COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

Tokyo Stock Exchange Prime Market

17-Jun.-2024

FISCO Ltd. Analyst
Ikuo Shibata

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

Index

Summary

In FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand. The Branded Business continued to struggle due to changes in the market environment, but the liquidation of negative legacy assets progressed to a certain extent, with plans to implement further structural transformation

Wacom Co., Ltd. <6727> (hereafter, also "the Company") is a global leading manufacturer aiming to create value for customers based on technologies in the field of digital pen and ink. It has high 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 and notebook PCs.

1. FY3/24 results

In FY3/24, sales and profits increased, with net sales increasing 5.4% YoY to ¥118,795mn and operating profit increasing 250.6% to ¥7,058mn. This performance reflected a contribution from growth in sales of the Technology Solution Business supported by the effect of the yen's depreciation and brisk OEM demand. However, the Branded Business continued to struggle due to rapid changes in the market environment. On the earnings front, profits increased substantially due to factors such as a decline in one-time costs (cost of sales) associated with growth in the Technology Solution Business, the liquidation of negative legacy assets, and reduction in SG&A expenses (excluding the weaker yen impact), even while the Company continued to actively invest in R&D. In terms of activities, the Company achieved some success in areas such as technology development for the proposal of new use cases, although new products introduced to the market in 2023 were slow to take off.

2. FY3/25 results outlook

For the FY3/25 consolidated results outlook, the Company expects net sales to increase 1.0% YoY to ¥120,000mn, and operating profit to increase 20.4% to ¥8,500mn. Looking ahead to the next medium-term business direction (Wacom Chapter 4), which will begin in FY3/26, the Company plans to establish an earnings base that will serve as a foundation for business growth, while also advancing the structural transformation of the Branded Business. In terms of net sales, the Company will increase the market penetration of its new product portfolio in the Branded Business. Concurrently, it maintains a cautious outlook for the Technology Solution Business, with net sales expected to remain largely unchanged at this time. On the earnings front, the Company expects to generate increased profits through further enhancing profitability by improving gross profit in the Branded Business (initial forecasts do not anticipate the additional expenses associated with the liquidation of negative legacy assets and related items, resulting in smaller losses), while continuing to actively invest in R&D.

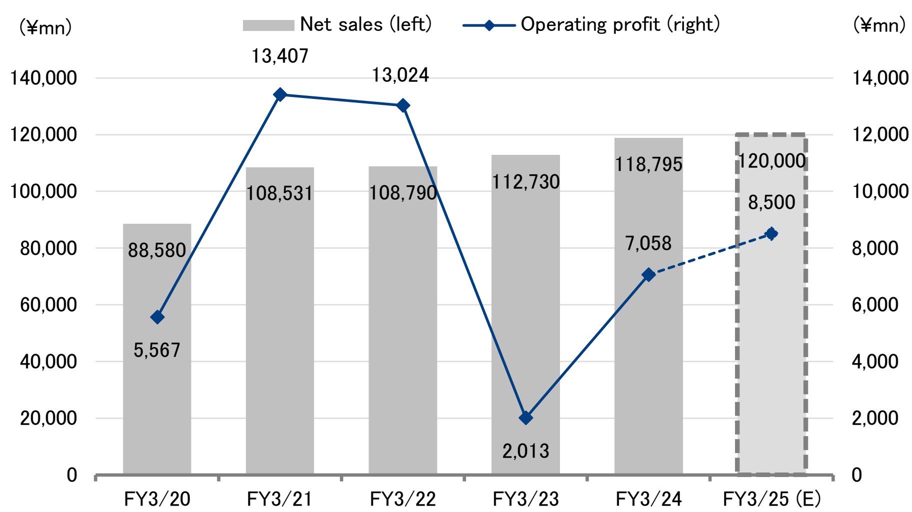
3. Revision of update of "Wacom Chapter 3," the medium-term business direction

The Company has been promoting initiatives under "Wacom Chapter 3" (FY3/22 to FY3/25), its four-year medium-term business direction. The new direction will promote 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 core technologies and business models; and this basic direction has not been revised. However, in addition to responding to external factors such as the recent rapid changes in the market environment, the Company has room for improvement in its own structure in areas such as renewing the product portfolio, improving gross profit, and strengthening sales channel management in the Branded Business. Accordingly, the Company has positioned the latter two years of the medium-term business direction (FY3/24 to FY3/25) as a period for business structure transformation to ensure business growth in the next phase, "Wacom Chapter 4." The Company has announced a policy of focusing on gross profit improvement and growth foundation construction (update plan). While subsequently revising the policy based on conditions, it has been undertaking structural transformation in preparation for "Wacom Chapter 4." In May 2024, the Company announced the preliminary guidance of "Wacom Chapter 4." It provided a roadmap for centralizing management resources, and for commercialization and market implementation of technology that serves as next-generation growth engines. (The final draft is scheduled to be announced in May 2025.)

Key Points

- In FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand, while the Branded Business has continued to struggle since the previous fiscal year, impacted by changes in the market environment. However, the liquidation of negative legacy assets has progressed to a certain extent
- Regarding the FY3/25 consolidated results outlook, the Company expects to generate increases in sales and profits, while advancing structural transformation in the Branded Business
- Under the next medium-term business direction, which will begin in FY3/26, the Company will work to centralize management resources, while aiming for commercialization and market implementation of technology that serves as next-generation growth engines

Result 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 has high 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. These changes include negative factors such as competition with Chinese manufacturers in mid- to low-priced models and a shift in demand to other categories (iPad and other devices) in the entry-level zone, along with trends such as the 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.

The Branded Business has an overseas sales ratio (overseas local entity sales ratio) of about 84%*1, and transaction prices for the Technology Solution Business (sales area is categorized as Japan) are denominated in US dollars. Therefore, close consideration should be given to the impact of foreign exchange market fluctuations on earnings (a weaker yen has a positive impact*2).

*1 In FY3/24, the United States accounted for 31.9% of the sales of the Branded Business, followed by Europe (Germany) at 30.5%, Asia/Oceania at 21.6%, and Japan at 16.0%.
*2 Segment profit (loss) in the Branded Business is impacted by fluctuations in the euro-yen rate with a positive impact by a weaker yen, being offset by the US dollar-yen rate with a negative impact by a weaker yen, whereas segment profit (loss) in the Technology Solution Business is impacted by the US dollar-yen rate with a positive impact by a weaker yen.

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 business has played a pivotal role since the dawn of the digital content market and possesses strong brand clout and market share with professional creators. Product types* include Displays and Pen Tablets, and understanding their difference is important in assessing the competition environment and growth potential.

* Up until now, the Company had divided its products into three categories: Displays, Pen Tablets, and Mobile, others; however, to facilitate a more appropriate discussion of earnings suited to the changed environment, from FY3/24, the category scope has changed, and for Mobile, others, the results pertaining to Mobile have been incorporated into Displays, and those pertaining to others have been incorporated into Pen Tablets.

a) Displays

This category covers products that use an LCD panel as the tablet* and allow the user to directly write 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 an approximately 16-inch entry-level model with an actual sales price in the ¥60,000 to ¥70,000 range (sales price excluding tax at the time of launch; same below) in January 2019, a 22-inch model (actual sales price in the ¥100,000 to ¥110,000 range) in July 2019, and an approximately 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-level model segment where it faces tough price competition from other companies (Chinese manufacturers, etc.). But in light of recent trends such as a decline in consumer sentiment and a shift in demand to other categories, the Company has continued to struggle in mid- to low-priced models. In response, the Company is updating its product portfolio by narrowing down its product line-up and making new value propositions (new use cases and others) through a return to basics centered on professional and creative specialized education.

* 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 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 as joint use with Displays is viewed as a use case, demand has declined due to aging since the products were announced, and competition has emerged with other companies (Chinese manufacturers and others) in the mid- to low-price range, where differentiation is difficult. Furthermore, although the Company will continue to meet customer needs for Pen Tablets, it is strategically shifting its management resources toward Displays, where demand is shifting due to their more intuitive operability and lower prices.

* Sometimes referred to as "opaque tablets" as well.

2) Business Solution

The Company sells business-use products that are capable of direct drawing and character entry (signature) 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*1 based on digital pen technologies*2. It supplies pen sensor systems to smartphone and tablet and notebook PC manufacturers. Business has been growing, centered on sales for the Samsung Electronics (Galaxy series), which has adopted EMR. Moreover, it has formed business relationships with major PC manufacturers, including Lenovo <HKG:0992> and Fujitsu <6702>, which have adopted AES, along with customers in China, such as Xiaomi Corp <HKG:1810>. 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. Manufacturers also appear to highly rate the Company's technology, as it has been early to implement foldable devices (folding-type smartphones and PCs, etc.) and compatibility with devices that use electronic paper technology.

*1 To facilitate an explanation of performance more suited to the changed environment, the segment names were partially changed from FY3/24, and the others previously included in EMR Technology Solution, others sales have been omitted.
*2 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 FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand. The Branded Business continued to struggle due to changes in the market environment, but the liquidation of negative legacy assets has progressed to a certain extent

1. FY3/24 results

In the FY3/24 consolidated results, sales and profits increased, as net sales increased 5.4% YoY to ¥118,795mn, operating profit rose 250.6% to ¥7,058mn, ordinary profit climbed 243.6% to ¥9,853mn, and profit attributable to owners of parent (hereinafter, "net profit") grew 154.5% to ¥4,562mn. These results exceeded the upwardly revised forecasts announced on March 29, 2024.

Net sales increased due to growth in the Technology Solution Business, supported by the effect of the yen's depreciation* and brisk OEM demand. However, the Branded Business experienced declining demand for professional display products (existing models) while low-priced models continued to struggle due to a deterioration in consumer sentiment.

* This factor increased the Company's overall sales by approximately ¥7.5bn.

On the earnings front, operating profit increased due to growth in the Technology Solution Business, including the impact of the yen's depreciation*1 and a decline in one-time costs*2 from the previous fiscal year, even while the Company continued to actively invest in R&D*3. However, in the Branded Business, the Company continued to record a segment loss due to factors such as the posting of valuation reserve for inventory purchase commitments*4, as well as a decline in earnings due to lower sales. Net profit increased substantially, as the posting of increased operating profit and foreign exchange gains (non-operating income) of ¥2.9bn outweighed the impact of an extraordinary loss of ¥4.1bn*5.

*1 This factor boosted overall operating profit by approximately ¥1.2bn (most of which was due to the Technology Solution Business).

*2 The total (net amount) of one-time expenses related to the posting of valuation reserve for inventory purchase commitments arising from rapid changes in the market environment and the posting (and reversal) of loss on valuation of inventory was ¥2.2bn. This marked a decrease by ¥2.5bn from total one-time expenses of ¥4.7bn recorded in the previous fiscal year.

*3 R&D expenses increased to ¥7,676mn (up ¥996mn YoY).

*4 Valuation reserve for inventory purchase commitments is a liability reserve, allocating the amount of expected losses following a deterioration in market conditions, etc. against long-term purchase commitments for inventories aimed at generally ensuring stable procurement of materials.

*5 Extraordinary losses recorded in connection with settlement payments of ¥2.5bn made to certain suppliers for surplus parts and materials related to long-term purchase commitments in the Branded Business, as well as the recording of impairment losses on non-current assets of ¥0.9bn and business restructuring expenses of ¥0.6bn related to the Branded Business.

Looking at the Company's financial position, total assets increased by 5.8% from the end of the previous period to ¥79,620mn, mainly reflecting increases in cash and deposits and in accounts receivable–trade due to higher sales, despite a decrease in inventories due to progress on inventory management*1 (optimization). Equity decreased by 11.2% to ¥35,968mn, as negative factors (acquisition of treasury stock*2) outweighed positive factors (increase in retained earnings and increase in foreign currency translation adjustment). As a result, while the equity ratio decreased to 45.2% (53.8% at the end of the previous period), ROE, which reflects capital efficiency, improved dramatically to 11.9% (4.3% at the end of the previous period).

*1 As of the end of FY3/24, the amount of inventories (total of finished goods and merchandise, work in process, raw materials and supplies) had decreased significantly by 40% from the end of FY3/23 to ¥13.1bn. This represents a decline of around ¥16.0bn compared to the end of December 2022, when the amount of inventories reached a peak. The Company generated more than ¥10.0bn in cash as a result of this decrease in inventories.

*2 The Company acquired treasury stock in the total amount of approximately ¥7.5bn (11.04 million shares) in FY3/24.

FY3/24 financial results

(¥mn)

	FY3/23		FY3/24		Change	
	Results	% of net sales	Results	% of net sales	Amount	%
Net sales	112,730		118,795		6,065	5.4%
Branded Business	41,161	36.5%	33,814	28.5%	-7,347	-17.8%
Technology Solution Business	71,569	63.5%	84,981	71.5%	13,412	18.7%
Cost of sales	81,556	72.3%	82,028	69.1%	472	0.6%
SG&A expenses	29,160	25.9%	29,709	25.0%	549	1.9%
Operating profit	2,013	1.8%	7,058	5.9%	5,045	250.6%
Branded Business	-3,981	-9.7%	-4,520	-13.4%	-539	-
Technology Solution Business	10,756	15.0%	16,481	19.4%	5,725	53.2%
Adjusted amount	-4,762	-	-4,902	-	-140	-
Ordinary profit	2,868	2.5%	9,853	8.3%	6,985	243.6%
Profit attributable to owners of parent	1,792	1.6%	4,562	3.8%	2,770	154.5%

	End of FY3/23	End of FY3/24	Change	
			Amount	%
Total assets	75,279	79,620	4,341	5.8%
Shareholders' equity	40,490	35,968	-4,522	-11.2%
Equity ratio	53.8%	45.2%	-8.6pt	-

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

Breakdown of SG&A expenses

(¥mn)

	FY3/23	FY3/24	Change	
			Amount	%
Personnel expenses	11,061	11,079	19	0.2%
R&D expenses	6,680	7,676	996	14.9%
Sales promotion and advertising expenses	2,211	1,805	-406	-18.4%
Freight and packing expenses	1,573	1,368	-205	-13.0%
Outsourcing expenses	1,544	1,511	-32	-2.1%
Depreciation and amortization	431	472	41	9.5%
Other	5,661	5,798	136	2.4%
Total	29,160	29,709	549	1.9%
SG&A expenses ratio	25.9%	25.0%		-0.9pt

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

2. Results overview by business

1) Branded Business

Net sales decreased, and the Company recorded a segment loss, with net sales down 17.8% to ¥33,814mn and segment loss of ¥4,520mn (loss of ¥3,981mn for the previous fiscal year). Net sales declined, reflecting lower sales of display products and pen tablet products in the mainstay Creative Solution due to changes in the market following deterioration in consumer sentiment, and so forth. These impacts were partially offset by the beneficial effect of the yen's depreciation (approximate ¥2.0bn increase in sales). On the other hand, net sales in Business Solution rose from the previous fiscal year amid the effects of changes in fluid market conditions and progress on projects. On the earnings front, the segment reported a larger loss, reflecting a depressive effect on earnings from lower sales and the recording of expenses for valuation reserve for inventory purchase commitments (approximately ¥2.0bn), although the Company recorded a gain on reversal of loss on valuation of inventory (approximately ¥1.9bn) along with implementing measures such as reducing SG&A expenses. In its activities, although the Company introduced new products* to revamp its product portfolio, these new products were slow to take off since inventory reduction promotions for existing models (discounted sales) had to be balanced with new product sales.

* In August 2023, the Company unveiled an LCD pen tablet with new functions and services for the Wacom One (entry-level model). Additionally, in the Wacom Cintiq Pro (for professionals) line, the Company announced the Wacom Cintiq Pro 17 and the Wacom Cintiq Pro 22 in October 2023.

Earnings breakdown in the Branded Business

(¥mn)

	FY3/23	FY3/24	Change	
			Amount	%
Creative Solution	36,948	29,170	-7,778	-21.1%
Displays	21,650	17,496	-4,154	-19.2%
Pen Tablet	15,298	11,674	-3,624	-23.7%
Business Solution	4,213	4,644	431	10.2%

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

a) Creative Solution sales

Net sales decreased 21.1% YoY to ¥29,170mn. By product, in Displays, sales decreased due to declining demand for existing models, while new products, particularly professional models and low-priced models, contributed to sales. In Pen Tablets, sales decreased due to declines in demand for professional models and mid-priced existing models, despite a contribution to sales from mid-priced new products.

b) Business Solution sales

Net sales increased by 10.2% YoY to ¥4,644mn. Although sales were affected by fluid changes in market conditions and progress on projects, sales rose over the previous fiscal year.

(2) Technology Solution Business

This segment recorded increases in sales and profits, with net sales rising 18.7% YoY to ¥84,981mn and segment profit increasing 53.2% to ¥16,481mn. Net sales benefitted from the impact of the yen's depreciation (approximately ¥5.4bn increase in sales), while increase in demand for OEM partners in EMR Technology Solution contributed to the increase in sales. In AES Technology Solution, the Company delivered increased sales despite changes in the market environment. On the earnings front, earnings increased for several reasons, such as the absence in FY3/24 of the expenses for valuation reserve for inventory purchase commitments (approximately ¥2.0bn) recorded in FY3/23; the effect of increased sales on boosting earnings; and the positive effect of the yen's depreciation (a positive impact of approximately ¥1.3bn).

Earnings breakdown in the Technology Solution Business

(¥mn)

	FY3/23	FY3/24	Change	
			Amount	%
AES Technology Solution	23,383	26,263	2,880	12.3%
EMR Technology Solution	48,186	58,718	10,532	21.9%

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

3. Key takeaways of FY3/24 results

To summarize FY3/24, while the Company achieved higher sales and profits due to growth in the Technology Solution Business, supported by brisk OEM demand, the Company's performance included a mix of factors including the yen's depreciation, which was a positive factor, and the impact of one-time expenses, which was a negative factor, making its earnings results difficult to evaluate. Excluding those factors, a reasonable perspective would be that in reality, the environment remained difficult, particularly in the Branded Business. As described later, 1) a delay in recovery from the "future demand consumption" that occurred during the spread of the COVID-19 virus (hereinafter, the "COVID-19 pandemic," 2) a continued trend of "purchasing restraint" among consumers, and 3) a trend of demand shifting to other categories (diversification of user options) can be cited as factors. However, it is necessary to discriminate clearly between business cycle factors such as 1) and 2) and structural changes such as 3), while paying close attention to megatrends such as the penetration of new technologies and trends in digital transformation (DX). Looking back at the Branded Business from FY3/21 onwards, the scale of the ebb and flow between the rapid growth in results during the COVID-19 pandemic and the stall caused by the recoil from this expansion is notable. However, it may be more appropriate to consider this variability as being smoothed out over time. Instead, the most important themes of "Wacom Chapter 3" were supposed to be that the Company would identify its targeted market domains in anticipation of megatrends and prepare to enter those domains. In this regard, FISCO would like to positively evaluate the Company's achievements in making a certain extent of progress on the liquidation of negative legacy assets and clearly establishing its preliminary guidance for the future. Furthermore, the Company has achieved specific successes in terms of preparing a foundation for the future, such as proposing new use cases, addressing the digital transformation (DX) of creative workflows, and launching a Digital Ink Service. Those successes are another commendable achievement in our view.

Outlook

Continued increases in sales and profits expected for FY3/25, while implementing additional structural transformation in preparation for "Wacom Chapter 4"

1. FY3/25 results outlook

For the FY3/25 consolidated results outlook, the Company expects an increase in profit (except ordinary profit) and sales with net sales to increase 1.0% YoY to ¥120,000mn, operating profit to increase 20.4% to ¥8,500mn, ordinary profit to decrease 13.7% to ¥8,500mn, and profit attributable to owners of parent (hereinafter, "net profit") to increase by 35.9% to ¥6,200mn.

Looking at net sales, the Branded Business has made progress to a certain extent on the liquidation of negative legacy assets caused by surplus parts and materials procurement and production. The Branded Business anticipates increased sales while implementing additional structural transformation in anticipation of a return to profitability in FY3/26, so that it can address structural changes in the market environment. On the other hand, the Technology Solution Business is expected to generate mostly flat sales at this time.

On the earnings front, the Company expects the amount of losses in the Branded Business to decrease due to the alleviation of one-time expenses that had weighed on profits until the previous fiscal year, as well as structural transformation (improved gross profit, cost optimization and other measures), despite continuing proactive R&D investment. The smaller extent of losses is expected to contribute to higher operating profit. The decrease in ordinary profit is attributable to the absence of foreign exchange gains. However, because extraordinary losses will not be recorded, net profit is expected to increase.

Forecasts for FY3/25

(¥mn)

	FY3/24		FY3/25		Change	
	Results	% of net sales	Forecast	% of net sales	Amount	%
Net sales	118,795		120,000		1,205	1.0%
Branded Business	33,814	28.5%	35,000	29.2%	1,186	3.5%
Technology Solution Business	84,981	71.5%	85,000	70.8%	19	0.0%
Operating profit	7,058	5.9%	8,500	7.1%	1,442	20.4%
Branded Business	-4,520	-13.4%	-2,000	-5.7%	2,520	-
Technology Solution Business	16,481	19.4%	16,000	18.8%	-481	-2.9%
Adjustment	-4,902	-	-5,500	-	-598	-
Ordinary profit	9,853	8.3%	8,500	7.1%	-1,353	-13.7%
Profit attributable to owners of parent	4,562	3.8%	6,200	5.2%	1,638	35.9%

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

(1) Branded Business

Net sales are expected to increase 3.5% YoY to ¥35,000mn, and segment loss is expected to be ¥2,000mn (segment loss of ¥4,520mn in the previous period). Although efforts will be made to expand market penetration of the updated product portfolio, the Company expects only a small increase in net sales based on a conservative assessment of factors such as changes in the market environment. On the earnings front, the Company expects to post smaller losses, assuming the alleviation of one-time expenses recorded until the previous fiscal year, and the currently identifiable effects of structural transformation. In the Branded Business, the Company will advance structural transformation in order to return to profitability in the first fiscal year (FY3/26) of the next medium-term business direction ("Wacom Chapter 4").

(2) Technology Solution Business

Net sales are expected to remain flat YoY at ¥85,000mn, while segment profit is expected to decrease by 2.9% to ¥16,000mn. At this time, the Company expects to maintain the same level of net sales as in the previous fiscal year, given the need to cautiously assess trends around OEM partners. On the earnings front, while one-time expenses recorded until the previous fiscal year will be alleviated, the Company expects segment profit to decrease modestly due to continuing proactive R&D investment for the future.

2. Key considerations for FISCO

There remains a need for caution regarding the impacts of foreign exchange rate trends and the uncertain outlook for economic conditions. However, FISCO believes that the Company has made reasonable assumptions for its consolidated results forecasts, and we consider the forecasts to be fully achievable. It should also be noted that growth in the Technology Solution Business and the market penetration of own new products released in the previous fiscal year could provide an upside to performance. Furthermore, on the earnings front, the liquidation of negative legacy assets has progressed to a certain extent around the balance sheet, so now the key is likely to be how to effectively advance the optimization of operational expenses on the profit and loss statement. Meanwhile, the Company must continue to invest for the future, and we hope to see it conduct strategic business operations with a focus on clear priorities.

From a medium- to long-term perspective, we would like to focus on the progress of the transformation of business structure (revised plan) set forth in the "Wacom Chapter 3" update. The update also lays out more specifically what the Company should do going forward, 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 with new core technologies (AI, XR, Security, as well as others including remote technology) and the launch of a new business model are 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. Furthermore, the Company has so far provided the different elements of the pen experience (hardware, software, technology, community and others) on a standalone basis and built up a track record for each element. Going forward, we believe that the Company's advantages will grow if it provides those elements as a unified "integrated pen experience." 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, it will be able to support individual users on a deeper level using AI's deep learning functionality. By generating new experiences and value from this area, the chances of it being able to establish an unrivaled position in innovative domains will be much greater. The Company targets three market domains, namely Digital Content Creation, Education DX, and Workflow DX, where the potential is growing in various directions. Maintaining a solid position in technology and brand clout will be critical for capitalizing on this potential.

Progress on update of "Wacom Chapter 3" (revised), the medium-term business direction

The Company will promote business structure transformation to accelerate growth in the next "Wacom Chapter 4." It has announced additional plans for the Branded Business

1. Basic direction and history to date

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*1," 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*2. In particular, the Company's leading strategy is to select three fields*3 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).

*1 "Continuing to provide 'meaningful human experiences' to customers and society over a long time period based on Wacom's technology"
*2 We have omitted a description of the overall image of "Wacom Chapter 3" (update plan) from this explanation, including the five key strategic initiatives (technology leadership, community, engagement, new core technology/new value proposition, technology innovation for sustainable society, meaningful growth for people and society) and the six main streams for technology innovation (pen technology, pen and paper technology, digital ink technologies, AI × Digital ink, XR × Digital ink, and Security × Digital ink)
*3 Remote technology has been added to the three fields.

However, the Branded Business has experienced a greater downturn than expected, mainly due to a sharp decrease in consumer sentiment following the current deterioration of the economic environment. Moreover, the Company's own structure appears to have room for improvements, including strengthening the product portfolio and sales channel management. For this reason, the latter two years of the medium-term business direction (FY3/24 to FY3/25) have been positioned as a period for business structure transformation to ensure business growth in the next phase, "Wacom Chapter 4," and the Company has announced a policy (the update plan) of focusing on gross profit improvement and growth foundation construction (announced in May 2023). In addition, the Company has judged that further structural transformation is needed in the Branded Business. It therefore announced a revision of the update plan*.

* Among the factors that led to the revision of the update plan were the following: 1) recovery from the "future demand consumption" that occurred during the spread of the COVID-19 pandemic was delayed further than expected, 2) a persistent trend of "purchasing restraint" among consumers as part of general market conditions in specific regions (China and others), and 3) in the entry-level zone for pen tablet products, alternative options other than pen tablet products have diversified, causing a slight shift in demand towards other categories.

2. Progress on update plan (revised) (as of April 2024)

(1) Recent trends in the market environment

1) Branded Business

The potential importance of Wacom products has grown with the digital transformation (DX) of creative work flows. Even so, users have assigned a relatively lower priority to replacement purchases of Wacom products as the technology infrastructure for professional creative workflows has been successively updated. This has led to the emergence of longer and more protracted procurement cycles. In the entry-level zone, a trend toward a shift in demand to other categories (iPad and others) is underway. The trend of purchasing restraint in specific regions (China and others) continues. While the “future demand consumption” that occurred during the COVID-19 pandemic is improving, difficult conditions persist.

2) Technology Solution Business

While the smartphone market as a whole is expanding only slightly, growth is expected for high-value-added and sophisticated models. On the other hand, while the PC and tablet market is in recovery mode, the trend in demand for pen-enabled models is different for each type of customer. Demand for e-books and e-notebooks using e-paper is expected to continue increasing going forward.

(2) Outline and progress on the update plan (revised)

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

The Company is working to improve its cost structure through i) new value proposition (entry level to professional), ii) pricing policy to improve gross profit, and iii) value engineering. With regard to i), the Company is sequentially introducing a new product portfolio that provides a new value proposition. Two new product models were launched in 3Q. New products* that create new use cases were introduced in April 2024. However, with regard to ii), while price hikes contributed to a partial improvement in the gross profit margin, the effect of the improvement was diminished by a drop in gross profit due to inventory reduction promotions. Based on the above, the Company has assessed its progress in this area as “undershooting.”

* “Wacom Movink” that creates Portable Creative (a portable and drawing specific experience)

2) Market development in focused areas (Branded Business)

The Company is working on i) concentrating on the creative area, ii) responding to new work flows (virtualization / remote), and iii) systems for providing solution-based value propositions. With regard to i), the Company is working on a variety of creative education projects*1. With regard to ii), the Company officially introduced a commercial version of a remote solution*2. With regard to iii), the Company is examining solution-based value propositions for each region. Based on the above, the Company has assessed its progress in this area as “in progress.”

1 Products were introduced to a Florida state technical college, an education program for training Webtoon creators in collaboration with KENAZ, and HAL College of Technology & Design (Tokyo, Osaka, Nagoya), among others
*2 Initiated the commercial launch of Wacom Bridge, a solution for cloud / remote environments, in January 2024.

3) Enhance sales channel management (Branded Business)

The Company is working i) to enhance B2B channels (cultivation of direct customers for provision of solution-based value propositions) and ii) to enhance its e-store channel (maximize user engagement through experience-based services, etc.). With regard to i), the Company is striving to develop direct customers and the B2B ratio has reached its target of 30%*. With regard to ii), the Company has started introducing Wacom Adventure, an experience-based service and has worked to secure channels to an e-store through a dedicated e-store version and services. The e-store ratio improved to over 13% (from around 10% in the previous full-year period). However, overall sales have declined and have not led to an improvement in gross profit. For this reason, the Company has assessed its progress in this area as "undershooting."

* The Company has achieved successes such as delivering solutions to an online school in Pennsylvania, providing workflow support for hospitals, and supporting online banking services.

4) Improving inventory management (Companywide)

The Company is working i) to reduce the inventory balance at the end of December 2022 (approximately ¥30.0bn) by approximately one-third, ii) to pare down additional new purchasing, and iii) to strengthen the monitoring of excessive ordering. With regard to i), as of March 31, 2024, inventories had been reduced to ¥13.1bn (book value), enabling the generation of more than ¥10.0bn in cash. With regard to ii) and iii), orders for existing products are almost nil, and the Company will continue working to strengthen monitoring over ordering. Based on the above, the Company has assessed its progress in this area as "achieved."

5) Expanding customers and applications (Technology Solution Business)

The Company is working i) to drive further de facto standardization in the industry and ii) to develop proprietary hardware (main units, pens, and services) to expand applications. With regard to i), initiatives are steadily being implemented, and the number of customers and projects are on an uptrend*. With regard to ii), the Company is currently considering plans for the development of proprietary hardware. Based on the above, the Company has assessed its progress in this area as "in progress."

* Includes support for the New Galaxy S pen, and the introduction of a universal pen experience, etc.

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

The Company is working i) to develop solutions for general education and ii) to develop services in addition to hardware. With regard to i), the Company is currently developing next-generation solutions for general education. With regard to ii), it officially launched an updated version of its commercial education services. Based on the above, the Company has assessed its progress in this area as "in progress."

7) Capital policy/Shareholder returns (Companywide)

The Company is working i) to invest in future technology and pursue its capital policy and ii) to acquire treasury stock. In regard to i), the Company invested ¥7.7bn as R&D spending in FY3/24, with ¥8.0bn expected in FY3/25. With regard to ii), in line with its policy of acquiring a total amount of treasury stock of up to ¥20.0bn during the period of "Wacom Chapter 3," by the end of March 2024, the Company had acquired a cumulative total of ¥12.5bn in treasury stock. Based on the above, the Company has assessed its progress in this area as "in progress."

8) Digital Ink Service launch and investment (Companywide)

The Company is working i) to launch businesses in three core value fields (AI, XR, and Security), and ii) to recover its investments in technology development. With regard to i), in addition to the three fields of AI (started commercialization in the education field*1), XR (planning commercialization for FY3/25), and Security (announced market release of Wacom Yuify beta version*2), the Company is also promoting projects in remote technology (officially introduced commercial version of remote solution). Based on the above, the Company has assessed its progress in this area as "in progress."

*1 Released "Searching Experience CHIENOWA" (knowledge graph-based learning experience triggered by handwriting), an educational service using digital ink.
*2 A solution for certifying creators' rights of artworks

3. Awareness of issues and direction of additional plans for the Branded Business

The Branded Business continues to struggle due to the impact of rapid changes in the market environment. As described earlier, the Branded Business missed its target for achieving profitability in FY3/24 due to delays in product portfolio renewal and gross profit improvement, and enhancing sales channel management, among other areas. A segment loss is expected to continue in FY3/25. The Company has announced an additional structural transformation plan including far-reaching reductions in fixed costs and operational costs, in preparation for "Wacom Chapter 4." It intends to address four themes: 1) product portfolio, 2) focused business areas, 3) sales channel and regional operation, and 4) organizational structure. With regard to 1), the Company will work to establish the new use case Portable Creative and shift to solution-based value propositions. With regard to 2), the Company will focus on professional and creative specialist education, while the K12 (elementary, middle, and high school) creative education market will be covered by the Technology Solution Business. Regarding (3), the Company will focus on e-store, B2B, and communication engagement and strive to achieve an asset light and minimized operation through drastic aggregation and integration of operations. Regarding 4), the Company will pursue transformation under new leadership*, along with optimization and aggregation of development and operations. By working to optimize operational costs (approximately ¥2.0bn) the Company aims to restore segment profitability in FY3/26 (the first fiscal year of Chapter 4), while striving to increase sales from FY3/27 onward and maintain and improve its brand position in the creative community.

* The leadership of the Branded Business was revamped as of April 1, 2024.

Preliminary guidance of the next medium-term business direction (Wacom Chapter 4)

Presenting the preliminary guidance of the next medium-term business direction ("Wacom Chapter 4"). Evolving to a phase of commercializing next-generation engines and implementing them in the market

1. Preliminary guidance (summary)

The Company has presented the preliminary guidance of its next medium-term business direction ("Wacom Chapter 4"), which will begin in FY3/26. (The final draft is scheduled to be announced in May 2025.) The Company recognizes that business opportunities for digital pens are associated with market domains*1 where sustainable growth can be achieved, such as the digital content creation market, the Education DX Edtech market, and the Workflow DX market. Based on this recognition, in order to capitalize on this growth, the Company seeks to evolve from the preparation period of "Wacom Chapter 3" to an implementation period (commercialization of technology development that serves as next-generation growth engines and market implementation). The Company has defined the sources of its value propositions as an "Evolving technology roadmap" and "Community (user, customer, technology) engagement." Concurrently, the Company will implement an "integrated pen experience" composed of various new technology elements*2 it has so far developed. Furthermore, in addition to existing target use cases, the Company will explore new use cases such as Portable Creative, K12 creative education, and mission-specific use cases. It intends to deliver the integrated pen experience to the target use cases via the shortest path possible*3.

*1 The average growth rates (2024 to 2030) are forecast to be 16.3% for the Digital Content Creation market, 13.4% for the Education DX Edtech market, and 24.1% for the Workflow DX market. (The forecasts are from the Company's earnings results briefing materials.)
*2 Includes pen input technology and sensor modules, as well as digital ink technology (a combination of AI, security, XR space and cloud).
*3 The Company will work to achieve an asset light operation for Wacom branded product solutions focusing on e-store/B2B. Additionally, for OEM partners, the Company will provide platforms (technology platforms delivering an integrated pen experience with hardware, software, service, user interface) in addition to device parts modules.

2. Revenue scale and profitability

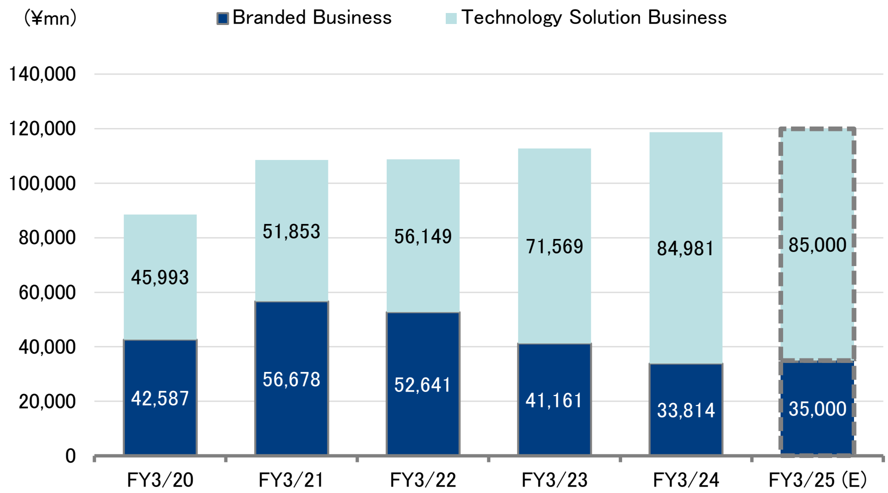
For now, the Company has maintained its currently projected scenario, which was announced in May 2023. It expects to manage business operations with net sales of around ¥150.0bn (within a range of around plus or minus 10%), and an operating profit margin of around 10% in the final fiscal year (FY3/29). (These assumptions are scheduled to be updated in May 2025 together with other KPIs.)

Results trends in past years

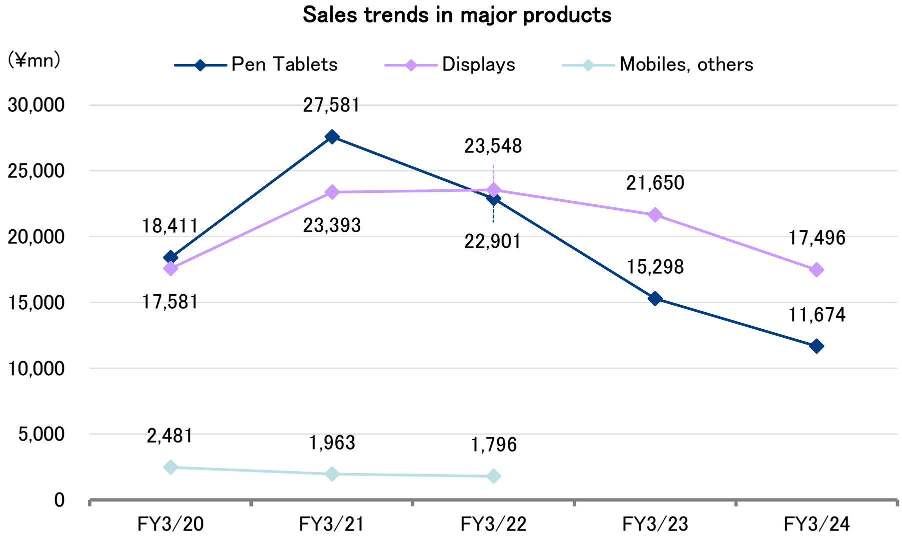
Technology Solution Business driving growth over the past few years due to increase in demand from OEM partner manufacturers for smartphones, etc.

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 Branded Business experienced rapid growth in sales in FY3/21, mainly due to stay-at-home demand including online education amid 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 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.

Trends in net sales by business

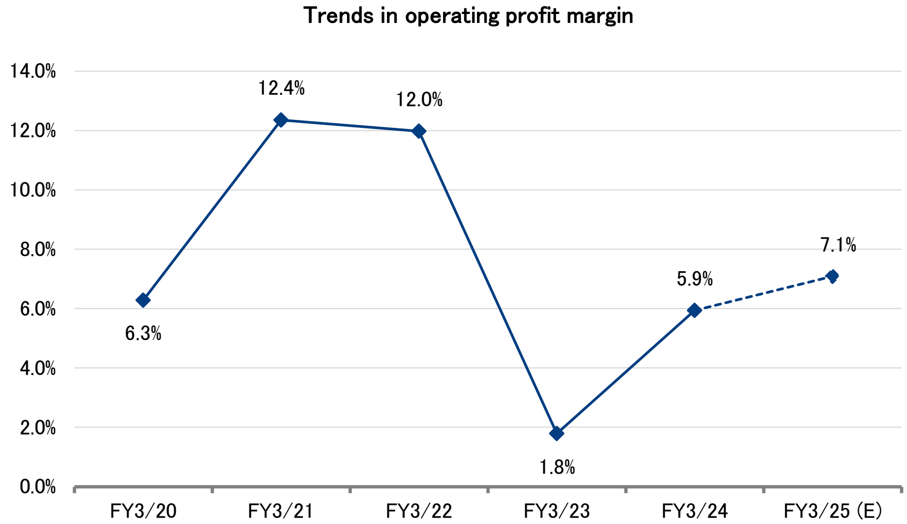


Source: Prepared by FISCO from the Company's financial results and results briefing materials



Note: The category scope has changed from FY3/24. Results for Mobiles, others were reclassified into Displays and Pen Tablets. Figures for FY3/23 were retrospectively restated.
Source: Prepared by FISCO from the Company's financial results

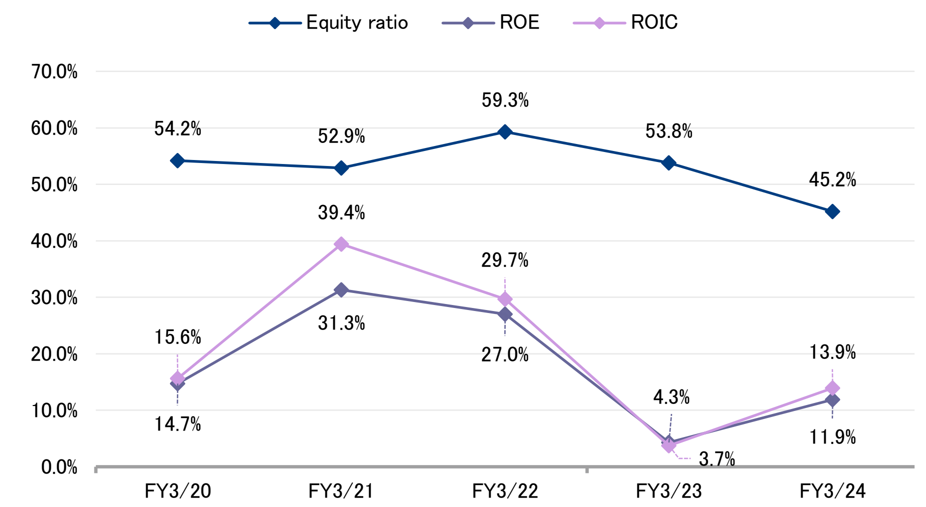
In earnings, since incurring an operating loss in FY3/17, the operating profit margin has improved gradually from the 4% level to the 6% level while the Company conducted aggressive R&D and new product development. In FY3/21 and FY3/22, the Company retained a high profit margin for two consecutive years due to factors such as higher profits atop an increase in sales, improvements in the product mix, and optimization of SG&A expenses. Since FY3/23, the Branded Business has recorded a segment loss for two consecutive years, and the overall profit margin has decreased significantly.



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

In financial standing, while the equity ratio temporarily slipped in FY3/17 on a hefty net loss due to recording impairment losses on IT assets, it has steadily improved since then with buildup of retained earnings and has moved close to 60%. However, the equity ratio has been on a downtrend since 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. However, ROE and ROIC temporarily experienced significant declines in FY3/23 along with the drop in profits. However, in FY3/24, they both started improving and cash flows have also improved due to progress on reducing surplus inventories. Against the backdrop of an increasingly robust growth foundation in the Technology Solution Business, the Company has judged that it can now focus on the optimal rebalancing of equity and liabilities on the balance sheet. Accordingly, the Company has indicated that it intends to promote business management with awareness of capital efficiency through the use of financial leverage up to a D/E ratio of around 0.3x to 0.5x from FY3/24 to FY3/25, while ensuring financial soundness. As of the end of FY3/24, the D/E ratio stood at just under 0.4x, which indicates that the Company has retained a good balance. Going forward, allocation of cash flow generated through proper management of operating capital, particularly inventories, and business profits to investments and shareholder returns, will also be important financial indicators for determining if the Company is maintaining its sound financial state, and should be monitored in conjunction with the D/E ratio.

Trends in equity ratio, ROE and ROIC



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" in May 2023 to communicate the Company's philosophy and value creation mechanisms

The Company places emphasis on initiatives that contribute 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 analyzing 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, using AI to enable visualization of the creative activity by creators can help to promote learning by others in creative activities.
*3 For example, combining programming 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% (reference year: FY2014). 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. Based on these activities, the Company announced its support for the TCFD (Task Force on Climate-related Financial Disclosures) recommendations on April 13, 2023.

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.

Shareholder returns

The Company paid a dividend of ¥20.0 per share for FY3/24, the same amount as the previous period, based on a policy of continuing stable dividends. It is actively engaged in the acquisition of 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 a 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. For the period covered by "Wacom Chapter 3" (FY3/22 to FY3/25), the Company's treasury stock acquisition policy has an upper limit of ¥20.0bn in total (by March 31, 2024, the Company had completed the acquisition of cumulative amount of ¥12.5bn in treasury stock).

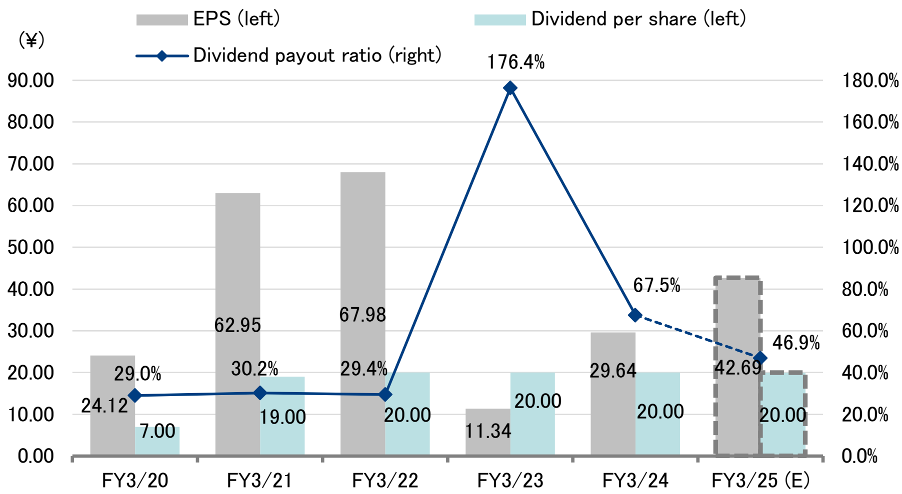
With regard to dividends for FY3/24, the Company paid a dividend of ¥20.0 per share, the same amount as the previous fiscal year (dividend payout ratio of 67.5%). The Company acquired treasury stock in the total amount of approximately ¥7.5bn (11.04 million shares).

In addition to forecasting a dividend of ¥20.0 per share (dividend payout ratio of 46.9%) for FY3/25, the Company has also resolved on May 9, 2024, to acquire treasury stock* up to a total amount of ¥3.0bn (up to 6 million shares), and to cancel 6 million shares of its treasury stock (cancelled on May 16, 2024).

* The acquisition period of the Company's treasury stock acquisition under this resolution is from May 10, 2024 to September 30, 2024.

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 continue making 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", and "COM" includes "communication" and recently "community." 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 US 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 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

■ 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