COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

Tokyo Stock Exchange First Section

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Summary

The Company has announced new initiative to raise its corporate value over the medium term by converting to a management stance that stresses profitability

Wacom Co., Ltd. <6727> (hereafter, also "the Company") is the world's leading manufacturer of pen tablets. It possesses a global share of approximately 90% of the market of creators and hobbyists. Its two main businesses are the Brand Business, selling its own-brand pen tablet products, and the Technology Solution Business, which consists of the supply of digital pen components to manufacturers of finished products, including tablets.

1. An operating loss in FY3/17 was due to the impact of yen appreciation and disappointing sales of new products

In the fiscal year through March 2017, the Company's consolidated net sales declined by 8.1% year-on-year (YoY) to ¥71,313mn, and the Company suffered an operating loss of ¥1,171mn, reversing an operating profit of ¥3,664mn in FY3/16. In the first half of FY3/17, performance was impaired by the effect of yen appreciation. The Company had hoped that the sale of new products would support a full-year recovery in 2H, but these products did not sell as well as planned because of a delay in their launch and some quality problems.

2. The Company has announced a new approach to lift its corporate value over the medium term

On March 14, 2017, the Company announced that it would abandon its current plan of operations (medium-term management plan), called Strategic Basic Plan SBP-2019, because its results in FY3/17 fell far short of the plan's targets on its way. Instead, the Company plans to alter its management team, in part, by replacing top management in spring 2018. It intends to conduct a rationalization program in FY3/18 that will include cutting costs resulting from the reformation of its global organization.

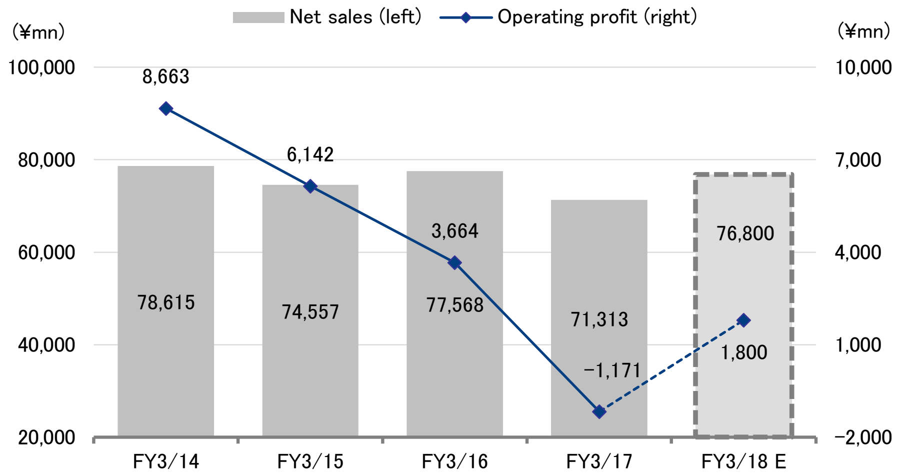
3. Company projects a return to profitability in FY3/18, expecting new products in the Brand Business to contribute fully

For FY3/18, the Company forecasts a 7.7% YoY rise in consolidated net sales to ¥76,800mn and an operating profit of ¥1,800mn, in contrast to the operating loss of ¥1,171mn reported for FY3/17. The Company expects this turnaround in performance to be led by the full-year contribution of the new products in its Brand Business initially marketed in 2H FY3/17. This appears to be a persuasive scenario for self-recovery as the Company still holds the dominant share of the global market for pen tablet products for top creators. For its Technology Solution Business, the Company foresees a continuing increase in sales of its digital pens for tablet personal computers (PCs).

Key Points

- Yen appreciation was the main cause of losses in 1H FY3/17. Sales of new products in 2H failed to meet Company expectations.
- The Company has announced a new approach to lift its corporate value over the medium term by adopting a strategy that emphasizes profitability
- The Company aims to return to profitability in FY3/18, led by the full-scale contribution of new products in the Brand Business

Result trends



Source: Prepared by FISCO from the financial results summary

Company profile

Established in 1983, the Company has grown steadily and now holds a share of more than 80% of the global market for pen tablets for creators

1. History

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). 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 in the United States for film production. Subsequently, it constantly enhanced its products, and in the creative pen tablets markets for creators and hobbyists, since the 2000s it has consistently kept a global share of 80% and above.

In 2002, it entered into the pen sensor components field (currently, the Technology Solution Business). This business involves supply of components and modules, such as the Company’s digital pens, control IC and sensor boards, to the manufacturers of finished products. As it is described in more detail below, the business is growing rapidly on the back of the expansions of the markets for tablets and smartphones.

In the securities market, after listing on the Japan Securities Dealers Association’s JASDAQ market in April 2003, the Company listed on the Tokyo Stock Exchange (TSE) 1st Section in December 2005, where it remains today.

History

July 1983	Founded in Ageo City, Saitama Prefecture. Launched an electronic devices business (currently, the Brand Business) and an ECS business (currently, the engineering solutions business).
1984	Announced the creation of the world's first cordless pen tablets, the WT series
1987	Announced the development of the world's first cordless graphics tablets for professionals, the SD series
July 1990	Completed the Toyonodai plant in Kazo City, Saitama Prefecture
1990	U.S. Walt Disney Company produced "Beauty and the Beast" using Wacom pen tablets
September 1998	Announced the Intuos Series of pen tablets for professionals
November 1999	Announced the creation of pen tablets for general consumers, the Graphire/FAVO
September 2001	Announced the development of the Cintiq series of pen tablets with liquid crystal displays
April 2002	Entered into the pen sensor components field (currently, the Technology Solution Business)
April 2003	Listed on the Japan Securities Dealers Association's JASDAQ market
December 2005	Listed on the TSE First Section
October 2008	Developed a high-performance multi-touch sensor system
May 2011	Announced the creation of the Bamboo stylus for use with the iPad
October 2011	Samsung Electronics began using Wacom's digital pen input systems in its smartphones
September 2013	Announced the development of the Cintiq Companion mobile product incorporating an operating system
February 2014	Launched WILL™ digital ink technology
March 2014	Announced the development of an active electrostatic (ES) coupling technology applicable to digital pens
April 2014	Cumulative production of pen input components for mobile devices reached 100 million units
April 2015	Revamped global organization
September 2015	Announced the development of the Company's first digital stationery, Bamboo Spark
September 2016	Established the Digital Stationery Consortium
October 2016	Announced the development of the Wacom MobileStudio Pro mobile products
November 2016	Announced the creation of the Wacom Cintiq Pro display product
January 2017	Announced the development of the Wacom Intuos Pro pen tablet product

Source: Prepared by FISCO from Company materials

The Company's two main businesses are selling its own brand of pen tablets and supplying parts for equipment

2. The business units and the main products

The Company's products are devices for computer interface called "pen tablets." While it is possible to utilize the commonly used mouse to draw pictures and write text, as the accuracy of the pointing when using it is low, it is difficult to draw a line exactly as intended. This is Wacom's products come in. When using an digital pen tablet (the name is derived from stone tablets) known together as a pen tablet, it becomes possible to input pictures and text simply and accurately.

The main uses of pen tablets are for design on computers and when producing illustrations, graphics, and other content. This is because they can be operated more accurately than mice, and depending on the product, they can express the user's strokes sensitively by detecting technology components such as pen pressure and angle.

Some products integrate a pen tablet with a liquid crystal display (LCD), enabling users to draw directly on the LCD screen using an digital pen. As is explained below, in the Company's products classifications, these products correspond to LCD pen tablets referred to as "displays" (some products are also included in the "mobile" classification). They are expensive compared to conventional pen tablets, but are in widespread use among creators as they make more intuitive input possible.

The Company has three business units; the Brand Business, the Technology Solution Business, and Other Businesses. The Brand Business consists of WACOM brand products, such as pen tablet finished products and input pens, to from creative users, like creators and hobbyists, through to general consumers, and also to enterprize users. The Technology Solution Business involves supply of the Company's pen tablet components (including digital pens, sensors, and control IC) to the manufacturers of tablets and smartphones. The main portion of Other Businesses comes from CAD systems for digital design, which is referred to as the engineering solutions business. Each business unit is described in detail below.

Overview of the Business units and the main products

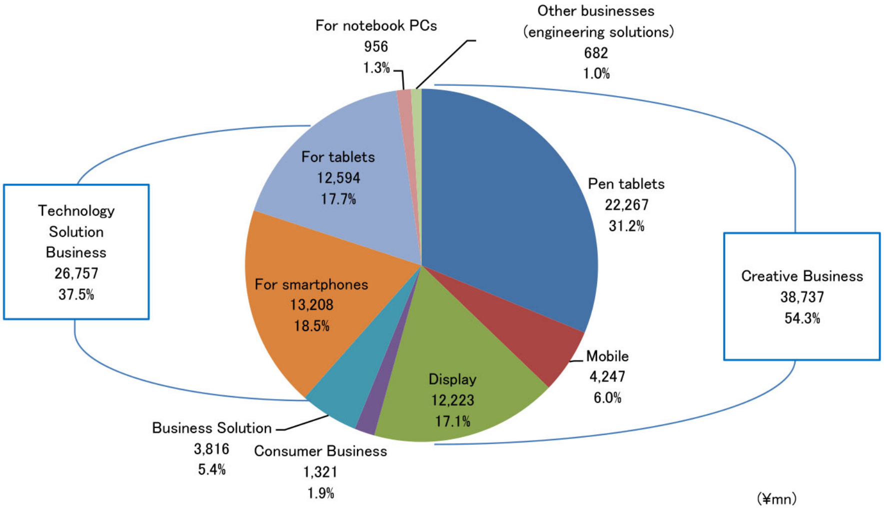
Business classification	Product classification	Main products	Product description	Intended use	Product series
Brand business	Creative Business		"Supporting creative users expressing their passion"	-	-
		Pen tablets	Pen tablets for professionals that make possible extremely delicate drawing, such as from a pressure-sensitive pen, and pen tablets for general users that can be used via simple operations	Graphic design using computer graphics, film and animation production, photo editing, industrial design, illustrations, creation of homepages, etc.	Wacom Intuos Pro series, Intuos series
		Mobile	LCD pen tablets for professionals that enable		Wacom MobileStudio Pro series
		Display	users to draw and write text directly on an LCD screen		Wacom Cintiq Pro series, Cintiq series
	Consumer Business	Styluses, digital stationery	Digital stationery makes everyone's life more creative		Bamboo Series
	Business Solution	Pen tablets for businesses	Business-use products that enable users to draw and write text directly on an LCD screen	Used in the digital signature , education, and medical fields	STU Series DT Series
Technology Solution Business		Digital pens, sensors, touch panel components, and modules	-	For use in mobile devices, such as tablets, digital books, and cellular telecommunications equipment	-
	-	For smartphones	-	Pen sensor systems for smartphones	-
		For tablets	-	A pen sensor system for tablet PCs and notebook PCs	-
Other	-	Digital design use CAD systems	-	Used in the manufacturing industry (for mechatronics)	-

Source: Prepared by FISCO from Company materials

In FY3/17, the Brand Business supplied 61% of the Company's total net sales, the Technology Solution Business provided 37.5%, and other businesses accounted for 1.0%. A large portion of the sales in the Brand Business are to Creative Businesses. Pen tablets and displays account for large proportions of the sales to creative businesses.

The Technology Solutions Business supplies parts for smartphones, tablet PCs, and notebook PCs. There is little difference between parts for tablet PCs and parts for notebook PCs, and in recent years, users of notebook PCs using pen tablets have migrated to tablet PCs. Because of this trend, the business plans to combine its parts for tablet PCs and its parts for notebook PCs in FY3/18, when sales of parts for the combined tablet PCs are expected to overwhelm parts for smartphones.

Breakdown of Net sales by Business classification, Products classification, and Main products (FY3/17 results)



Source: Prepared by FISCO from the financial results summary

The Company sells worldwide through global subsidiaries. Overseas sales comprise about 90% of its total net consolidated sales.

3. Sales situations

The Company has established subsidiaries in regions throughout the world, starting with Wacom Computer Systems in 1988 (currently, Wacom Europe), up to Wacom India in 2010. It sells its brand products through these subsidiaries.

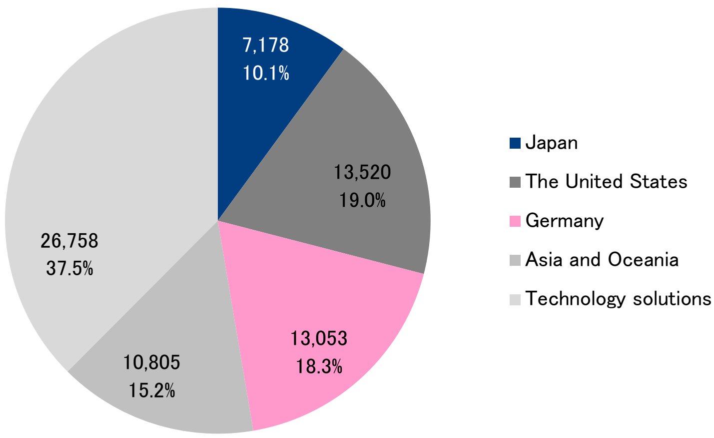
History of Establishment of Subsidiaries

April 1988	Established Wacom Computer Systems (now, Wacom Europe), in Neuss, Germany
July 1991	Established Wacom Technology in Vancouver, US
March 2000	Established Wacom China in Beijing, China
April 2004	Established Wacom Digital Solutions (currently, Wacom Korea) in Seoul, South Korea
April 2005	Established Wacom Australia Pty. Ltd. in North Ryde, Australia
April 2006	Established Wacom Hong Kong in Hong Kong
May 2006	Established Wacom Singapore in Singapore
September 2008	Established Wacom Taiwan Information in Taiwan
August 2010	Established Wacom Technology Services in Vancouver, the United States
October 2010	Established Wacom India Pvt. Ltd. in New Delhi, India

Source: Prepared by FISCO from Company materials

The Company discloses its sales in the Brand Business by four major geographical markets, and these sales are fairly well balanced. Practically most of the sales by the Technology Solution Business are made overseas. Thus, about 90% of the Company's total consolidated net sales are made overseas, and these overseas sales are affected by fluctuations in yen exchange rates. Operating profit is also affected by fluctuations in yen exchange rates, though differently than sales are affected in the case of the yen-US dollar rate. About 98% of the Company's products are manufactured outside Japan, and most of the overseas plants record their costs in US dollars. Therefore, while yen appreciation against the euro erodes both sales and operating profit, yen appreciation against the US dollar lowers sales but increases operating profit.

Net sales conditions by region (FY3/17 results)



Source: Prepared by FISCO from the financial results briefing materials

98% of the Company's products are manufactured outside Japan. However, the Company supplies the equipment for production, thereby preventing the leakage of its technology and know-how

4. The manufacturing formation

Although the Company has a plant at its headquarters in Kazo City, Saitama Prefecture, it is basically a fabless company. It plans, develops, and designs products and components and outsources production to OEM and ODM in Japan and overseas. Many of these plants are located in mainland China, but from the perspective of mitigating country risk, it also utilizes EMS (electronic manufacturing services) centered on Taiwanese and Japanese capital. In terms of production ratio whether inside or outside Japan, the percentage from outside Japan is overwhelmingly larger, at approximately 98%, with the remainder being produced at the headquarters plant and by outsourcers in Japan.

The Company is a fabless company, but the structure is that it develops and designs in-house the manufacturing equipment used on the production lines, then machinery manufacturers in Japan produce the manufacturing equipment, and then this equipment is installed in the plants of its outsourcers, which carry out the production. Through this method, the Company aims to both utilize inexpensive labor costs from production outside Japan and to black box its technologies and expertise to prevent them flowing out of the Group.

Results trends

Yen appreciation was the main cause of losses in 1H FY3/17. Sales of new products in 2H failed to meet Company expectations.

1. FY3/17 results

In FY3/17, consolidated net sales fell 8.1% YoY to ¥71,313mn, and the Company logged an operating loss of ¥1,171mn, reversing an operating profit of ¥3,664mn in FY3/16, an ordinary loss of ¥870mn, versus an ordinary profit of ¥3,776mn in FY3/16, and a loss attributable to owners of parent of ¥5,534mn, against a net profit of ¥2,309mn in FY3/16.

Summary of the FY3/17 results

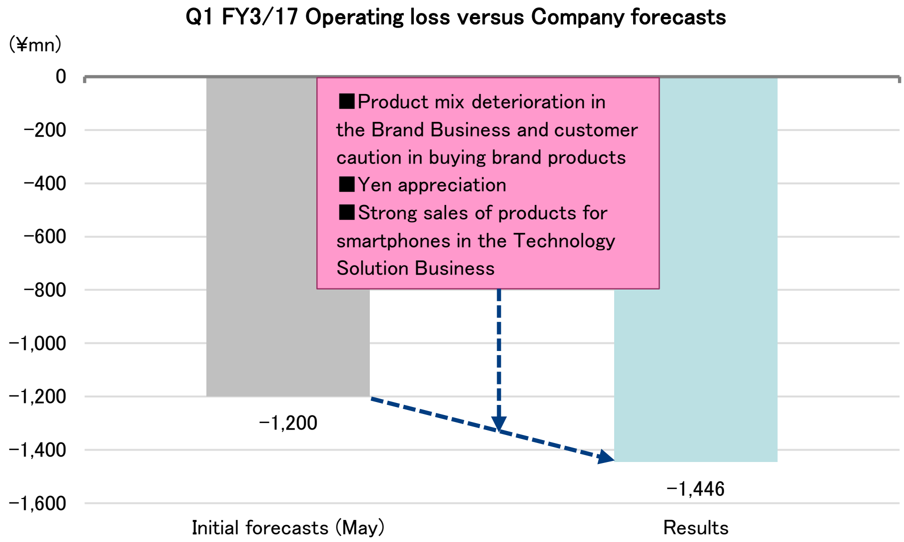
(¥mn)

	FY3/16	FY3/17					
	Full fiscal year results	Revised full-year forecast	Full fiscal year results	YoY		Growth rate	
				Change	vs. revised forecast	Growth rate	Change
Net sales	77,568	71,500	71,313	-8.1%	-6,254	-0.3%	-186
Gross profit	30,735	-	27,565	-10.3%	-3,170	-	-
SG&A expenses	27,071	-	28,736	6.2%	1,665	-	-
Operating profit	3,664	-500	-1,171	-	-4,835	-	-671
Operating profit margin	4.7%	-0.7%	-1.6%	-	-	-	-
Recurring profit	3,776	-650	-870	-	-4,646	-	-220
Profit attributable to owners of parent YoY	2,309	-5,600	-5,534	-	-7,843	-	65

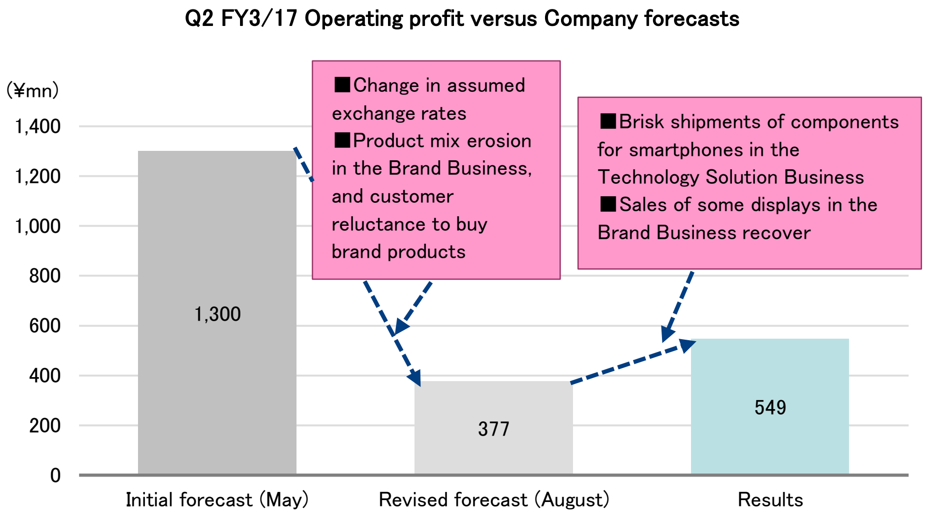
Source: Prepared by FISCO from the financial results summary

The Company's business is seasonal; most of its sales and profits are recorded in 2H, probably because of general retail sales drives at the year-end shopping season and enterprize sales at the end of a business year. Consequently, at the start of FY3/17, the Company forecast a low operating profit of only ¥100mn for 1H. However, due mainly to the United Kingdom's decision to leave the European Union (Brexit), the yen appreciated sharply against the euro from the end of the first quarter (1Q) of FY3/17, causing the Company to undershoot its operating profit forecast for 1H by about ¥1,000mn. The adverse impact on profits of yen appreciation and a deterioration of the sales mix in the Brand Business overwhelmed the positive impact of sales growth in the Technology Solution Business in 1H.

When the Company announced its results for 1H FY3/17, it lowered its full-year forecasts for three reasons: 1) it suffered a large operating loss in 1H because of yen appreciation and changed its assumed yen exchange rates for 2H to reflect the stronger yen, 2) it projected a delay in the development of some new products in the Brand Business previously planned for 2H, and 3) in the Technology Solution Business, it foresaw a YoY decline in sales of pen sensor components for smartphones.



Source: Prepared by FISCO from the financial results summary

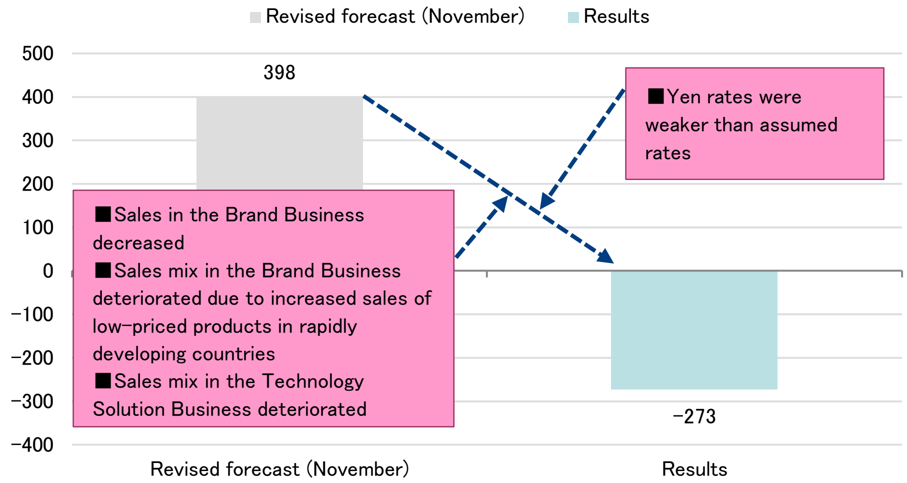


Source: Prepared by FISCO from the financial results summary

In 3Q FY3/17, the Company's effective yen rate averaged ¥111 to the US dollar and ¥119 to the euro, which were weaker rates than the rates assumed by the Company, of ¥103 to the US dollar and ¥114 to the euro. Furthermore, sales of new products in the Brand Business were brisk. As a result of these factors, consolidated net sales in 3Q surpassed the Company's forecast. Based on its results in 3Q, the Company changed its assumed yen rates for 4Q to ¥110 to the US dollar and ¥120 to the euro and raised its forecast of sales of new products. Thus, it lifted its forecast of full-year consolidated net sales from ¥70,300mn to ¥71,500mn while maintaining a forecast of a ¥500mn operating loss and altering its projections of profitability per business.

In 4Q, the Company's effective yen rate averaged ¥112 against the US dollar and ¥120 versus the euro. However, the sales in the Brand Business lowered comparing to the Company's forecast as sales of high-priced products decreased due to a delay in the sale of new products to professionals and creators in Europe and the US while unit sales of lower-priced products in rapidly developing countries and areas increased. In the Technology Solution Business, 4Q net sales exceeded the Company's forecast, reflecting the receipt of additional orders, but the sales mix eroded, weakening profits. Because of these factors, the Company suffered an operating loss of ¥273mn in 2H FY3/17, which was ¥671mn less than the Company forecast of a ¥398mn operating profit. The Company's final forecast of FY3/17 results, released just before the results, reflected this disparity in 2H profits from the Company's projections.

Company forecast of operating profit in 2H FY3/17
versus actual operating profit



Source: Compiled by FISCO from a Company news release

The Company reported a net loss attributable to owners of the parent in FY3/17 because it suffered extraordinary losses of ¥4,838mn, including an impairment loss of ¥4,224mn on part of its global IT infrastructure system.

Sales of new products in 2H were weaker than planned because of a delay in product launch

2. Trends in the Brand Business

In the Brand Business, net sales dropped 10.3% YoY in FY3/17 to ¥43,873mn, and operating profit fell 29.3% to ¥5,684mn. The segment operating profit margin declined by 3.4 percentage points from 16.4% in FY3/16 to 13.0% in FY3/17. Performance was impaired in 1H by the sale of many products near the end of their model lives. The business had hoped to offset this weak performance in 1H by selling many new products in 2H, but some of the new products came to market later than planned, so these hopes were thwarted.

Brand Business results

(¥mn)

	FY3/16	FY3/17					
				Full fiscal year			
	Full fiscal year results	1H results	2H results	November forecasts	March forecasts	Results	YoY growth rate
Net sales	48,931	19,326	24,547	48,400	45,700	43,873	-10.3%
Operating profit	8,035	2,051	3,633	7,300	6,500	5,684	-29.3%
Operating profit margin (%)	16.4%	10.6%	14.8%	15.1%	14.2%	13.0%	-

Source: Prepared by FISCO from the financial results summary

In the Creative Business, sales decreased 7.4% YoY in FY3/17 to ¥38,737mn, or about 88% of segment net sales. Sales in the Creative Business by product line are described below.

Sales of pen tablets declined 7.8% YoY to ¥22,267mn. Pen tablets are the most basic type of input device, comprising a pen and a tablet screen. The Company sells a wide range of pen tablets, from those for entry level users to those for professional users. Pen tablets account for about half of all sales by the Creative Business. Sales of the Intuos Pro model of pen tablet, targeted to professionals, rose YoY in unit terms but declined in value terms because of yen appreciation and opportunity losses accompanying model changes. In January 2017, the Company started selling a new model of pen tablet incorporating the next generation of technology, but this model proved less appealing to users than the Company had anticipated. Sales of pen tablets to ordinary consumers for 3D modeling grew YoY, but overall sales to consumers declined because the Company's supply of components was interrupted by the Kumamoto earthquake. Unit sales of pen tablet models geared to rapidly developing countries increased 40% YoY in FY3/17 as the Company acquired new users in China, India, and South America.

The Company's mobile devices are tablet PCs incorporating pen tablets. These devices compete with tablet PCs with pen input capability made by other companies. The Company's mobile devices are much more advanced than competing devices because they allow specialized input. However, the number of customers requiring this specialized input is limited, which is a marketing weakness. In 1H FY3/17, sales of mobile devices plummeted 52.4% YoY. In 2H, the Company marketed new models of mobile devices, which sold well. Therefore, for all of FY3/17, sales of mobile devices declined by only 4.6% YoY to ¥4,274mn. Sales of high-performance models with large screens to professional creators grew strongly, reflecting their clear superiority to tablet PCs made by other companies. However, sales of down-market models fell because of competition from other makes of tablet PCs.

Displays are pen tablets with liquid crystal panels as tablets. In that they use liquid crystal panels to write on, they resemble mobile devices, but because they lack an operating system and memory device, they resemble simple pen tablets. The Company's customers appreciate its displays because they can be freely connected to PCs or other digital devices and they can be used for a long time. In November 2016, the Company announced the development of a 13-inch display and a 16-inch display. The 13-inch model contributed to sales in 2H FY3/17, but the 16-inch model was not commercialized until the end of the fiscal year. Therefore, sales of displays decreased 7.6% YoY in FY3/17 to ¥12,223mn.

In the Consumer Business, sales fell 38.6% YoY in FY3/17 to ¥1,321mn. The Consumer Business sells the Bamboo series of two product lines, stylus pens, which can be used on tablets produced by other companies (third parties), and digital stationery, which can digitize hand-written input. In FY3/17, sales of stylus pens fell substantially YoY because sales for use with the iPad dropped, reflecting intense competition and product quality defects. Sales of digital stationery were weak in 1H FY3/17 because the Company was about to replace its first-generation products with second-generation products, so potential customers postponed their purchases. In September 2016, it launched the second-generation Bamboo Slate/Bamboo Folio models of digital stationery, and these models sold well in 2H, but not well enough to offset the 1H weakness in sales of digital stationery.

In the Business Solution, net sales dropped 23.0% YoY in FY3/17 to ¥3,816mn. This sales decline was led by a sales fall in mainstay Europe and reflected the impact of yen appreciation against the euro and the impact of competitors' systems enabling the input of digital signatures using generally-sold mobile devices. Sales of some products, such as those for credit card settlement systems, grew in Japan and India, but not enough to compensate for the large sales drop in Europe.

FY3/17 sales in the Brand Business by product line

(¥mn)

	FY3/16	FY3/17						
	Full fiscal year results	1H results	2H results	Full-year forecast	YoY growth rate	Full fiscal year results	YoY growth rate	Ratio to sales
Brand product business	48,931	19,326	24,547	45,700	-6.6%	43,873	-10.3%	100.0%
Creative business	41,824	16,876	21,861	40,100	-4.1%	38,737	-7.4%	88.3%
Pen tablets	24,148	9,794	12,473	22,700	-6.0%	22,267	-7.8%	50.8%
Mobile	4,453	1,224	3,023	4,800	7.8%	4,247	-4.6%	9.7%
Display	13,223	5,858	6,365	12,600	-4.7%	12,223	-7.6%	27.9%
Consumer business	2,149	465	856	1,500	-30.2%	1,321	-38.6%	3.0%
Business solution	4,958	1,986	1,830	4,100	-17.3%	3,816	-23.0%	8.7%
Operating profit	8,035	2,051	3,633	6,500	-19.1%	5,684	-29.3%	-
Operating profit margin	16.4%	10.6%	14.8%	14.2%	-	13.0%	-	-

Source: Prepared by FISCO from the financial results summary

Demand remains strong for pen sensor systems for tablet PCs

3. Technology Solution Business

In the Technology Solution Business, net sales edged down 4.3% YoY in FY3/17 to ¥26,757mn, and operating profit fell 21.9% to ¥2,443mn. Despite these declines, net sales exceeded the Company's most recent forecast by 6.6% and operating profit surpassed its most recent forecast by 22.2%. The sales fall was due mainly to the sharp appreciation of the yen in the end of 2Q. However, shipments continued to grow YoY, and in 2H, when actual yen exchange rates were close to the Company's assumed rates, sales and profits improved relative to 1H.

Technology Solution Business results

(¥mn)

	FY3/16	FY3/17					
				Full fiscal year results			
	Full fiscal year results	1H result	2H results	November forecasts	March forecasts	Results	YoY growth rate
Sales	27,974	14,141	12,615	21,200	25,100	26,757	-4.3%
Operating profit	3,130	1,788	655	900	2,000	2,443	-21.9%
Operating profit margin (%)	11.2%	12.6%	5.2%	4.2%	8.0%	9.1%	-

Source: Prepared by FISCO from the financial results summary

Sales of components for smartphones dropped 19.2% YoY to ¥13,208mn. These components are all sold to Samsung Electronics. In 1H FY3/17, shipments of components for the Galaxy Note 7 smartphone grew briskly YoY, but in 2H, these shipments dropped sharply due to quality problems. In 2H, the business continued to produce parts for Samsung Electronics' previous generation of smartphone, the Galaxy Note 5, and it sold the remaining parts for the Galaxy Note 7 which had been initially ordered by Samsung, but 2H sales were only about half of 1H sales, leading to a large YoY fall in total sales for the full fiscal year.

Sales of components for tablet PCs increased 32.1% YoY in FY3/17 to ¥12,594mn, mainly because the number of tablet PC models using the Company's active ES pens increased, as did shipments of these pens to a wide range of tablet PC makers, including Hewlett Packard, Fujitsu (6702), and Huawei. Furthermore, the demand from Lenovo for the Company's Electronic Magnetic Resonance (EMR) digital pen sensor systems grew YoY, and Google started to use these systems in its Chromebook.

Sales of components for notebook PCs fell 54.3% YoY in FY3/17 to ¥956mn, mainly because market demand shifted from notebook PCs to 2-in-1 tablet PCs, and the market for notebook PCs shrank. From FY3/18, the Company plans to merge its subsector of components of notebook PCs with its subsector of components for tablet PCs.

Sales in the Technology Solution Business by product line

(¥mn)

	FY3/16	FY3/17						
	Full fiscal year results	1H Results	2H results	Full-year forecast	YoY growth rate	Full fiscal year results	YoY growth rate	Ratio to sales
Technology solution business	27,974	14,141	12,616	25,100	-10.3%	26,757	-4.3%	100.0%
For smartphones	16,353	8,435	4,773	12,900	-21.1%	13,208	-19.2%	49.4%
For tablets	9,532	5,162	7,432	10,600	11.2%	12,594	32.1%	47.1%
For notebook PCs	2,089	545	411	1,600	-23.4%	956	-54.3%	3.6%
Operating profit	3,130	1,788	655	2,000	-36.1%	2,443	-21.9%	-
Operating profit margin (%)	11.2%	12.6%	5.2%	8.0%	-	9.1%	-	-

Source: Prepared by FISCO from the financial results summary

Medium to long-term growth strategy

Company announced new initiatives to adopt a management approach stressing profitability and to improve the quality of management decisions

1. New initiatives from FY3/18

In April 2015, the Company announced its Wacom Strategic Management Plan SBP-2019 (medium-term management plan). However, the Company's performance in FY3/16 and FY3/17 fell far short of the targets contained in its management plan. Therefore, on March 14, 2017, the Company announced that it would abandon its SBP-2019 plan and instead adopt new group initiatives aiming to increase the Company's enterprise value over the medium term by switching to a management stance that stresses profitability.

The Company announced two new initiatives: 1) improve its cost structure to enable it to move to a position stressing profitability, and 2) improve the quality of its management decisions.

Summary of group's new initiatives (announced on March 14, 2017)

	New initiative		Concrete actions
1	improve cost structure	①	Review the plan to introduce a global IT infrastructure system
		②	Optimize the Company's global organization
2	improve the quality of management decisions	①	Establish a nomination committee
		②	Change the way of selecting the Chairman of the Board of Directors

Source: Prepared by FISCO from the financial results briefing materials

The Company plans to take two concrete actions to improve its cost structure. One is to scrap its plan to introduce a global IT infrastructure system. This plan had been part of its SBP-2019 management plan, and the Company had expected the introduction of this system to generate enough additional profit to earn a return on its investment. As the Company has abandoned its SBP-2019 plan, it has also terminated its plan to introduce remaining part of a global IT infrastructure system.

The second concrete action planned by the Company to improve its cost structure is to optimize its global organization. Before the Company adopted its SBP-2019 plan, it had organized important work flow, such as marketing, sales and other operations, along geographical lines. One component of the SBP-2019 plan was to reorganize these functions according to global business unit. The Company plans to maintain this basic business model while reducing or eliminating inefficient units and optimizing its global cost structure.

The Company also plans to take two concrete actions to promote constructive dialog in the Board of Directors and to enable a healthy transition of management. The first action is to establish a committee to nominate directors of the Board, including top management. This committee will establish standards for the selection of candidates for the position of director, and will submit its opinion on recommended candidates to the Board of Directors.

The second action is to change the rules governing the selection of the Chairman of the Board of Directors. The Company's current articles of incorporation specify that the Company President also serves as the Chairman of the Board. The Company intends to revise its articles of incorporation to allow the Board to select someone other than the Company President as the Chairman of the Board.

To establish a foundation for the rapid realization of these initiatives and concrete actions, the Company announced that it plans to change its top management. The current Company CEO, Mr. Masahiko Yamada, will attempt to achieve the Company's forecasts for FY3/18 while also conveying to his successor his vision for the Company's future and the knowledge he has accumulated through years of experience, enabling the continuous progress of operations. By the autumn of 2017, the nominating committee is expected to choose a candidate to assume the position of CEO. If he is confirmed as CEO, he will lead the effort to compile a new medium-term business plan for the Company, which the Company hopes to announce in May 2018.

2. Evaluating the "new initiatives"

Thinking about the background for the release of the Company's new initiatives and several events which affected its FY3/17 business results, FISCO notes the following points.

(1) Failure of new products to generate overall sales growth and Company response

As stated above, the Company attributed its poor performance in FY3/17 to two main causes, yen appreciation and a decline in sales in the Brand Business, the latter stemming from a delay in the launch of some new products and quality problems with some new products. Perhaps these problems in the Brand Business occurred because the Company's plan to develop new products exceeded its capacity in terms of personnel, equipment, and facilities.

The Company's decision to change the manner in which the Chairman of the Board is selected could imply that under the new CEO, management decisions will not be made by the CEO solely but by a management team. There is no evidence that a team can make better decisions than an individual, but we believe that administrative efficiency and quality of management decisions can be improved based on thorough discussions of the collective wisdom of the team members, thereby avoiding overcapacity in resources in the future and producing a management team that makes few mistakes.

(2) Reform of global organization and Company response

While net sales were lower than Company forecasts in every quarter of FY3/17, SG&A expenses were not cut as planned. FISCO believes that SG&A expenses remained firm because the Company's global organization did not make the change from a geographical basis to a business unit basis as completely as the Company had assumed. In fact, the wording of the Company's news release about its new initiatives implies that this was the case.

The Company plans to continue to model its global organization on business units, and we believe that this is a wise decision. To revert to a geographical basis of organization would probably cause confusion and increase costs. However, the Company did not specify any concrete measures to smooth the transition to an organization based on business units. It merely stated that it would minimize inefficient organization and optimize its cost structure. We believe that the Company should take measures in FY3/18 to smooth the transition to an organization based on business units, rather than wait for the new medium-term plan to appear next year to implement such measures.

(3) Reviewing of plan to introduce a global IT infrastructure system

In FY3/17, the Company claimed a large extraordinary loss on its software in progress account accompanying its plan to introduce a global IT infrastructure system. We doubt that it will claim such a loss in FY3/18, but the software that was completely developed in FY3/17 will be fully depreciated in FY3/18. This will most likely lead to an increase in the overall depreciation cost. Nonetheless, the Company should be able to offset this increase in depreciation cost by reducing its outsourcing cost, which ballooned in FY3/17, and some other costs.

The new initiatives released by the Company are based on programs to determine procedures and schedules. The Company is unlikely to fix a more formal basis for these initiatives until it announces its next medium-term business plan in May 2018. Thus, it is difficult to evaluate the initiatives, but we believe that its programs could generate meaningful changes as they refer to a new CEO to take office in a year.

Business outlook

Company aims for a return to profitability based on the full contribution of new products in the Brand Business

For FY3/18, the Company forecasts a 7.7% YoY rise in consolidated net sales to ¥76,800mn, an operating profit of ¥1,800mn, reversing the operating loss of ¥1,171mn in FY3/17, an ordinary profit of ¥1,740mn, reversing the ordinary loss of ¥870mn in FY3/17, and a net profit attributable to owners of the parent of ¥1,130mn, reversing the net loss of ¥5,534mn in FY3/17.

Company forecasts for FY3/18

(¥mn)

	FY3/17			FY3/18			
	1H results	2H results	Full fiscal year results	1H Results	YoY growth rate	Full-year forecast	YoY growth rate
Net sales	33,796	37,517	71,313	35,180	4.1%	76,800	7.7%
Gross profit	13,240	14,324	27,565	-	-	-	-
SG&A expenses	14,138	14,598	28,736	-	-	-	-
Operating profit	-897	-273	-1,171	-470	-	1,800	-
Operating profit margin	-2.6%	-0.7%	-1.6%	-1.3%	-	2.3%	-
Recurring profit	-1,021	150	-870	-500	-	1,740	-
Profit attributable to owners of parent YoY	-1,226	-4,308	-5,534	-100	-	1,130	-

Source: Prepared by FISCO from the financial results summary

The Company is assuming average yen exchange rates of ¥110 to the US dollar and ¥118 to the euro for FY3/18. Its effective average rates in FY3/17 were ¥109.03 per US dollar and ¥119.37 per euro. In the ¥/$ exchange rate, for each yen that weakens against the dollar, the Company's sales increase by ¥520mn per year (weak yen benefit), and operating profit increases by ¥30mn per year (strong yen benefit). Against the euro, for each yen that weakens against the euro there is an increase in sales of ¥140mn and operating profit of ¥100mn (both weak yen benefits).

For the Brand Business, the Company projects a 12.1% YoY upturn in sales in FY3/18 to ¥49,200mn and a 42.5% jump in operating profit to ¥8,100mn. The Company expects new models of mobile products and displays to drive an increase in sales and profits in the Creative Business. The prospects for sales of pen tablets in the Creative Business are similar to their sales pattern in FY3/17, unit sales in rapidly developing countries are likely to grow strongly, but the average price of tablets category will probably fall. The Company anticipates a recovery of sales and profits in the Consumer Business by sales of new digital stationery products.

For the Technology Solution Business, the Company foresees a 0.5% YoY increase in sales to ¥26,900mn and a 7.5% decline in operating profit to ¥2,260mm. It projects brisk growth in sales of components for tablet PCs and notebook PCs combined, but weak sales of components for smartphones. For 1H FY3/18, it forecasts lower than normal sales of smartphone components because it cannot expect parts shipments for Samsung Electronics' Galaxy Note 7 smartphone which Samusung has stopped production since FY3/17 as well as for Samsung Electronics' next-generation smartphone which is expected to contribute for parts shipment in 2H.

Company forecasts for FY3/18 by business

(¥mn)

		FY3/17			FY3/18	
					Full fiscal year	
		1H Results	2H results	Full fiscal year results	Forecast	YoY growth rate
Net sales	Brand business	19,326	24,547	43,873	49,200	12.1%
	Technology solution business	14,141	12,615	26,757	26,900	0.5%
	Other	327	354	682	700	2.6%
	Subtotal	33,796	37,517	71,313	76,800	7.7%
	Net sales total	33,796	37,517	71,313	76,800	7.7%
Operating profit	Brand business	2,051	3,633	5,684	8,100	42.5%
	Technology solution business	1,788	655	2,443	2,260	-7.5%
	Other	-13	-19	-32	40	-
	Subtotal	3,826	4,269	8,095	10,400	28.5%
	Adjusted amount	-4,724	-4,542	-9,266	-8,600	-
	Operating profit total	-897	-273	-1,171	1,800	-

Source: Prepared by FISCO from Company materials

FISCO believes that the Company's performance in FY3/18 is likely to depend on its sales of new products and the impact of these sales on overall sales growth, as well as progress in controlling costs, such as SG&A expenses. As noted earlier, the Company aims to improve its cost structure as part of its change in management approach towards a greater concern with profitability. More than a year will be needed to lower some costs, but despite this limitation, we believe that whether the Company can be successful in reducing costs in FY3/18 will indicate the probaility of improvement in the quality of its management and the likelihood of attaining the goals set in its next medium-term plan of operations. More specifically, we will monitor the extent to which the Company can stremline the organizations bearing cost duplication stemming from the difficult transition to an organization based on global business units and the extent to which it can lead to cut SG&A expenses.

The profit statement and the main indicators

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17	FY3/18	
					1H (F)	Full fiscal year (F)
Net sales	78,615	74,557	77,568	71,313	35,180	76,800
YoY	28.7%	-5.2%	4.0%	-8.1%	4.1%	7.7%
Gross profit	29,931	30,050	30,735	27,565	-	-
Gross margin	38.1%	40.3%	39.6%	38.7%	-	-
SG&A expenses	21,268	23,907	27,071	28,736	-	-
Ratio of SG&A expenses to net sales	27.1%	32.1%	34.9%	40.3%	-	-
Operating profit	8,663	6,142	3,664	-1,171	-470	1,800
YoY	9.5%	-29.1%	-40.3%	-	-	-
Operating profit margin	11.0%	8.2%	4.7%	-1.6%	-1.3%	2.3%
Recurring profit	8,282	6,064	3,776	-870	-500	1,740
YoY	9.6%	-26.8%	-37.7%	-	-	-
Profit attributable to owners of parent	5,249	3,473	2,309	-5,534	-100	1,130
YoY	10.0%	-33.8%	-33.5%	-	-	-
EPS after adjustment for share-split (¥)	31.31	20.86	14.00	-33.93	-0.62	6.96
Dividends after adjustment for share-split (¥)	17.50	18.00	18.00	6.00	-	6.00
BPS after adjustment for share-split (¥)	196.14	202.14	188.22	130.75	-	-
Capital investment amount	3,464	4,082	4,862	3,580	-	2,400
Depreciation and amortization	1,812	1,970	2,004	2,573	-	2,800
R&D expenses	2,863	3,180	4,342	4,397	-	4,900

Source: Prepared by FISCO from the financial results summary

Balance Sheet

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Current assets	42,751	40,073	40,187	37,873	39,499
Cash and deposits	21,596	15,393	16,686	14,365	14,204
Notes and accounts receivable	10,601	11,388	9,875	10,161	10,768
Inventories	5,483	9,329	10,216	10,097	11,664
Fixed assets	7,372	10,785	11,269	13,692	10,749
Tangible fixed assets	4,409	5,332	4,608	4,538	4,303
Intangible fixed assets	2,407	3,221	5,441	8,131	4,312
Investments and other assets	554	2,231	1,219	1,023	2,133
Total assets	50,124	50,859	51,456	51,566	50,249
Current liabilities	19,596	16,239	15,880	16,478	17,383
Accounts payable	11,818	9,429	9,203	6,102	7,481
Short-term debt	600	600	600	4,000	3,000
Fixed liabilities	1,316	1,820	1,717	3,991	11,508
Shareholders' equity	29,926	31,939	32,617	30,770	21,536
Capital	4,203	4,203	4,203	4,203	4,203
Capital surplus	7,573	7,563	7,550	7,513	6,098
Retained earnings	18,353	21,710	22,318	21,629	13,134
Treasury stock	-204	-1,538	-1,455	-2,576	-1,900
Total accumulated other comprehensive profit	-810	713	1,061	188	-306
Net assets, total	29,211	32,799	33,858	31,096	21,356
Total liabilities and net assets	50,124	50,859	51,456	51,566	50,249

Source: Prepared by FISCO from the financial results summary

Cash Flow Statement

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17
Cash flow from operating activities	5,894	733	6,782	2,009	121
Cash flow from investing activities	-1,611	-4,415	-3,277	-4,878	-3,479
Cash flow from financing activities	4,336	-3,255	-2,849	1,209	3,298
Gain or loss on translation of foreign currency cash and deposits	1,006	735	637	-661	-100
Change in cash and deposits balance	9,626	-6,202	1,292	-2,321	-160
Cash and deposits balance at start of fiscal year	11,969	21,596	15,393	16,686	14,365
Cash and deposits balance at end of fiscal year	21,596	15,393	16,686	14,365	14,204

Source: Prepared by FISCO from the financial results summary

Returns to Shareholders

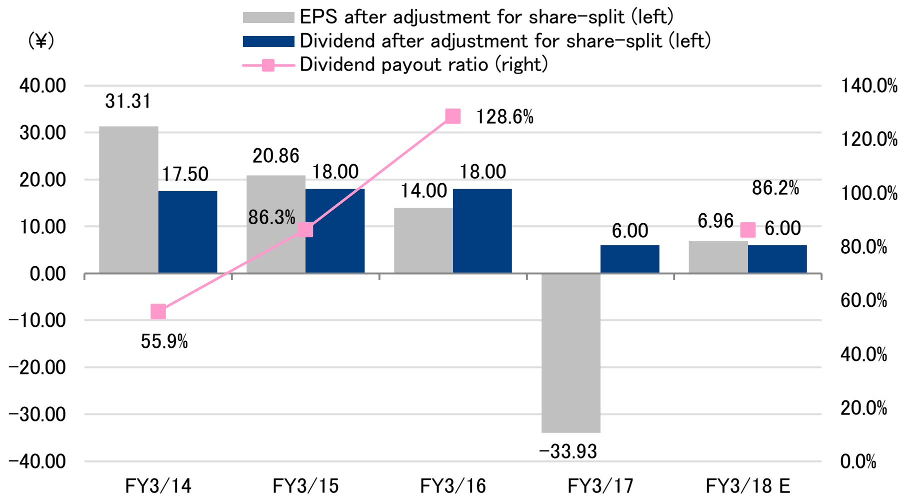
Despite the losses suffered in FY3/17, the Company is expected to pay dividends of ¥6 per share, indicating the importance it places on maintaining stable dividends

The Company's basic policy towards shareholder returns is to pay steady dividends based on its profits after considering the amount of funds to be retained for future business development and sound financial base. Management has made guidance of maintaining a dividend payout ratio of at least 40% in midium term, and to reduce the clerical cost of paying dividends, the Company pays them only once at the end of each fiscal year.

At the start of FY3/17, the Company planned to pay dividends of ¥18.0 per share for the year, but as it lowered its sales and profit forecasts, it also gradually reduced its planned dividends and ended up paying dividends of ¥6 per share. The Company suffered losses in FY3/17, but it decided that the risk of a further deterioration of financial condition was limited, and it considered the stable payment of dividends important. Thus, it continued to pay dividends for FY3/17, although lower than the dividends paid for FY3/16.

For FY3/18, the Company plans to maintain dividends of ¥6.0 per share, while it forecasts an EPS of ¥6.96, indicating a dividend payout ratio of 86.2%. We believe that this is a wise decision, which balances a recovery of profitability, the maintenance of financial health, and dividends stability.

Trends in net profit per share, dividend, and dividend payout ratio



Source: Prepared by FISCO from the financial results summary

The Company also buys back its outstanding shares when the opportunity arises as part of its basic policy to provide shareholder returns. It originally planned to buy back up to 5.0 million of its shares in FY3/17, but after buying 2,156,500 shares, it stopped further buybacks in line with downward revisions of its forecasts of performance. We pay attention on the Company's move that it may resume share buybacks in FY3/18 because it projects a return to profitability during the year.

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