COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

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Index

Summary

In FY3/23, sales increased but profits decreased significantly. The Branded Business (mid- to low-priced models) experienced a steep slowdown, mainly due to cooling consumer sentiment. The Company updated "Wacom Chapter 3," its medium-term business direction, with an eye on the future

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. FY3/23 results

For FY3/23, sales increased while profits decreased significantly, with net sales increasing 3.6% YoY to ¥112,730mn and operating profit decreasing 84.5% to ¥2,013mn. Net sales increased due to the positive impact of the yen's depreciation and growth in the Technology Solution Business. However, the Branded Business experienced a significant downturn, mainly reflecting cooling consumer sentiment and the decline of special demand related to COVID-19 (demand for online education and stay-at-home demand, etc.), in mid- to low-priced models, despite growth in display products for professionals. On the earnings front, operating profit decreased significantly due to a decrease in gross profit, the result of a lower gross profit margin (reflecting the impacts of deterioration in the product mix, foreign exchange fluctuations*, and the recording of a loss on valuation of inventory, etc.) as well as the decrease in sales in the Branded Business, despite a positive impact on earnings from growth in the Technology Solution Business.

* Increase in US-dollar purchasing prices due to foreign exchange fluctuations while non-US-dollar sales revenues were negatively impacted by foreign exchange fluctuations.

2. Update on "Wacom Chapter 3," the medium-term business direction

The Company is promoting initiatives under "Wacom Chapter 3" (FY3/22 to FY3/25), its four-year medium-term business direction. 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. However, the Company is likely to have room for improvement in its own structure, such as responding to external factors with the recent sharp deterioration in the economic environment and strengthening its product portfolio and sales channel management. Accordingly, the Company has positioned the next two years (FY3/24 to FY3/25) as a period for transformation of business structure that will lead to business growth in the next phase, "Wacom Chapter 4," and has established a policy of focusing on improving gross profit and building a growth platform (primary report announced in January 2023, secondary report in May 2023).

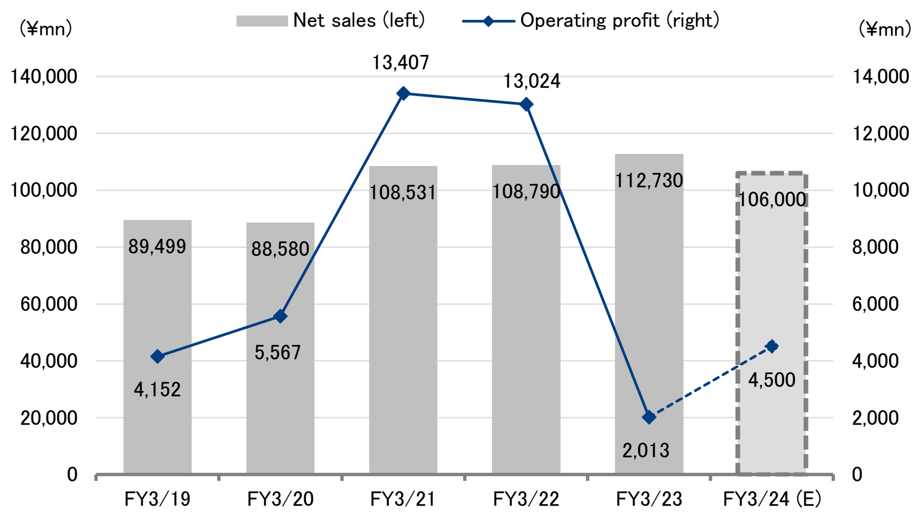
3. FY3/24 results outlook

For the FY3/24 consolidated results outlook, the Company is expecting sales to decrease while profits increase, with net sales to decrease by 6.0% YoY to ¥106,000mn and operating profit to increase by 123.5% to ¥4,500mn. The reasons for the expected decrease in sales is continuing uncertainty in the market environment and projections of a strong yen (negative impact), which are expected to result in a decrease in sales in the Technology Solution Business. In the Branded Business, sales are expected to remain level with the previous fiscal year despite the impacts of an uncertain market environment and projection for a strong yen, mainly due to the product portfolio renewal and pricing policies. On the earnings front, a return to profitability in the Branded Business is expected to contribute to higher profits, even while continuing to invest proactively in R&D. The Company plans to make forward-looking R&D investment of ¥7,700mn for the year, up 15.3% YoY, while focusing on transformation of business structure.

Key Points

- In FY3/23, the Company recorded higher sales but lower profits due to a sharp slowdown in the Branded Business (mid- to low-priced models) along with a significant impact from cooling consumer sentiment with the deterioration of the economic environment and the decline of special demand related to COVID-19
- The medium-term business direction, “Wacom Chapter 3,” was updated to respond to the external environment and recognized issues. Under the next phase, “Wacom Chapter 4,” the Company’s policy is to focus on transformation of business structure to accelerate growth
- For FY3/24, the Company is forecasting lower sales with higher profits. Gross profit improvement is expected atop product portfolio renewal and pricing policy initiatives in the Branded Business and the elimination of loss on valuation of inventory, etc. recorded in the previous fiscal year

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- to low-priced models and evolution of user needs and workflow, as well as the spread of online education and teleworking accompanying advances in digital technologies (VR/MR, 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. Recently, the Branded Business (mid- to low-priced models) is struggling due to factors such as a rapid cooling of consumer sentiment, but the two businesses have been more or less balanced.

With the overseas sales ratio (overseas local entity sales ratio excluding the Technology Solution Business) at about 85%*, careful attention should be given to the impact of foreign exchange market fluctuations on earnings (fluctuations in the euro-yen rate have a bigger impact on operating profit than fluctuations in the US dollar-yen rate. A stronger yen has a negative impact).

* According to FY3/23 consolidated results, the US accounts for 29.7% of the total, Asia and Oceania 29.9%, and Europe (Germany) 25.6%.

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 sites 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, such as its site in Vietnam.

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 are 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- to 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, in smartphone-related use, a growing market, the Company is expanding sales to Samsung Electronics (Galaxy series), which has adopted EMR. Tablet and notebook PC manufacturers also appear to 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. Moreover, its deals with major manufacturers is steadily growing, including Lenovo <HKG:0992> and Fujitsu <6702>, which have adopted AES, along with Xiaomi and others. 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 FY3/23, sales increased while profits decreased significantly. The Branded Business (mid- to low-priced models) experienced a steep slowdown, mainly due to cooling consumer sentiment and a decline of special demand related to COVID-19

1. FY3/23 results

In the Company's FY3/23 consolidated results, sales increased while profits decreased, with net sales increasing 3.6% YoY to ¥112,730mn, operating profit decreasing 84.5% to ¥2,013mn, ordinary profit decreasing 80.0% to ¥2,868mn, and profit attributable to owners of parent decreasing 83.6% to ¥1,792mn.

Net sales increased due to the positive impact of the yen's depreciation* and growth in the Technology Solution Business. However, the Branded Business experienced a significant downturn, mainly reflecting cooling consumer sentiment and the decline of special demand related to COVID-19 in mid- to low-priced models, despite growth in display products for professionals.

* This factor increased the Company's overall sales by approximately ¥15.6bn

On the earnings front, despite a boost to profits from growth in the Technology Solution Business, including the effect of the yen's depreciation*1, operating profit decreased, mainly due to a decrease in gross profit caused by a decline in the gross profit margin*2 and the decrease in sales in the Branded Business. The main causes of the decrease in the gross profit margin in the Branded Business were deterioration in the product mix and foreign exchange fluctuations*3, while temporary factors due to recording loss on valuation of inventory, etc. were also significant.

*1 This factor boosted overall operating profit by approximately ¥1.3bn. 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 ¥1.5bn in the Branded Business and a positive impact of approximately ¥3.1bn in the Technology Solution Business. Furthermore, in non-operating income, the Company recorded foreign exchange gains due to the yen's depreciation (approximately ¥0.8bn)

*2 Selling, general and administrative expenses increased by approximately ¥2.5bn, including an increase of approximately ¥1.2bn in R&D expenses and an increase of approximately ¥2bn caused by the yen's depreciation.

*3 Increase in US-dollar purchasing prices due to foreign exchange fluctuations while non-US-dollar sales revenues were negatively impacted by foreign exchange fluctuations.

Looking at the Company's financial position, total assets increased by 2.7% from the end of the previous period to ¥75,279mn, mainly reflecting the securing of inventories (raw materials and inventory goods) to respond to disruptions in the supply chain due to the COVID-19 pandemic and an increase in investment securities*. On the other hand, equity decreased by 6.9% to ¥40,490mn due to the continuation of stable dividend policy and flexible acquisition of treasury stock. As a result, the equity ratio decreased slightly to 53.8% (59.3% at the end of the previous period).

* The increase was associated with a capital alliance with CELSYS Inc. <3663>. Please refer to the previous FISCO Report (issued December 8, 2022) for details and aims of the alliance.

FY3/23 financial results

(¥mn)

	FY3/22		FY3/23		Change	
	Results	% of sales	Results	% of sales	Amount	%
Net sales	108,790	-	112,730	-	3,940	3.6%
Branded Business	52,641	48.4%	41,161	36.5%	-11,480	-21.8%
Technology Solution Business	56,149	51.6%	71,569	63.5%	15,420	27.5%
Cost of sales	69,180	63.6%	81,556	72.3%	12,376	17.9%
SG&A expenses	26,586	24.4%	29,160	25.9%	2,574	9.7%
Operating profit	13,024	12.0%	2,013	1.8%	-11,011	-84.5%
Branded Business	8,712	16.6%	-3,981	-	-12,693	-
Technology Solution Business	8,888	15.8%	10,756	15.0%	1,868	21.0%
Adjusted amount	-4,577	-	-4,762	-	-185	-
Ordinary profit	14,351	13.2%	2,868	2.5%	-11,483	-80.0%
Profit attributable to owners of parent	10,955	10.1%	1,792	1.6%	-9,163	-83.6%

	March 31, 2022	March 31, 2023	Change	
			Amount	%
Total assets	73,332	75,279	1,947	2.7%
Shareholders' equity	43,503	40,490	-3,013	-6.9%
Equity ratio	59.3%	53.8%	-5.5pt	-

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

Breakdown of SG&A expenses

(¥mn)

	FY3/22	FY3/23	Change	
			Amount	%
Personnel expenses	10,205	11,061	856	8.4%
R&D expenses	5,477	6,680	1,203	22.0%
Sales promotion and advertising expenses	2,652	2,211	-441	-16.6%
Freight and packing expenses	1,454	1,573	119	8.2%
Outsourcing expenses	1,331	1,544	213	16.0%
Depreciation and amortization	435	431	-4	-1.0%
Other	5,033	5,661	628	12.5%
Total	26,586	29,160	2,574	9.7%
SG&A expenses ratio	24.4%	25.9%		1.5pt

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 21.8% to ¥41,161mn and segment loss of ¥3,981mn (profit of ¥8,712mn in the previous fiscal year). Looking at net sales, sales decreased in Creative Solution (particularly mid- to low-priced models) due to the impact of a rapid cooling of consumer sentiment with the deterioration of the global economic environment and a decline in special demand related to COVID-19. In Business Solution, sales decreased slightly, mainly due to fluctuating changes in market conditions and progress on projects. 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 pressure on profits from the recording of loss on valuation of inventory, etc.

Earnings breakdown in the Branded Business

(¥mn)

	FY3/22	FY3/23	Change	
			Amount	%
Creative Solution	48,245	36,948	-11,297	-23.4%
Displays	23,548	20,620	-2,928	-12.4%
Pen Tablets	22,901	14,744	-8,157	-35.6%
Mobiles, others	1,796	1,584	-212	-11.8%
Business Solution	4,396	4,213	-183	-4.2%

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

a) Creative Solution sales

Net sales decreased 23.4% YoY to ¥36,948mn. 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 special demand associated with COVID-19. 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 decreased (stylus pen products other than mobile products increased).

* Evaluation of the flagship model Wacom Cintiq Pro 27, launched in September 2022, appears to have been excellent.

b) Business Solution sales

Net sales decreased slightly by 4.2% YoY to ¥4,213mn. It was affected by fluctuating changes in market conditions and progress on projects.

(2) Technology Solution Business

The segment recorded increases in sales and profits, with net sales increasing 27.5% YoY to ¥71,569mn and segment profit increasing 21.0% to ¥10,756mn. In net sales, amid only mild global production supply chain restrictions, sales benefitted from the positive impact of the yen's depreciation, while EMR Technology Solution, other sales contributed to higher overall sales, and AES Technology Solution sales also increased. On the earnings front also, 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)

	FY3/22	FY3/23	Change	
			Amount	%
AES Technology	22,142	23,383	1,241	5.6%
EMR Technology, others	34,007	48,186	14,179	41.7%

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

a) AES Technology Solution sales

Net sales increased 5.6% YoY to ¥23,383mn as the solutions continue to be highly regarded by OEM partner manufacturers.

b) EMR Technology Solution, other sales

Net sales significantly increased 41.7% YoY to ¥48,186mn, driven by successful portfolio changes by OEM partner manufacturers.

3. Key takeaways of FY3/23 results

To summarize FY3/23, everything boils down to 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, leaving an ongoing sense of uncertainty regarding what will happen going forward. 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. Judging from the high regard for the Company among its business partners (OEM partner manufacturers in the Technology Solution business), 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 through its branded products that will not be affected by economic cycles. From this perspective, we take a positive view of the direction that the Company has come up with of engaging in transformation of business structure over the coming two years, such as updating the medium-term business direction, "Wacom Chapter 3," which is currently in progress, and providing new added value by renewing its product portfolio, rebuilding its business in focus areas, and strengthening the B2B channel. In particular, the Company has stated its commitment to the themes of steadily developing use-cases and taking an experiential approach towards incorporating the high-potential creative education field and widening its user-base. This shows the Company's intention to create and develop truly foundational markets, and we see the Company's determination to reconfirm and clarify what it needs to do going forward as a positive point.

Update on "Wacom Chapter 3," the medium-term business direction

The Company has positioned the next two years as a period for transformation of business structure and is working to build a foundation for growth acceleration under the next business direction, "Wacom Chapter 4"

1. Basic direction

The Company has been promoting initiatives in line with the four-year medium-term business direction "Wacom Chapter 3"(FY3/22 to FY3/25). The new direction will continue the vision of "lifelong ink*," and redefine five key strategic initiatives. In addition, the new direction has defined six main streams for technology innovation to implement the direction, and will promote specific value propositions and sustainable growth. 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 core technologies and new business models. Moreover, the direction 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. There has been no change in these basic directions (storyline).

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

2. Progress up to the update and key initiatives

Due to factors such as the rapid cooling of consumer sentiment following the deterioration in the economic environment, the Branded Business (mid- to low-priced models) has declined more than expected, and the Company sees room to make improvements in its own structure, such as strengthening its product portfolio and sales channel management. Based on this recognition, the Company has positioned the next two years (FY3/24 to FY3/25) as a period for transformation of business structure that will lead to business growth in the next phase, “Wacom Chapter 4,” and has established a policy of focusing on improving gross profit and building a growth platform (announced in May 2023). With the recent declines in performance there have been some delays in the initially expected growth trajectory; however, from FY3/26 onward, as it launches into “Wacom Chapter 4,” the Company is aiming for business operation that will realize and maintain a double-digit operating profit margin. The Company’s initiatives over the coming two years are as follows.

(1) Product portfolio renewal and gross profit improvement (Branded Business)

The Company plans to strengthen its product capabilities across the full line-up, including not only the high-end zone but also the entry-level zone. It will also work to increase added value (differentiate) by adding new category products in hardware products while combining service solutions for areas such as remote work compatibility and copyright protection. To counter rising costs, the Company will implement strategic pricing policies and develop a pricing strategy that appropriately reflects the product appeal of its new products. Other initiatives include cost structure improvements through VE (Value Engineering). Through these measures, the Company expects to improve its gross profit.

(2) Rebuilding business in focus areas (Branded Business)

Continuous growth in the digital content market is predicated on shifting the concentration of resources from general education, which has been the focus so far, to creative education in terms of access to the education market through the Branded Business. Specifically, in addition to specialist education such as vocational school, higher education, and unique education systems offered by studios, the Company will provide solutions for art education for K12 (the 12 years of education through to high school), which is an entry point for creator education. In terms of structure, as part of strengthening the B2B team, the Creative BU and Business Solution BU will be merged and the Company will take a unified organization-wide approach.

Moreover, assuming that creative workflows (processes) will become even more virtualized and adapted to remote work, the Company will look to establish the position of Wacom devices within the new workflows in order to maintain and expand its position in the professional creator market. For example, the Company aims to provide identical performance and functionality in both remote and local environments, and new added value in new workflows that have been virtualized and made real-time.

(3) Strengthening sales channel management (Branded Business)

To promote the transition to providing solution-type value, the Company intends to strengthen the B2B channel and its e-store (in-house online sales store) for building deep, direct relationships with customers (users). In particular, strengthening the B2B channel is vital for developing markets in the aforementioned creative education field and for building new creative workflows. The Company also plans to increase the B2B sales ratio*. For the e-store, the Company is thinking to work on increasing user touchpoints and customizing the store for each region, in addition to offering a copyright protection service and so forth. Strengthening sales channel management will also lead to improved gross profits as it will enable strategic price setting and optimization of distribution costs.

* In FY3/23, the B2B sales ratio was around 25%, and the e-store sales ratio was around 10%. For FY3/24, the Company is targeting an increase in both ratios, with a B2B sales ratio of around 30% and an e-store sales ratio of around 15%. It plans to set successively higher targets for each ratio thereafter also.

(4) Improving inventory management (Corporate wide)

The Company aims to reduce inventory balance of approximately ¥30bn at the end of December 2022 by approximately ¥10bn at the end of FY3/24. (As of the end of March 2023, the balance had already been reduced by ¥7.6bn through measures such as restricting purchasing. However, the estimated direct impact on cash flow excluding valuation reduction, etc., was a reduction of just over ¥5.0bn.) Specific measures for achieving this include detailed management of promotions for current products and optimization of timing new product launches to reduce inventory, while continuing to pare down purchasing for products and materials for which there is excess inventory. Furthermore, by setting more detailed volume control gates at the time of ordering, the Company will strengthen monitoring to avoid excessive ordering.

(5) Expanding customers and applications (Technology Solution Business)

The Company aims to maximize its customer portfolio for products equipped with pens by driving further de facto standardization in the industry. Moreover, by combining proprietary hardware (main units and pens) with applications and services to expand new applications for pens, the Company will develop and provide the overall experience of pens (E2E* platform business), leading to the expansion of new customer groups.

* End-to-End. Rather than simply providing components and technology modules, this refers to providing a series of pen experiences to match applications in a form that is close to a finished product.

(6) Business development in the field of general education (Technology Solution Business)

Through its OEM customers’ product lines, the Company will develop solutions for general education (for education, the Company will develop a hybrid with its Branded Business, focusing on creative education). The Company will deliver an experience supporting learning that combines hardware and service software (Z-kai, a collaborative partner, has introduced a new service using the Company’s digital ink technology from April 2023).

(7) Capital policy/Shareholder returns (Corporate wide)

Regarding cash allocation, the Company will prioritize growth investments and strategic investments to create future enterprise value, and will actively return surplus funds to shareholders (see below for details). Meanwhile, as for the source of funds, the Company will pursue capital efficiency through the use of financial leverage (interest bearing liabilities) while ensuring financial soundness. The Company aims for a debt-equity ratio (D/E ratio) of around 0.3x to 0.5x (currently about 0.2x) as the degree of financial leverage that can ensure financial soundness.

(8) Digital Ink Service launch and investment (Corporate wide)

The Company will launch a new Digital Ink Service in addition to the existing Branded Business and Technology Solution Business. These three value propositions are generated from investment in common technology development, and the two existing businesses will grow through leveraging each other while the new Digital Ink Service is intended to contribute to the growth of the former hardware businesses. The Company is working to provide services and remote solutions particularly in the three new core areas of AI, XR, and Security, and will begin their commercial service implementation in FY3/24 and full-scale development in the next phase, “Wacom Chapter 4.”

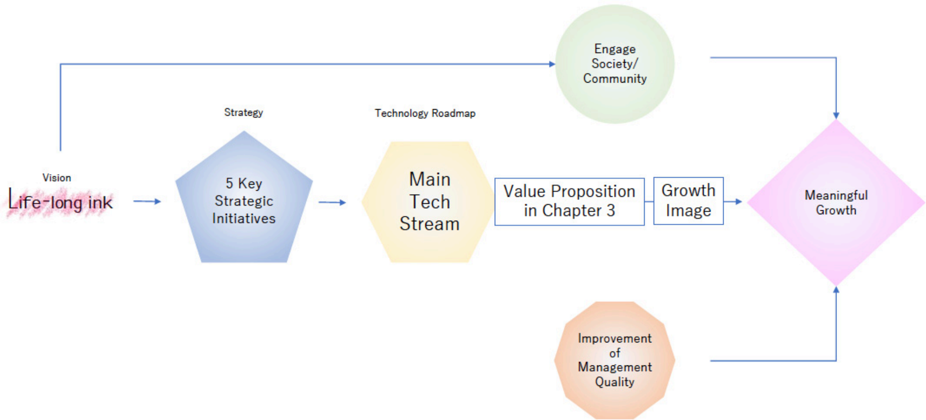
3. Financial policy guidelines (updated)

Due to the downturn in performance in FY3/23 and the positioning of the next two years as a period for transformation of business structure, the Company has lowered its ROIC and ROE targets. By improving gross profit in the Branded Business, the Company aims to restore ROIC to 10% or more in FY3/25. It also expects ROE, which indicates capital efficiency, to be in the 10% to 15% range (ROIC and ROE have fallen significantly to 3.7% and 4.3%, respectively, in FY3/23).

4. Five key strategic initiatives and six main streams for technology innovation

The five key strategic initiatives that form the basis of the "Wacom Chapter 3" direction (storyline) and the six main streams for technology innovation for its implementation are as follows.

Storyline of Wacom Chapter 3



Source: From the Company's results briefing materials

(1) Five key strategic initiatives

a) 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" digitally through technology development spanning hardware, software, and services.

b) Community Engagement

Under this strategy, the Company will form valuable experiences 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 certified Chromebook-compatible products and Android compatibility, which have been widely adopted in education and other fields, and worked on building creative workflows in remote environments.

c) 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 × Digital in the education field and has also been working on joint development with sdtech Inc. towards use of AI in Handwriting × 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.

d) 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. Starting with its participation in the Japan Climate Initiative (JCI), the Company has endorsed the TCFD and implements its information disclosure, as well as CDP score disclosure. In addition, through the establishment of the tech team for environment-friendly product development, the Company is promoting sustainability conscious technology innovation such as the development of environment-friendly products that use more recyclable PCR plastic and aluminum. 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.

e) 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

a) 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.

b) 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).

c) 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.

d) 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.

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

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

f) 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.

Outlook

The Company expects profits to increase in FY3/24, despite lower sales. It is also working to improve gross profit through product portfolio renewal and pricing policies, etc.

1. FY3/24 results outlook

For the FY3/24 consolidated results outlook, the Company expects profits to increase while sales decrease, with net sales to decrease 6.0% YoY to ¥106,000mn, operating profit to increase 123.5% to ¥4,500mn, ordinary profit to increase 56.9% to ¥4,500mn, and profit attributable to owners of parent to increase 84.1% to ¥3,300mn.

The forecast for lower overall sales mainly reflects the expectation of lower sales in the Technology Solution Business due to the continuing uncertainty in the market environment and projections of the negative impact of a strong yen*. In the Branded Business, the Company expects to secure the same level of sales as in the previous fiscal year by renewing its product portfolio and implementing pricing policies, while taking into account the impact of the market environment and the assumed appreciation of the yen.

* In foreign exchange rates for FY3/24, the Company is assuming US$1=¥130 (FY3/23 average: ¥134.95) and €1=¥140 (FY3/23 average: ¥141.24).

On the earnings front, a return to profitability in the Branded Business is expected to contribute to higher profits, even while continuing to invest proactively in R&D. The Company plans to make forward-looking R&D investment of ¥7,700mn for the year, up 15.3% YoY, while focusing on the aforementioned transformation of business structure. The results outlooks and activity policies by business are as follows.

Forecasts for FY3/24

(¥mn)

	FY3/23		FY3/24		Change	
	Results	% of sales	Forecast	% of sales	Amount	%
Net sales	112,730		106,000		-6,730	-6.0%
Branded Business	41,161	36.5%	41,500	39.2%	339	0.8%
Technology Solution Business	71,569	63.5%	64,500	60.8%	-7,069	-9.9%
Operating profit	2,013	1.8%	4,500	4.2%	2,487	123.5%
Branded Business	-3,981	-	200	0.5%	4,181	-
Technology Solution Business	10,756	15.0%	9,500	14.7%	-1,256	-11.7%
Adjustment	-4,762	-	-5,200	-	-438	-
Ordinary profit	2,868	2.5%	4,500	4.2%	1,632	56.9%
Profit attributable to owners of parent	1,792	1.6%	3,300	3.1%	1,508	84.1%

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

(1) Branded Business

Net sales are forecast to increase 0.8% YoY to ¥41,500mn, with segment profit of ¥200mn (compared to a loss of ¥3,981mn in the previous fiscal year). The Company will secure the same level of net sales as in the previous fiscal year by renewing its product portfolio while taking into account the continuing uncertainty in the market environment and projections of a strong yen (negative impact). On the earnings front, the Company expects a return to profitability mainly due to the elimination of loss on valuation of inventory recorded in the previous fiscal year and improved gross profit resulting from the Company's pricing policies, even while continuing to invest proactively in R&D.

(2) Technology Solution Business

Net sales are forecast to decrease 9.9% YoY to ¥64,500mn and segment profit to decrease 11.7% to ¥9,500mn. The expected decrease in sales is due to the continuing uncertainty in the market environment and projections of a strong yen (negative impact). On the earnings front, while the Company expects a decrease in profits caused by lower sales driving down earnings, it expects to maintain a segment profit margin of 14.7%, around the same level as FY3/23 (15.0%).

2. Focus points identified by FISCO

We see the Company's earnings forecast as being sufficiently achievable, as it reasonably reflects the impact of external factors such as the unstable global economic situation, foreign exchange market trends, and an unclear outlook in the business environment, as well as the probability of the Company's own initiatives (e.g., product portfolio renewal, pricing policies). The biggest theme will be to improve gross profit in the Branded Business in particular, excluding one-off factors such as the loss on valuation of inventory recorded at the end of the previous fiscal year. The key will be to renew the product portfolio by launching new products at the best timing to improve profitability while keeping in mind the inventory situation of current products (including distribution inventories). The Company also plans to implement uniform price increases for current products commensurate with value propositions in response to cost increases, and it will be necessary to follow up on such trends as well. In addition, the absence of loss on valuation of inventory, etc. (our estimate is around ¥2bn), which kept profits down in the previous fiscal year, can be seen as a factor that will boost profits compared to the previous fiscal year. From a medium- to long-term perspective, we would like to focus on the progress of the transformation of business structure set forth in the "Wacom Chapter 3" update. The update has specified what needs to be done over the next two years, and we would like to follow up on the results of each of these efforts to see how they will be linked to growth acceleration in "Wacom Chapter 4." In particular, the combination of the three new core technologies (AI, XR, and Security) and the launch of a new business model is an important basis for forecasting the Company's medium- to long-term direction and future prospects. For this reason, the Company's success is likely to be determined not only by its inhouse technology development, but also by the degree to which it can deliver value through new services based on collaboration with other companies. With regard to new value propositions using digital ink and AI, movement has already started in the education field, and 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 becomes much greater.

Results trends in past years

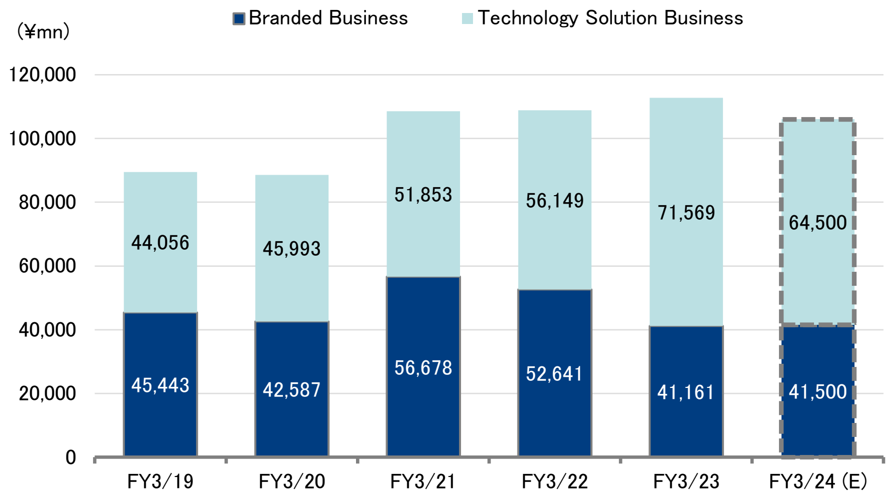
Technology Solution Business driving growth over the past few years due to increase in demand from OEM partner manufacturers for smartphones, etc.

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. 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. Since entering FY3/23, the Branded Business (especially low- to mid-priced models) experienced a significant downturn due to a sharp drop in consumer sentiment caused by the global economic slump and decline of special demand related to COVID-19, but the growth of the Technology Solution Business secured an increase in sales.

In earnings, since incurring 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. In FY3/21 and FY3/22, the Company retained a high profit margin for two consecutive years due to higher profits atop an increase in sales, improvements in the product mix, and optimization of SG&A expenses, etc. In FY3/23, however, the Branded Business recorded a segment loss due to a deterioration of the product mix and loss on valuation of inventory, and the overall profit margin declined significantly.

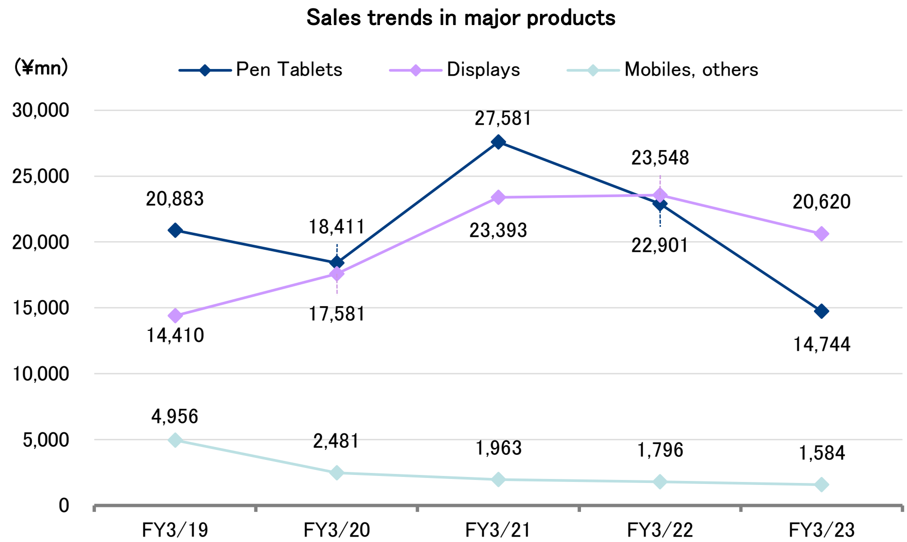
In financial standing, while the capital ratio temporarily slipped in FY3/17 on a hefty net loss due to recording impairment losses, it has steadily improved since then with buildup of retained profits and has moved close to 60%. However, the capital ratio declined slightly in FY3/23 due to the acquisition of treasury stock and other factors. ROE, which reflects capital efficiency, and ROIC, which reflects efficiency of business activities, have been at high levels, but declined significantly in FY3/23 along with the drop in profits.

Trends in net sales by business

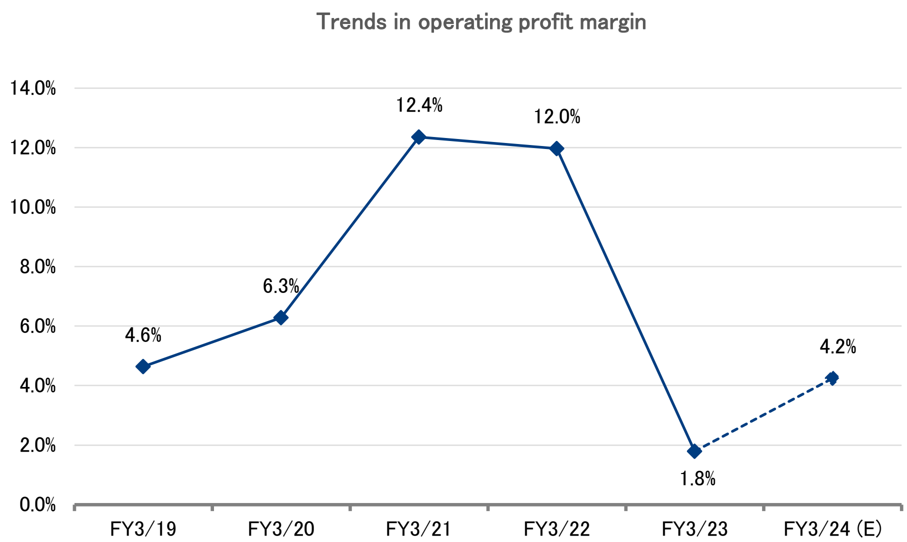


Source: Prepared by FISCO from the Company's financial results and results briefing materials

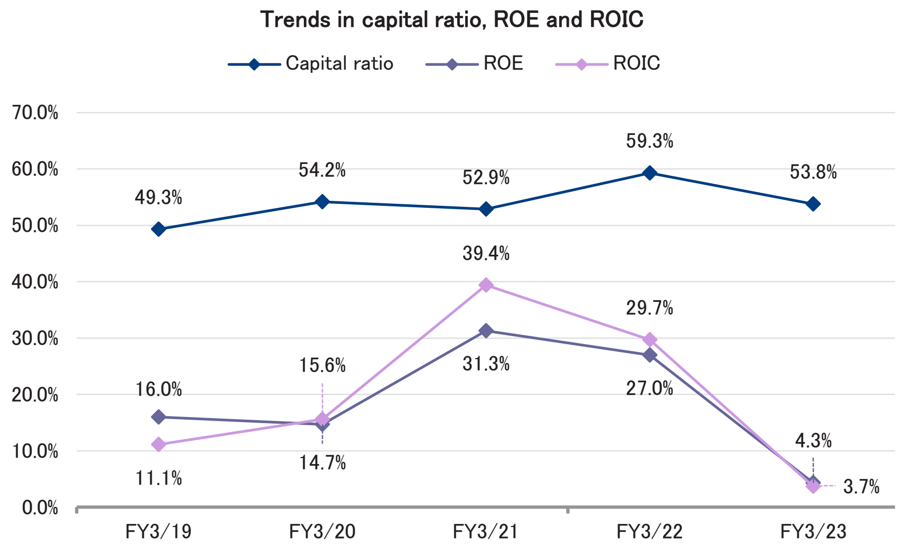
Results trends in past years



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



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



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

Initiatives for society

Supporting a sustainable society through provision of "lifelong ink"; Publishing the Wacom Story Book to communicate the Company's philosophy and value creation mechanisms

The Company places emphasis on initiatives that contributes to ESG improvements and a sustainable society. It discloses its fundamental views and specific activities on "Social Initiatives" on the Company website. 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 also 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 will include efforts to publish environmental performance information, such as the reduction of greenhouse gases (GHGs) and CO_2 emissions (Scope 1, Scope 2, and Scope 3). At the same time, the Company will conduct business activities based on analysis of the risks and opportunities to the business environment created by climate change. In addition, as an action that will lead to a reduction in CO_2 emissions in the value chain as a whole, it requires that its suppliers support and implement the Wacom Suppliers 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 launched the “Wacom Story Book”* in May 2023, a booklet that covers some elements from the integrated report, primarily ESG, and tells a series of stories about the Company’s philosophy, the thoughts of its employees, and the feedback of its users.

* Beginning with an introduction to the Company’s most important values, it also features team member discussions on the Company’s product planning and technology development trajectory, as well as feedback, artworks, and examples of various community partners and artists.

Returns to shareholders

The Company paid ¥20 per share, the same amount as the previous fiscal year, for FY3/23. It also intends to proactively purchase 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, the Company has set a guide for consolidated dividend payout ratio of around 30%, keeping in mind the need to ensure financial soundness. Even if dividends exceed that level, the Company intends to maintain steady dividends per share in principle 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. 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 the period covered by "Wacom Chapter 3" (FY3/22 to FY3/25), the Company has formulated a treasury stock acquisition policy with an upper limit of ¥20bn* in total (by March 31, 2023, the Company had completed the acquisition of a total of ¥5bn in treasury stock).

* Based on a resolution dated January 31, 2023, the Company has upwardly revised the total upper limit from ¥10bn to ¥20bn in total.

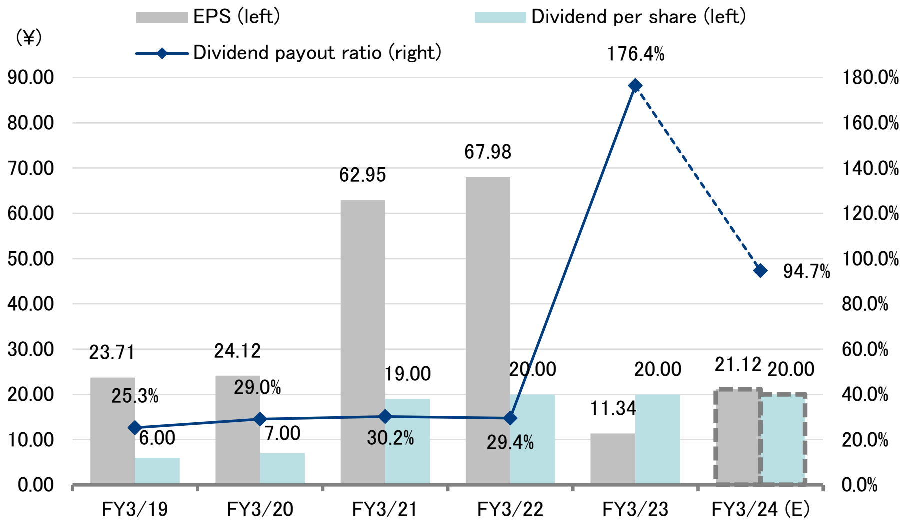
With regard to dividends for FY3/23, the Company paid a dividend in line with the initial forecasts of ¥20.0 per share, the same amount as the previous fiscal year (dividend payout ratio of 176.4%). With regard to treasury stock, in accordance with the Company's treasury stock acquisition policy announced on May 12, 2022, the Company has completed the acquisition of 2.77 million shares for ¥2bn and cancelled 8.55 million shares of its treasury stock holdings.

In addition to a forecasting a dividend of ¥20.0 per share (dividend payout ratio of 94.7%) for FY3/24, the Company has also resolved to acquire up to 4 million shares of its own stock for ¥2bn*.

* Based on the Company's treasury stock acquisition policy dated May 11, 2023 (target period from May 12, 2023 to September 29, 2023)

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 still 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

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 <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 pads, and other parts and modules to finished product manufacturers. It has 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

Disclaimer

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