures in a mobile environment, take notes while engaging in a video call, or check a to-do list while reading email. This is the result of long-standing collaboration between the Company and Samsung Electronics, and going forward, it intends to expand and deepen the scope of this collaboration. In addition, the Company's AES input pen has been bundled with second-generation Foldable PCs made by Lenovo Group Limited <HKG:0992> and appears set to see further increases in uses with foldable devices going forward.

3. Launch of flagship model Wacom Cintiq Pro 27

As part of an effort to strengthen the product portfolio, in September 2022, the display product Wacom Cintiq Pro 27 for professionals was finally announced. Defining features of the product include seamless connection with creative software to enable comfortable operation, while significant improvements have been made to key points for LCD pen tablet users, such as pen accuracy and multi-touch input, a high refresh rate, accurate color reproduction, and easier-to-use product design and customizability, to realize an immersive creation environment. User feedback indicates that users found the product enabled completely stress-free drawing, that it was easy to draw with, that it showed Wacom's continuing evolution, and that Wacom responded to user feedback. The Company plans to continue launching new product lines and to continue strengthening the product portfolio.

Outlook

FY3/23 earnings forecast revised downward. Full-year forecast for increased sales and decreased profit

1. FY3/23 results outlook

For the FY3/23 consolidated results outlook, the Company announced a downward revision on October 14, 2022, based on its 1H results and outlook*. For the full year, the Company expects increased sales and a decrease in profit, with net sales to increase 9.4% YoY to ¥119,000mn, operating profit to decrease 53.9% to ¥6,000mn, ordinary profit to decrease 45.0% to ¥7,900mn, and profit attributable to owners of parent to decrease by 46.1% to ¥5,900mn.

* The Company revised its initial forecast twice, on July 29 and October 14. As a result, the net sales forecast was reduced by ¥9,000mn from the initial forecast, the operating profit forecast by ¥7,700mn, the ordinary profit forecast by ¥5,800mn, and the forecast for profit attributable by owners of the parent by ¥4,300mn.

The reason for the downward revision in the net sales forecast is mainly in the Branded Business, where, in light of changes in the market environment, the Company 1) revised sales forecasts for mid- to low priced models in the Pen Tablets and Displays categories and 2) postponed the timing of market launch for certain products. As a result, the Company expects to secure a significant increase in sales over the full year, due to the positive effect of the yen's depreciation* and the maintenance of strong relationships with OEM partner manufacturers, despite a YoY decrease in sales in the Branded Business.

* In foreign exchange rates for FY3/23 (from October 2022 onward), the Company is assuming US$1=¥140 (FY3/22 average: ¥112.86), €1=¥138 (FY3/22 average: ¥131.01). This would appear to increase full-year net sales (overall) by approximately ¥16bn YoY and full-year operating profit (overall) by approximately ¥1bn YoY (estimated by FISCO).

On the earnings front, the Company is forecasting a significant decrease in profits, reflecting a decrease in sales due to factors such as revised sales forecast and a decrease in the gross profit margin associated with a deterioration in the product mix during 1H and the negative impact of the continued appreciation of the US dollar in the Branded Business, despite growth and the positive impact of the yen's depreciation in the Technology Solution Business. In addition, the Company has not changed its aggressive policy on R&D investment for the future, with plans for investment of ¥7,000mn for the year (up 27.8% YoY). The results outlooks and activity policies by business are as follows.

Forecasts for FY3/23

(¥mn)

	FY3/22		FY3/23				Change	
	Results	% of sales	Initial forecast	% of sales	Revised forecast (October 14)	% of sales	Amount	%
Net sales	108,790		128,000		119,000		10,210	9.4%
Branded Business	52,641	48.4%	63,000	49.2%	52,000	43.7%	-641	-1.2%
Technology Solution Business	56,149	51.6%	65,000	50.8%	67,000	56.3%	10,851	19.3%
Operating profit	13,024	12.0%	13,700	10.7%	6,000	5.0%	-7,024	-53.9%
Branded Business	8,712	16.6%	9,000	14.3%	700	1.3%	-8,012	-92.0%
Technology Solution Business	8,888	15.8%	9,900	15.2%	10,500	15.7%	1,612	18.1%
Adjustment	-4,577	-	-5,200	-	-5,200	-	-	-
Ordinary profit	14,351	13.2%	13,700	10.7%	7,900	6.6%	-6,451	-45.0%
Profit attributable to owners of parent	10,955	10.1%	10,200	8.0%	5,900	5.0%	-5,055	-46.1%

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

(1) Branded Business

Net sales are forecast to decrease 1.2% to ¥52,000mn and segment profit to decrease 92.0% to ¥700mn. The forecast for net sales is for a slight decrease due to revision of sales forecasts for mid- to low-priced models in light of changes in the market environment and delays in the launch of certain products. Meanwhile, on the earnings front, a significant decrease in profit is expected, while remaining profitable over the full year, reflecting a decrease in the gross profit margin due to a deterioration in the product mix in the same way as in 1H and the negative impact of continued appreciation of the US dollar, in addition to a policy of continuing aggressive R&D investment.

(2) Technology Solution Business

Net sales are forecast to increase 19.3% YoY to ¥67,000mn and segment profit to increase 18.1% to ¥10,500mn. The Company is forecasting an increase in sales due to the positive effects of the yen's continued depreciation from 1H and its maintenance and development of strong relationships with OEM partner manufacturers, despite expecting an impact from falling demand in the tablet and laptop PC markets. On the earnings front, the Company expects to secure profit growth due to a boost to profit from increased sales, even while accelerating aggressive R&D investment for the future.

2. FISCO's view

To achieve the revised earnings forecast, the Company requires 2H net sales of ¥64,862mn (up 10.8% YoY) and operating profit of ¥3,716mn (down 32.0%). Although the business environment has an unclear outlook and certainly does not offer room for optimism given the unstable global economic situation, foreign exchange market trends, and supply chain turmoil, we see the Company's earnings forecast as being sufficiently achievable, reflecting such uncertainties within a reasonable range. Furthermore, with regard to the increase in procurement cost, including the impact of foreign exchange fluctuations, a factor in the reduced gross profit margin of the Branded Business, the Company appears to have a policy for covering this that involves passing costs on to customers. Furthermore, with regard to new products, the Company plans to set prices that reflect the value of newly installed functions, taking into consideration the high-cost factor of components and materials. It seems that the key point here will be how this price strategy will contribute to improving earnings. Attention should be given to how the Company will recover in terms of catching up on its envisioned growth under the medium-term business direction Wacom Chapter 3. To begin, the Company's policy is to steadily execute the aforementioned "Business recover direction and initiatives" and we look forward to following up on their specific progress and results.

Results trends in past years

Technology Solution Business driving growth over the past few years due to increase in demand from OEM partner manufacturers for smartphones, etc.

Looking at how sales trended up to FY3/20, prior to the COVID-19 pandemic, the sudden, large slump in FY3/17 occurred because of the combined impacts of yen appreciation, excessive internal IT infrastructure investment, product cycle movement, and other factors. Since then, however, sales recovered with growth in the Technology Solution Business. Nevertheless, Branded Business sales have been trending lower with the structure of positive growth in the Technology Solution Business continuing to offset its decline. However, the Brand Business experienced rapid growth in sales in FY3/21, mainly for online education due to the COVID-19 pandemic, while in FY3/22 despite the end of a surge in stay-at-home demand, growth in display products for professionals and the Technology Solution Business resulted in and achieved new record high net sales for a second consecutive year.

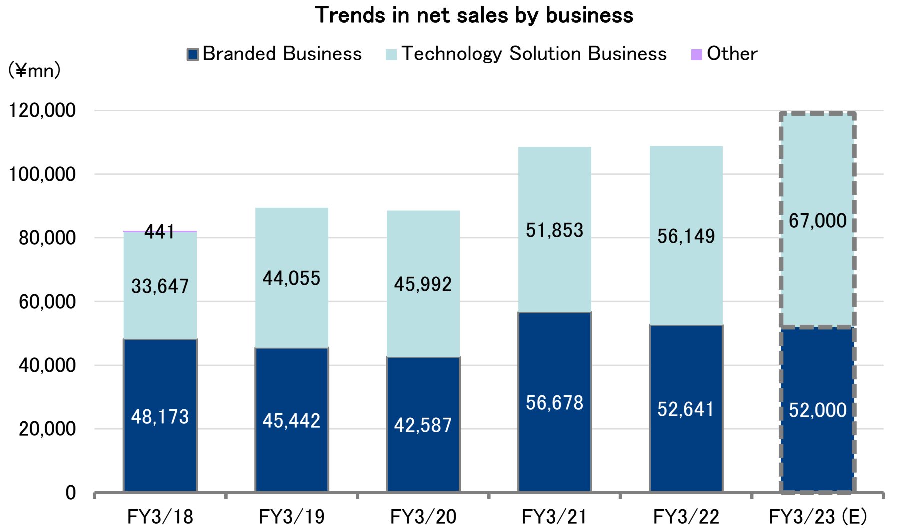
The main reason for the contracting trend in the Branded Business sales through to FY3/20 had been the need for time to fully compensate for growing competition in mid- and low-priced products in Pen Tablets, which had been a mainstay product, through a strategic demand shift to Displays. However, Displays is steadily developing a new market with entry models with high profit margins, and has grown while incorporating new demand from professional users as well, so it is important to recognize trend change in the sales mix (ratios).

Growth in the Technology Solution Business over the past few years, meanwhile, reflects expansion of the market for pen sensor systems for tablets and notebook PCs and strong performance in pen sensor systems for smartphones (particularly with Samsung Electronics' Galaxy series) aided by enhanced functionality.

In earnings, with the exception of an operating loss in FY3/17, the operating profit margin has improved gradually from the 4% level to the 6% level while conducting aggressive R&D and new product development. Since FY3/21, the Company has retained a high profit margin for two consecutive years due to higher profits atop a significant increase in sales, improvements in the product mix, and optimization of SG&A expenses, etc.

In financial standing, while the capital ratio temporarily slipped in FY3/17 on a hefty net loss due to recording impairment losses, it has steadily improved since then with buildup of retained profits and has moved close to 60%, the near-term goal for financial soundness. ROE and ROIC, which reflect capital efficiency, have been at a high level, and we think that the Company's finances are in a most excellent condition.

Results trends in past years



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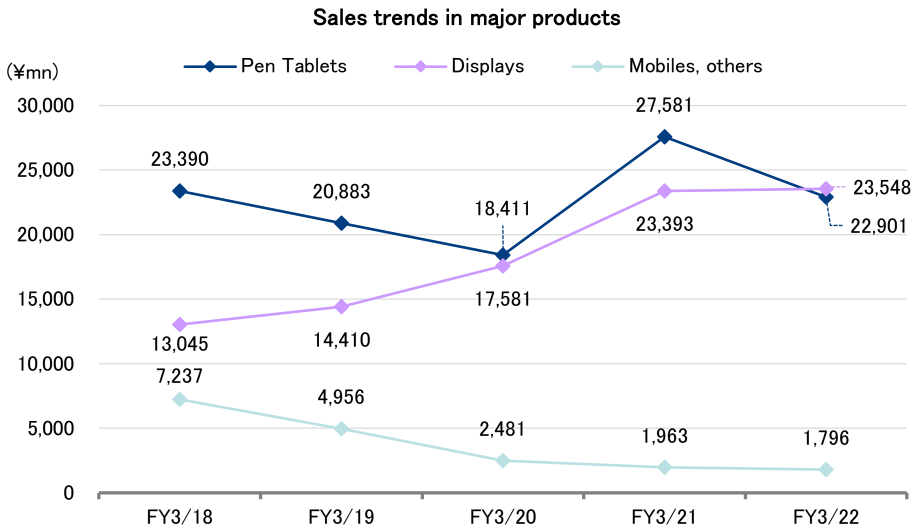

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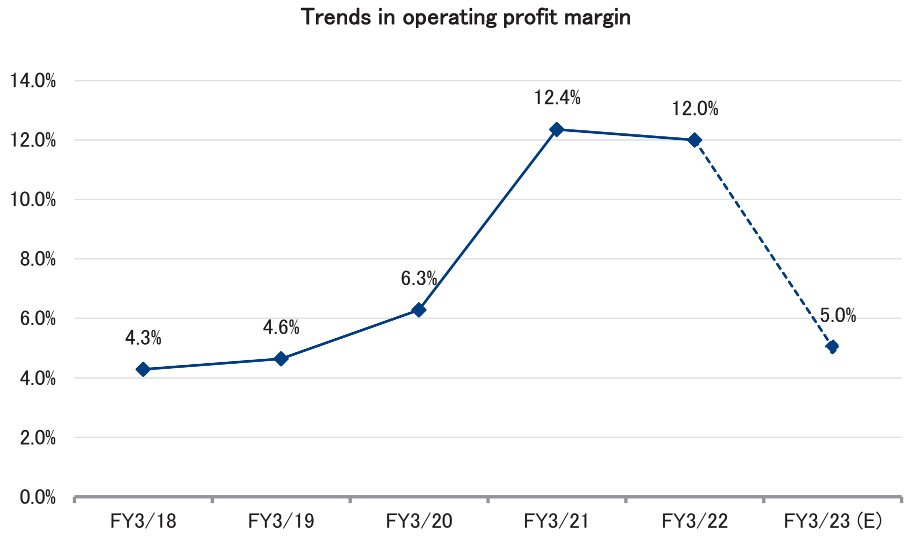

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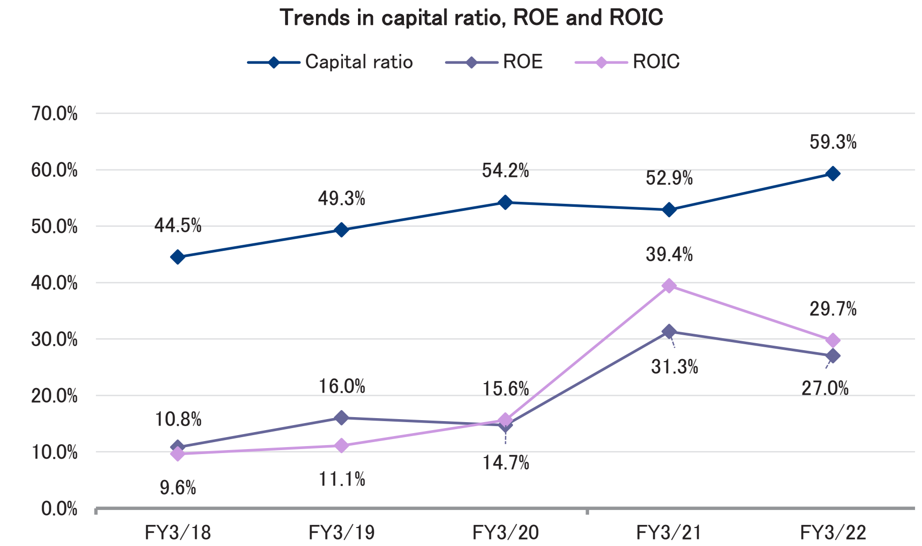


Source: Prepared by FISCO from the Company's financial results and results briefing materials

Growth strategy

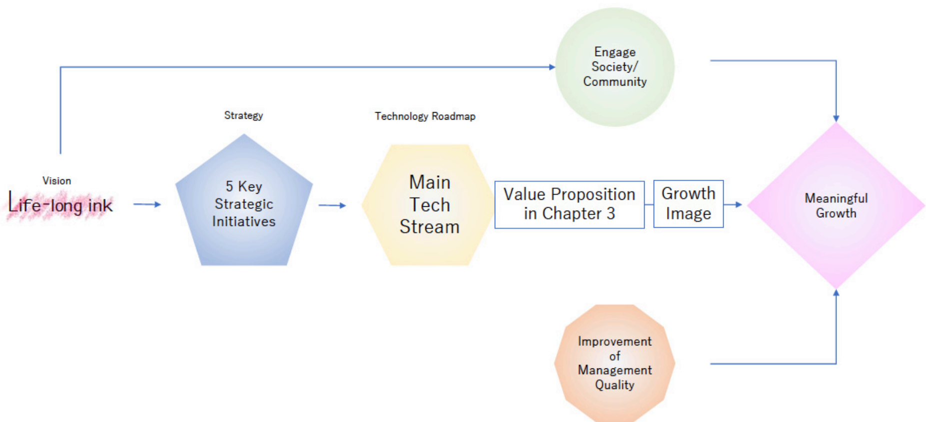
Promote the four-year medium-term business direction Wacom Chapter 3. To accelerate toward the next stage of growth, focus on establishing new core technologies and new business models

The Company is promoting initiatives in line with the four-year medium-term business direction Wacom Chapter 3 (FY3/22 to FY3/25), and FY3/23 is the second year of the direction.

Under Wacom Chapter 3, the Company has continued its vision of "Lifelong Ink"* and redefined its five key strategic initiatives to further develop and evolve its initiatives to date. In carrying out the five key strategic initiatives, the Company has set out six main streams for technology innovation, which it will operate as a corporate technology roadmap. The Company will use these to promote specific value propositions and sustainable growth. Moreover, the policy also calls for initiatives to increase the quality of management through corporate governance reforms and for engagement with society and communities through the Company's unique approaches.

* "Continuing to provide 'meaningful human experiences' to customers and society over a long time period based on Wacom's technology."

Storyline of Wacom Chapter 3



Source: From the Company's results briefing materials

1. Five key strategic initiatives

(1) Technology Leadership

Under this strategy, the Company will continue to focus on technology innovation as the source of its value provision, maintaining and developing its unrivalled technological advantage. The Company has worked to contribute to the creative field (digital content creation), education field, various types of digital transformation (DX) of workflows (public service desk procedures, document filing, and writing on PDFs in workflows, as well as digital voting, etc.), along with inclusion in various advanced devices and digital stationery, etc., and incorporation in smart home solutions. Now, the Company intends to continue providing the highest level of "pen, paper, and ink experience" through technology development spanning hardware, software, and services.

(2) Community Engagement

Under this strategy, the Company will form valuable experiences not only by itself, but also through deep collaboration with communities (partners). In a recent example, the Company jointly held an online drawing festival together with pixiv Inc.* In other collaborations, the Company has created designated Chromebook-compatible products, Android compatibility, and worked on building creative workflows in remote environments.

* Recently, the Company jointly held the third “Drawfest” event, on June 18 and June 25, 2022, a large-scale online drawing festival with participation by approximately 10,000 creators worldwide.

(3) New Core Technology, New Value Proposition

This strategy is to provide new value based on new core technologies in addition to existing core technologies. The idea is to select three fields that have a high affinity with its existing technologies–AI, XR, and Security–and realize new value propositions in these fields using new technologies and business models. The Company is already moving on collaborative projects with other companies, for example, creation of a new educational experience*1 through digital ink and AI, protection of copyrights through blockchain certification*2, and drawing experiences in XR space*3.

*1 The Company entered a comprehensive business alliance agreement with Z-kai Group for the use of Handwriting x Digital in the education field and has also been working on joint development with sdtech Inc. towards use of AI in Handwritingx Digital, among others.
*2 A system that uses digital signature authentication technology to certify digital art works by incorporating a signature into the digital artwork and its certificate, thereby preserving the rights of the creator and circulating the work.
*3 New creation experiences that involve joint creation by multiple and remote creators, as well as free exchange between 2D and 3D.

(4) Technology Innovation for Sustainable Society

The Company aims to contribute to the development of a sustainable society through technology and product development that contributes to environmental care. Through its existing participation in the Japan Climate Initiative (JCI) and establishment of the tech team for environment-friendly product development, the Company is promoting sustainability conscious technology innovation that leverages its unique strengths. The Company is also working to align corporate action with the circular economy. For example, it is engaged in activities to reuse “Connected Ink”* stages made from waste materials as furniture.

* An open event sponsored by the Company every year in Tokyo, Beijing, Dusseldorf, and Portland etc. The theme is “Creative Chaos”, created with partners in diverse domains including art, education, and technology by thinking about the source of human creativity. It is an event where people can experience the Company’s community engagement (contribution to society), and get a glimpse of various initiatives with partners and new challenges of the Company in addition to the projects introduced at the event. The contents of “Connected Ink 2022” can be viewed from the event’s homepage.

(5) Meaningful Growth

Under this direction, ensuring sound financial growth, the Company will target multi-dimensional, “meaningful growth” incorporating customers, users, society, communities, and individual stakeholders. This means aiming for sustainable growth from a long-term perspective.

2. Six main streams for technology innovation and specific value examples

(1) Pen technology (current core technologies/current business models)

The Company will further develop its digital pen technology, which is the source of its value proposition, and aim to introduce new product lines including environmentally friendly products.

(2) Pen and paper technology (current core technologies/current business models

The Company will cultivate new customer groups through collaborations with all kinds of “paper” (displays, apps).

(3) Digital ink technologies (current core technologies/current business models)

The Company will provide remote DX experiences, for example in the creative and education fields, through collaboration with data formats and apps, and cloud compatibility.

(4) AI × Digital ink (new core technologies/new business models)

The Company will expand into individually optimized education and creative support services, etc., by developing plugins that enable AI and ink collaboration.

(5) XR × Digital ink (new core technologies/new business models)

The Company will provide new 3D drawing work-flows for the creative, education, construction, and medical sectors through 3D drawing technology in XR space.

(6) Security × Digital ink (new core technologies/new business models)

The Company will provide individual authentication and copyright protection services for the creative, medical and other sectors, through handwriting-based personal authentical technologies.

3. Growth potential of target markets

The Company sees business opportunities for digital pens and ink in three large-scale markets with high growth potential*, adding the education DX market and the work-flow DX market to the creative market (digital content production and creation), which it has targeted to date. The Company recognizes that demonstrating technology leadership in these domains will enable it to accelerate its own growth. In particular, the provision of new value through the combination of new core technologies in AI, XR, and Security, which the Company is focused on, will be an essential element in the transformation and growth of these domains, and is aligned with the Company's strategic direction.

* According to the Company's materials, the average annual growth projections are 9.5% for the digital content production and creation market (2021–2027) (Source: Maia Research), 16.8% for the educational DX (Edtech) market (2021 to 2030) (Source: Grand View Research), and 16.5% for the work-flow DX market (2022 to 2023) (Source: IDC).

4. Envisioned growth and financial policy

Through the medium-term business direction Wacom Chapter 3, the Company will further promote its current core technologies and business model, while working to accelerate growth in the next stage by taking a strategic focus on establishing new core technologies and business models. The direction does not set numerical targets for the final fiscal year, but has set out expectations for the Company's growth direction and progress for each fiscal year on its strategic initiatives. Furthermore, for its financial policies, the Company has 1) set ROIC of around 25–30% as a new indicator and will target 2) ROE around 20%, and 3) dividend payout ratio around 30%. In addition, the Board of Directors will engage in frank and active discussion, keeping a close eye on the efficiency of business activities and capital efficiency in order to increase the feasibility of growth. However, as noted above, with the slowdown in recent financial results due to the deterioration of the economic environment the Company expects that the timeline for realizing its initially envisioned growth will be delayed. It appears to be targeting a scenario for a business structure that will achieve and maintain double-digit operating profit margin from FY3/26 onward, when Wacom Chapter 4 is set to begin. The specific revised plan is to be disclosed over two occasions, a first report and a second report (on the announcement of financial results for FY3/23).

5. Focus points identified by FISCO

We see Wacom Chapter 3 as an important basis for forecasting the Company's direction and future potential, as it establishes three new technologies (AI, XR, security) and new business models during the target period and has a major focus on how the Company will go about creating a platform for accelerating growth. The Company's success is likely to be determined not only by its in-house technology development, but also by the degree to which it can deliver value through new services based on collaboration with other companies. In particular, with regard to new value propositions using digital ink and AI, in addition to the education sector, where initiatives have already started, there is potential for various other sectors as well. If the Company can accumulate data and expertise ahead of other companies, the chances of it being able to establish an unrivaled position in innovative domains are likely to become much greater. If it can achieve this, it can also be expected to expedite collaboration with leading partners. Alongside the temporary impacts of the pandemic over the past two years, there has recently been a dampening impact due to decline in special demand related to COVID-19 and the rapid cooling of consumer sentiment with the deterioration of the economic environment. However, the widening range of entry-user products and capture of new demand should be steadily widening the base of users trying out digital pens and digital ink. If the launch of new core technologies and new business models succeeds in the medium term, synergy effects between hardware and services can also be expected. Furthermore, in terms of new business models, the Company seems likely to focus on providing Software as a Service (SaaS), and an important point to focus on will be how the shift to a fee-based revenue model will impact the Company's growth and earnings potential.

Initiatives for society

Supporting a sustainable society through provision of "lifelong ink"

The Company places emphasis on initiatives that contribute to ESG improvements and a sustainable society. It posts information on the "Social Initiatives" section of the Company website and discloses its fundamental views and specific activities. We think the Company's use of a concept of "lifelong ink" to describe its technology stands out. This reflects awareness of the origins of its significance and value creation in support for a sustainable society by facilitating "writing and drawing" experiences that accumulate throughout a person's life and communicating them to future generations. Together with various community partners, the Company is pursuing the potential of "lifelong ink*," not only in people's everyday lives, but also in fields ranging from the creative to business and education. In this way, the Company's direction should lead to sustainable growth for users and for the Company itself.

* For example, in the education field, together with partners it is developing AI Ink for Education, which provides a learning environment tailored to individuals by clarifying the learning characteristics of individual students from line-of-sight data and pen movements made during learning.

Moreover, the Company values relationships made between the local communities and individual staff members working in its bases around the world, while working to develop operations and products that are sensitive to the environment. The Company intends to continue making proposals for the future image of society together with the community, such as Ars Electronica*1 rather than just as a single company. Moreover, The Company also intends to conduct social implementation of technology services such as STEAM education*2 and exploratory learning*3.

*1 Ars Electronica, a global creative entity, has been continuously proposing "new creativity and future societal concepts facilitated by cutting-edge technologies" over 40 years from its location in Austria.
*2 Science, technology, engineering, art, and mathematics (STEAM) education is a gradually increasing trend in society. In the art domain, which is a component of STEAM, enabling visualization of the creative activity by creators can help to promote learning by others in creative activities.
*3 For example, combining programing education and digital pen and using AI to analyze the tracks of an individual student's ink data enables the development of logical thinking skills.

The Company considers responding to climate change to be an important issue in environmental management. It has joined the Japan Climate Initiative (JCI) and announced CO_2 emissions targets to be reached by fiscal 2030 by reducing its CO_2 emissions by an annual rate of 4.0% (reference year: 2014). This initiative includes efforts to publish environmental performance information, such as the reduction of greenhouse gases (GHGs) and CO_2 emissions (Scope 1, Scope 2). At the same time, the Company conducts business activities based on analysis of the risks and opportunities to the business environment created by climate change. In addition, as an action that leads to a reduction in CO_2 emissions in the value chain as a whole, it requires that its suppliers support and implement the Wacom Supplier Code of Conduct. The Company is also progressing the formulation of a BCP to respond to the risk of a restriction to corporate activities due to floods and other natural disasters, which are increasing year by year.

The Company is preparing to publish the "Wacom Story Book (provisional title)," by the end of March 2023. This will cover the content of the integrated report while telling the Company's philosophy and the thinking of its employees through a series of stories.

Returns to shareholders

The Company plans to pay ¥20 per share, the same amount as the previous fiscal year, for FY3/23. It also proactively purchases treasury stock

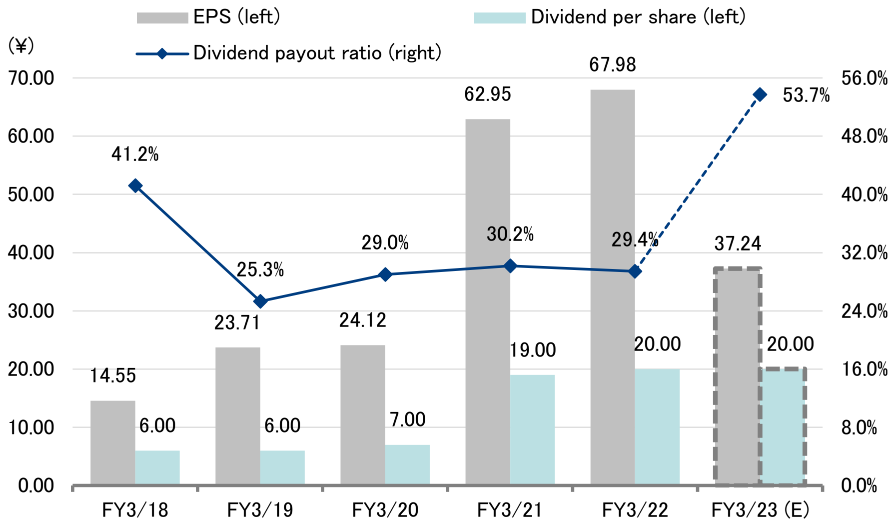
The Company's basic policy towards shareholder returns is to pay steady dividends on its profits after considering the amount of funds to be retained for future business development and a sound financial base. With regard to dividends in particular, the Company has set a guide for consolidated dividend payout ratio of around 30%, keeping in mind the need to ensure financial soundness, and aims to return profits through increasing dividends per share over the medium to long term. Also, the Company only pays dividends once at the end of the fiscal period in consideration of keeping down administrative costs. On the other hand, with regard to acquisition of treasury stock, the Company intends to execute a flexible capital policy in response to changes in the management environment, giving consideration to investment opportunities and its financial status, among other factors. In Wacom Chapter 3, the Company has formulated a treasury stock acquisition policy with an upper limit of ¥10bn in total.

With regard to dividends for FY3/23, the Company is forecasting a dividend of ¥20.0 per share, the same amount as the previous fiscal year (forecast dividend payout ratio of 53.7% calculated reflecting the revised full-year forecast announced in October 2022). With regard to treasury stock, in accordance with the Company's treasury stock acquisition policy* announced on May 12, 2022, by October 2022, the Company had completed the acquisition of 1,156,400 shares for approximately ¥0.93bn. Furthermore, the Company cancelled 2 million shares of its treasury stock holdings on May 26, 2022.

* In FY3/23, the Company plans to acquire treasury stock up to a limit of ¥2bn (upper limit of 4 million shares).

In achieving a balance between R&D related investments, including collaboration with partners, and shareholder returns through dividend payout and treasury share acquisitions, the Company intends to make effective use of cash flows while keeping an eye on capital-use efficiency (ROE) and business operation efficiency (ROIC).

Trends in EPS, dividend, and dividend payout ratio



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

Company profile

Established in 1983, the Company established the pen tablet market for creators and has grown to become the leading company in technology and the market leader

The Company was established in 1983 in Ageo City, Saitama Prefecture. Its name derived from “world” and “computer,” while “wa” includes the meaning of “harmony between people and computers” (“wa” being the Japanese word for harmony, a part of the new Reiwa era). In 1984, it announced the world’s first cordless pen tablet. In 1987, it launched the SD Series of graphic pen tablets for professionals, which were used by the Walt Disney Company <NYSE: DIS> in the United States for film production. Subsequently, it constantly enhanced its products, and in the creative pen tablet market for creators, it has consistently kept a leading position on a global basis since the 2000s.

In 1991, it entered into the pen sensor components field (currently, the Technology Solution Business). The Company conducts OEM supply of digital pens, control ICs, touch panels, and other parts and modules to finished product manufacturers. It achieved rapid growth amid expansion of tablet, notebook PC, and smartphone markets.

In the securities market, after listing on the Japan Securities Dealers Association’s JASDAQ market in April 2003, the Company became listed on the Tokyo Stock Exchange’s First Section in December 2005, where it remains today. (From April 2022, the Company transitioned to the Tokyo Stock Exchange’s Prime Market).

FISCO

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■ For inquiry, please contact: ■
FISCO Ltd.
5-13-3 Minami Aoyama, Minato-ku, Tokyo, Japan 107-0062
Phone: 03-5774-2443 (IR Consulting Business Division)
Email: support@fisco.co.jp