COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

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Summary

In 1H FY3/22, progress was as expected despite a subsidence of stay-at-home demand that accompanied the coronavirus pandemic. Full-year profit forecasts for FY3/22 were revised upward. The Company also actively acquired treasury shares

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

1. 1H FY3/22 results

In the 1H FY3/22 consolidated results, net sales decreased 9.2% YoY to ¥50,259mn and operating profit decreased 12.3% to ¥7,560mn, as sales and profits both declined due to a subsidence of stay-at-home demand that accompanied the spread of the novel coronavirus (hereinafter, "coronavirus"), but even so, the Company made progress as expected. Furthermore, the level of earnings has surpassed that from before the coronavirus pandemic (FY3/20) and the base portion seems to be steadily rising. In particular, in the Branded Business, although sales decreased, sales of professional Displays grew steadily. On the other hand, in the Technology Solution Business, a significant decrease in sales resulted from change in the product portfolio of OEM partner manufacturer, and production supply chain restrictions such as the coronavirus pandemic and component shortages is partially becoming apparent. In earnings, operating profit decreased due to the downward pressure from lower sales, as well as conducting aggressive R&D investment. However, the cost to sales ratio improved markedly due to factors such as the impact of the yen's depreciation, the avoidance of additional tariffs on Chinese imports into the United Sates, and a decrease in the cost of Displays. In addition, selling, general and administrative expenses were controlled to be mostly level with the same period of the previous fiscal year through optimization of various expenses, enabling the Company to maintain a high operating profit margin.

2. FY3/22 results outlook

In its consolidated results forecasts for FY3/22, the Company has revised its initial profit forecast upward. However, even after the revision, the Company is projecting net sales to decrease by 6.0% YoY to ¥102,000mn, operating profit to decrease by 10.5% to ¥12,000mn, reflecting uncertainty associated with the impact of the coronavirus pandemic and lower sales and income expected under the baseline scenario. The upward revision in the profit forecast reflects the avoidance of additional tariffs on Chinese imports to the United States and a revision of the expected exchange rate and is not a revision of the initially expected baseline scenario itself. Therefore, the full year forecast of decrease in sales reflects the same main factors as for the first half, with expected decreases in stay-at-home demand for individuals and a highly competitive mid-priced models (Pen Tablets) in the Branded Business. Furthermore, the level of sales also reflects a certain procurement risk for major components in the production supply chain. On the other hand, for earnings, the Company expects to maintain its operating profit margin at a high level, despite a decrease in operating profit due to downward pressure on earnings due to the decrease in sales and continued active R&D investment for the future. In addition, regarding dividends, at this point, the initial forecast remains unchanged, with a ¥1.5 YoY increase on an ordinary dividend basis to ¥15 per share. Furthermore, the Company is actively working to acquire treasury stock.

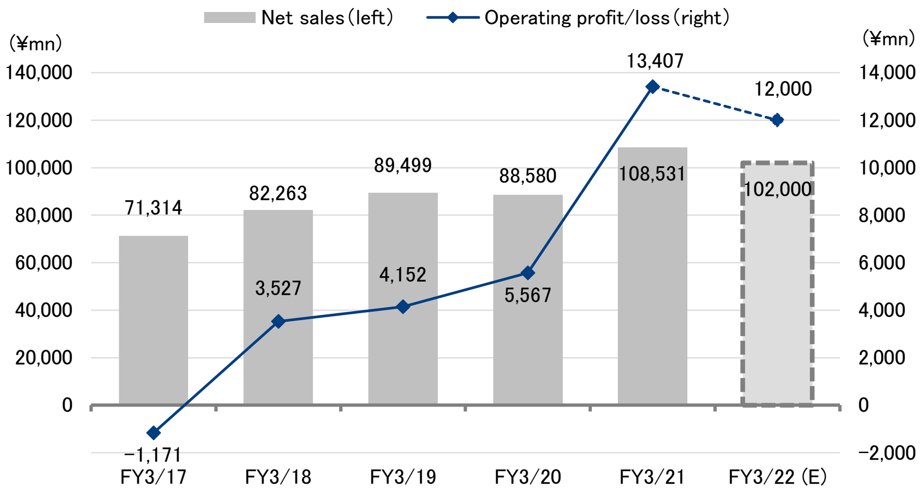
3. Growth strategy

The Company achieved the targets of “Wacom Chapter 2,” its medium-term business plan ending in FY3/22, one year early, and has therefore started a new medium-term business direction, “Wacom Chapter 3,” (FY3/22 to FY3/25). The new direction will promote the specific value propositions and sustainable growth, inheriting the vision of “lifelong ink,” and redefining five key strategic initiatives as well as six main streams for technology innovation for implementing the policy. In particular, the Company’s leading strategy is to select three fields that have a high affinity with its existing technologies–AI, XR, and Security–and realize new value propositions in these fields using new technologies and business models. Taking the growth of existing businesses as a baseline and adding the impact of new core technologies and business models, the policy aims for double-digit growth.

Key Points

- In 1H FY3/22, results were within expectations, despite decreases in sales and profits due to a subsidence of stay-at-home demand that accompanied the coronavirus pandemic.
- Sales of professional Displays grew briskly due to the resumption of economic activity, while entry-user products were also likely to experience significant sales expansion compared to FY3/20 prior to the coronavirus pandemic, which had a certain effect on lifting the base portion. The Company also actively pursued acquisitions of treasury stock.
- Full-year profit forecast for FY3/22 has been revised upward. However, the baseline scenario has not been revised, and sales and profits are expected to decrease for the full year.
- The new medium-term business direction Wacom Chapter 3 started from the current fiscal year. Aiming for growth acceleration with the establishment of new core technologies and new business models.

Results trends



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

Business overview

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

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

The Company is also striving to create new growth opportunities by rebuilding product line-ups and further evolving the business model amid major changes in the market environment, including tougher competition in low- and mid-priced product categories and evolution of user needs and workflow, as well as the spread of online education and teleworking accompanying advances in digital technologies (IoT, VR/MR, AI, and others) and the communications environment (mobile, cloud, 5G, and others). In particular, although at the current time the coronavirus pandemic is having both positive and negative effects, the Company is entering the next growth phase by capturing new demand from the new normal.

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

With the overseas sales ratio (overseas local entity sales ratio excluding the Technology Solution Business) at about 87%*, careful attention should be given to the impact of foreign exchange market fluctuations on earnings (in particular, fluctuations in the euro-yen rate have a major impact on operating profit).

* According to 1H FY3/22 consolidated results, the U.S. accounts for approximately 33% of the total, Asia and Oceania approximately 31%, and Europe (Germany) approximately 23%.

Additionally, while development sites are practically all concentrated in Japan, excluding developments of digital ink and security-related software (which are mainly in Europe), the Company consigns production to multiple overseas partners (which are mostly major electronics manufacturing service companies owned by either Japanese or Taiwanese with production bases in mainland China). However, from a perspective of mitigating regional concentration risk in the supply chain, the Company is proceeding to disperse its production sites into the surrounding Southeast Asia region (Taiwan and Vietnam, etc.) As a result, in 2Q FY3/22, the Company recorded temporary cost of sales improvement effects equivalent to approximately ¥0.7 billion yen, including the impact of the avoidance of additional tariffs on Chinese imports to the United States which were incurred in the preceding fiscal years.

Business and major product features

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

1. Branded Business

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

(1) Creative Solution

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

a) Displays

This category covers products that use an LCD panel as the tablet* and are similar to Mobiles, which are explained below, in terms of directly writing on an LCD screen with a digital pen. Meanwhile, they are also 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 ¥200,000 to ¥400,000. 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 and demand shift from Pen Tablets), it released multiple new models including a 16-inch entry model with an actual sales price in the ¥60,000 to 70,000 range (tax exclusive; same below) in January 2019, a 22-inch model (actual sales price in the ¥100,000 to 110,000 range) in July 2019, and a 13-inch model for beginners (actual sales price in the ¥30,000 to 40,000 range) in January 2020. The Company is gaining a stronger presence even in the entry model segment where it faces tough price competition from other companies (Chinese manufacturers, etc.).

* Sometimes referred to as "LCD pen tablets" too.

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, competition has intensified in the low- to mid-priced category where it is difficult to achieve differentiation. Furthermore, since the Company has strategically shifted management resources in response to a demand shift toward Displays with better operability and lower prices, sales have been steadily trending downward in the past few years.

* Sometimes referred to as "opaque pen tablets" too.

c) Mobiles, others

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

(2) Business Solution

The Company sells business-use products that are capable of direct drawing and character entry on an LCD screen. Usage is increasing in digital signature (hotel check-in, credit card payments, etc.) and medical (electronic medical records, etc.) areas.

2. Technology Solution Business

This business is divided into two segments, AES Technology Solution and EMR Technology Solution, based on digital pen technologies*. It supplies pen sensor systems to smartphone and tablet and notebook PC manufacturers. In particular, the Company is expanding sales to Samsung Electronics <KRX: 005930> (Galaxy series) in smartphone-related use, a growing market. Tablet and notebook PC manufacturers highly rate the Company's technology, and it deals with major manufacturers and the number of projects is steadily growing. The Company aims to expand business scale through promotion of its proprietary digital pen technology as a de facto standard, while expanding the scope of users.

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

Financial highlights

In 1H FY3/22, progress was as expected despite a subsidence of stay-at-home demand that accompanied the coronavirus pandemic. Sales of Professional Displays expanded steadily

1. 1H FY3/22 results

In the 1H FY3/21 consolidated results, net sales decreased 9.2% YoY to ¥50,259mn, operating profit declined 12.3% to ¥7,560mn, ordinary profit decreased 9.5% to ¥7,661mn, and profit attributable to owners of parent decreased 8.2% to ¥5,766mn, as the Company made progress as expected, despite decreases in sales and profits due to the subsidence of stay-at-home demand associated with the coronavirus pandemic. Moreover, the level of earnings* exceeded pre-coronavirus levels, with the base portion rising steadily.

* In FY3/20, which was the period prior to the coronavirus pandemic, consolidated net sales was ¥46,932mn, operating profit was ¥3,010mn, ordinary profit was ¥2,548mn, and profit attributable to owners of parent was ¥2,208mn.

In net sales, sales decreased in both the Branded Business and the Technology Solution Business. In the Branded Business, there was a slight decrease in sales compared to the same period of the previous fiscal year, when there was a surge in stay-at-home demand associated with the coronavirus pandemic. However, sales of mainstay professional Displays grew steadily. On the other hand, in the Technology Solution Business, sales decreased significantly due to change in the product portfolio of OEM partner manufacturer. And production supply chain restrictions* is partially becoming apparent. Therefore, it seems that temporary factors have played a significant part in the results.

* The impact of a resurgence in coronavirus infections in Southeast Asia and a global semiconductor shortage, etc.

In earnings, operating profit decreased due to downward pressure on profits from the decrease in sales and the impact of the product mix*1, as well as active investment in R&D. However, the cost to sales ratio improved markedly due to factors such as 1) the impact of the yen's depreciation*2, 2) the avoidance of additional tariffs on Chinese imports into the United Sates*3, and 3) a decrease in the cost of mainstay Displays. In particular, 3) as a notable point in that it also mitigated the impact of the product mix. Furthermore, SG&A expenses were maintained approximately level YoY despite active R&D investment for future growth acceleration, due to optimization of each expense item.

*1 The low compositional ratio of Pen Tablets in the Branded Business, which have a relatively low cost-to-sales ratio, was a factor that deteriorated the overall profit margin.
*2 According to the Company's calculations, this factor increased operating profit by approximately ¥0.9bn.
*3 The main production processes for some of the product lines in the Branded Business have been relocated to areas outside of mainland China (Taiwan, etc.), and for certain models exported to the United States, U.S. Customs and Border Protection has permitted non-application of additional tariffs on imports from China. This appears to have reduced cost of sales by approximately ¥0.7bn.

Looking at the Company's financial position, total assets decreased by 6.1% from the end of the previous fiscal year to ¥66,830mn, mainly reflecting a decrease in liquidity on hand (cash and deposits), and an increase in inventories to prepare for supply chain impacts (component shortages). On the other hand, shareholders' equity increased 4.7% to ¥39,445mn, due to the accumulation of internal reserves, so the equity ratio improved to 59.0% (52.9% at the end of the previous fiscal year).

1H FY3/22 financial results

(¥mn)

	1H FY3/21		1H FY3/22		Change	
	Results	% of sales	Results	% of sales	Amount	%
Net sales	55,326		50,259		-5,067	-9.2%
Branded Business	26,053	47.1%	25,879	51.5%	-174	-0.7%
Technology Solution Business	29,273	52.9%	24,380	48.5%	-4,893	-16.7%
Cost of sales	34,631	62.6%	30,564	60.8%	-4,067	-11.7%
SG&A expenses	12,077	21.8%	12,134	24.1%	57	0.5%
Operating profit	8,618	15.6%	7,560	15.0%	-1,058	-12.3%
Branded Business	4,276	16.4%	5,494	21.2%	1,218	28.5%
Technology Solution Business	6,481	22.1%	4,217	17.3%	-2,264	-34.9%
Adjustment	-2,139	-	-2,151	-	-12	-
Ordinary profit	8,469	15.3%	7,661	15.2%	-808	-9.5%
Profit attributable to owners of parent	6,282	11.4%	5,766	11.5%	-516	-8.2%

	End of March 2021 Results	End of September 2021 Results	Change	
			Amount	%
Total assets	71,181	66,830	-4,351	-6.1%
Shareholders' equity	37,689	39,445	1,756	4.7%
Equity ratio	52.9%	59.0%	6.1pt	-

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

Breakdown of SG&A expenses

(¥mn)

	1H FY3/21 Results	1H FY3/22 Results	Change	
			Amount	%
Personnel expenses	5,350	4,832	-518	-9.7%
R&D expenses	1,978	2,279	301	15.2%
Sales promotion and advertising expenses	826	983	157	19.0%
Freight and packing expenses	652	668	16	2.5%
Outsourcing expenses	602	655	53	8.9%
Depreciation	330	236	-94	-28.4%
Other	2,341	2,482	141	6.0%
Total	12,077	12,134	57	0.5%

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

2. Results overview by segment

(1) Branded Business

Net sales decreased by 0.7% YoY to ¥25,879mn, and segment profit was up 28.5% to ¥5,494mn, with profits increasing despite a fall in sales. While sales fell in the Creative Solution product category as stay-at-home demand and other factors subsided, sales in the Business Solution category grew, mainly in Europe, so that overall there was only a slight decrease in segment sales. In earnings, the segment secured significant gains, mainly due to the impact of the yen's depreciation, the avoidance of additional tariffs on Chinese imports into the United Sates, and a decrease in the cost of mainstay Displays.

Earnings breakdown in the Branded Business

(¥mn)

	1H FY3/21 Results	1H FY3/22 Results	Change	
			Amount	%
Creative Solution	24,425	23,731	-694	-2.8%
Displays	10,759	11,262	503	4.7%
Pen Tablets	12,580	11,430	-1,150	-9.1%
Mobiles, others	1,086	1,039	-47	-4.3%
Business Solution	1,628	2,148	520	31.9%

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

a) Creative Solution sales

Net sales decreased 2.8% YoY to ¥23,731mn. By product, Displays saw higher sales, while Pen Tablets and Mobiles, others saw lower sales. In Displays, sales of entry models faltered, while sales of professional products grew significantly, capturing expansion in creative demand (anime, movies, games, etc.) associated with the resumption of economic activity. Meanwhile, Pen Tablet's saw sales growth in professional products and low-priced models, while medium-priced models experience a sharp drop in sales due to the subsidence of demand. In Mobiles & others, sales of stylus pen which is not categorized under Mobiles decreased.

b) Business Solution sales

Net sales increased 31.9% year on year to ¥2,148mn. Proactive sales activities associated with the resumption of economic activity led to significant sales growth for LCD pen tablets, primarily in Europe.

(2) Technology Solution Business

Net sales decreased 16.7% YoY to ¥24,380mn, while segment profit declined 34.9% to ¥4,217mn, for lower sales and profits. Net sales reflected a significant decrease in the EMR Technology Solution segment, despite growth in sales in the AES Technology Solution segment. In earnings, profits felt downward pressure from lower sales, while R&D investment for the development of next-generation technologies also contributed to the decrease in profits.

Earnings breakdown in the Technology Solution Business

(¥mn)

	1H FY3/21 Results	1H FY3/22 Results	Change	
			Amount	%
AES Technology	8,987	9,888	901	10.0%
EMR Technology, others	20,286	14,492	-5,794	-28.6%

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

a) AES Technology Solution sales

Net sales increased 10% YoY to ¥9,888mn. The Company secured higher sales despite the impact of production supply chain restrictions and so forth as Active ES format digital pens have continued to be highly regarded by manufacturers to which the Company is an OEM supplier.

b) EMR Technology Solution, others sales

Net sales decreased 28.6% YoY to ¥14,492mn. The decrease reflected changes in the product portfolio of manufacturers to which the Company is an OEM supplier (temporary impact associated with new product release) and production supply chain restrictions.

3. Key takeaways of 1H FY3/22 results

Comprehensively assessing the 1H FY3.22 results from the above, there were decreases in sales and profits compared with the same period of the previous fiscal year, when demand rose sharply due to the coronavirus pandemic. However, looking at these in detail, we can see the impacts of both negative and positive aspects, such as a fallback due to the subsidence of temporary demand and an increase in demand following the resumption of economic activity, as the Company gradually returns to its original form with an eye on the new normal. From this perspective, we can see that the increase in the level of earnings over FY3/20 due to the capture of creative demand which make up the Company's core business and expansion of usage in the education field represent a steady growth trajectory. Meanwhile, although it is necessary to note the potential for hindrance from production supply restrictions, such as the resurgence of coronavirus in Southeast Asia and the global semiconductor shortage, there is also significant room for business expansion, such as growth in creative demand, expanded use in the education field*1, contribution to various social infrastructure DX*2, and coordinated movement with other companies' products. The Company's steady progress on activities to incorporate these factors (sales activities, R&D investment, etc.) should be recognized and commended.

*1 The spread of hybrid lessons combining online and face-to-face formats, and installation on educational devices, etc.
*2 Incorporation in the healthcare field and corporate documentation flows, use for various public and municipal government services and future electronic voting, etc.

Main results of activities

Steady progress on initiatives to realize new value propositions through technology leadership and community links

1. Launch of new professional product, Wacom Cintiq Pro 16 (2021)

On October 26, 2021, the Company announced a new Display, "Wacom Cintiq Pro 16" designed to offer ease of use for creators. The product features natural drawing feel and diverse expressive capabilities realized through the Company's accumulated expertise and technologies. It also incorporates improvements to functionality and operability that reflect user feedback. With these features, the product not only enables intuitive expression of the creator's inspiration but is also able to bring flexibility to working environments and spaces as a creative tool.

2. Deployment in next-generation smart education services through collaboration with Z-KAI Group

The Company entered into a comprehensive business alliance agreement with Zoshinkai Holdings Inc. (Z-KAI Group) for the use of Handwriting x Digital in the education field, under which the Company's digital pens are included on Z-KAI Group's exclusive tablet with pen, and the two companies have developed a writing app that runs on the tablet, which has finally reached the operation stage. Going forward, the Company will use the data obtained from the app to determine how to further develop new education services. To achieve this, the Company plans to further promote joint development for creating new educational experiences through digital ink and AI.

3. Start of the KISEKI ART Project

The Company has started a project in collaboration with Preferred Networks Inc. and CELSYS, Inc. in a project for grasping the creation process of pen and brush strokes using digital technology (visualizing the traces of creation), inspired by the idea that “the data from the traces of creation by creators and animators has value comparable to the works themselves, and is an asset that should be attributable to the artist.” Through this project, artists themselves can obtain insights that will help them to improve their skills, and it will be possible to support various activities such as proposing new value for enjoying art works. This is one of the initiatives for new value proposals through combination of new core technology (AI) promoted in “Wacom Chapter 3.” To begin, the companies held a joint exhibition of concept works in the open event, “Connected Ink,” * held by the Company during November 16-17, 2021.

> * An open event sponsored by the Company every year in a hybrid format connecting venues of Tokyo, Beijing, Dusseldorf, and Portland online. This time, the theme was “Creative Chaos”, created with partners in diverse domains including art, education, and technology by thinking about the source of human creativity. It is an event where people can experience the Company’s community engagement (contribution to society), and get a glimpse of various initiatives with partners and new challenges of the Company in addition to the projects introduced at the event. The contents of “Connected Ink 2021” can be viewed from the event’s homepage.

4. Digital pen technology featured in Samsung’s “Galaxy Z Fold3 5G”

The Company’s digital pen technology was adopted for the “S Pen” for the “Galaxy Z Fold 3 5G,” the world’s first folding smartphone with pen announced by Samsung Electronics on August 11, 2021. The S Pen can write freely on the 7.6 inch folding main display and uses a new construction optimized for this device. The force applied to the pen tip can be appropriately adjusted to protect the screen surface, allowing the pen to be used freely without damaging the screen. In addition, the Electromagnetic Resonance (EMR) sensors have been arranged through repeated trial and error to suit the folding construction, to realize a construction that can adequately withstand repeated opening and shutting action. This allows users to take handwritten notes on the screen while participating in a video meeting or confirm a to-do list while reading an email much more easily than ever before. In addition, users can make full use of the large screen for creative work, enabling them to carry out operations efficiently.

5. Other

The Company has achieved various results through initiatives to realize new value proposals through collaboration with technology leadership and communities (partners). These included expansion of products officially recognized as meeting the standard for technological compatibility with Chromebooks (officially designated products), which have drawn attention due to demand in the education sector and for teleworking, and expansion of inclusion in pen-equipped education devices through collaboration with Benesse Corporation, and development in the area of digital stationery through collaboration with Fujitsu Group <6702> and LAMY (equipment for QUADERNO electronic paper).

Outlook

Upward revision of full-year earnings forecasts for FY3/22. Decrease in sales and profits expected under the baseline scenario, considering the uncertainties associated with the effects of the coronavirus pandemic

For the FY3/22 consolidated results outlook, the Company has revised its initial profit forecast upward. However, even with this revision, the Company expects sales and profits to decrease under its baseline scenario, considering the uncertainties associated with the effects of the coronavirus pandemic. Forecasts are for net sales to decrease 6.0% YoY to ¥102,000mn, operating profit to decrease 10.5% to ¥12,000mn (revised upward by ¥1,000mn), ordinary profit to decrease 14.8% to ¥12,000mn (revised upward by ¥1,000mn), and profit attributable to owners of parent to decrease 13.9% to ¥8,800mn (revised upward by ¥800mn).

The main reason for the revision of the profit forecast is that the Company has factored in the successful avoidance in the Branded Business of additional tariffs on imports from China in the United States and an improvement in the expected exchange rate based on foreign exchange market trends*. The baseline scenario under the initial forecast has not been significantly revised.

* The envisaged foreign exchange rates for the Japanese yen have been revised from ¥105 to ¥108 for the U.S. dollar from October 2021 onward and from ¥125 to ¥128 for the euro from October 2021 onward.

That is to say, in net sales, lower sales are expected in both the Branded Business and the Technology Solution Business. Expectations of a particularly steep decrease in sales in the Branded Business reflect the incorporation of decreases in stay-at-home demand for individuals and sales of mid-priced models (Pen Tablets), which face strong competition. In addition, a certain level of procurement risk for core products in the production supply chain is factored in.

Meanwhile in earnings, operating profit is expected to decrease due to the impact of lower sales on profits and continued active R&D investment for the future. As a result, the operating profit margin is also expected to decline to 11.8% (from 12.4% in the previous fiscal year), but the Company is expected to secure a high level for the operating profit margin through cost reduction and optimization of SG&A expenses.

Forecasts for FY3/22 (after revision)

(¥mn)

	FY3/21		FY3/22				Change	
	Results	% of sales	Initial forecasts	% of sales	Revised forecasts	% of sales	Amount	%
Net sales	108,531		102,000		102,000		-6,531	-6.0%
Branded Business	56,678	52.2%	51,500	50.5%	51,500	50.5%	-5,178	-9.1%
Technology Solution Business	51,853	47.8%	50,500	49.5%	50,500	49.5%	-1,353	-2.6%
Cost of sales	67,123	61.8%						
SG&A expenses	28,000	25.8%						
Operating profit/loss	13,407	12.4%	11,000	10.8%	12,000	11.8%	-1,407	-10.5%
Branded Business	9,096	16.0%	7,500	14.6%	8,500	16.5%	-596	-6.5%
Technology Solution Business	9,260	17.9%	8,200	16.2%	8,200	16.2%	-1,060	-11.5%
Adjustment	-4,949	-	-4,700	-	-4,700	-	249	-5.0%
Ordinary profit	14,091	13.0%	11,000	10.8%	12,000	11.8%	-2,091	-14.8%
Profit attributable to owners of parent	10,226	9.4%	8,000	7.8%	8,800	8.6%	-1,426	-13.9%

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

Below we review results outlooks and activity policies by business area.

(1) Branded Business

Net sales are forecast to decrease 9.1% YoY to ¥51,500mn and segment profit to decrease 6.5% to ¥8,500mn. The net sales forecast incorporates the risk of a partial decrease in demand for individual home-use hobby applications, etc., despite growth in professional products. In earnings, the outlook takes into account the abovementioned demand forecast as well as active R&D investment for the future, etc.

(2) Technology Solution Business

Net sales are forecast to decrease 2.6% YoY to ¥50,500mn and segment profit to decrease 11.5% to ¥8,200mn. The Company's policy is to maintain and develop strong relationships with its major customers while aiming to capture business opportunities leading to the fields such as digital transformation (DX) in education. The Company will also engage in active R&D investment for the future.

Results trends in past years

Technology Solution Business driving growth over the past few years

Looking at how sales trended up to the previous period, prior to the coronavirus pandemic, the sudden, large slump in FY3/17 occurred because of the combined impacts of yen appreciation, product cycle movement, product recalls by Samsung Electronics, and other factors. Since then, however, sales recovered with growth in the Technology Solution Business. Nevertheless, Branded Business sales have been trending lower with the structure of positive growth in the Technology Solution Business continuing to offset its decline. However, the Brand Business experienced rapid growth in sales in FY3/21, mainly for online education due to the coronavirus pandemic, and achieved new record high earnings.

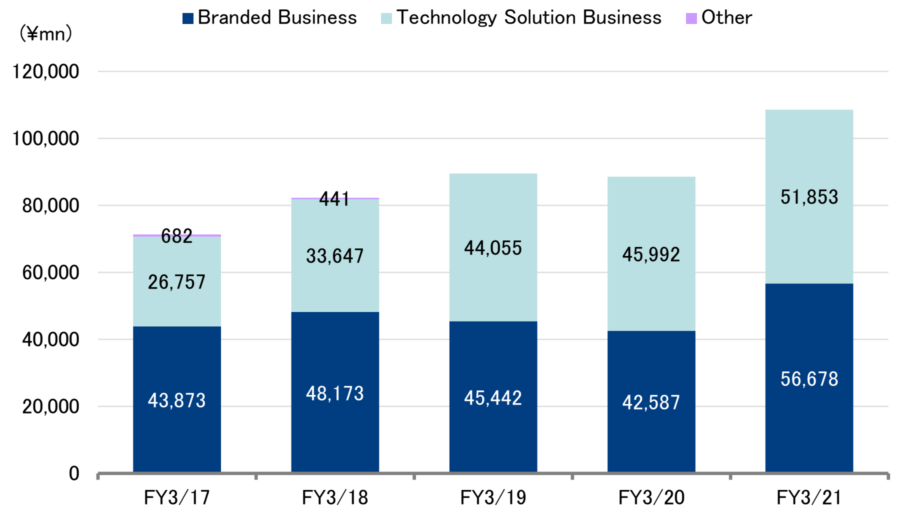
The main reason for the contracting trend in the Branded Business sales through to FY3/20 had been the need for time to fully compensate for growing competition in low- and mid-priced products in Pen Tablets, which had been a mainstay product, through a strategic demand shift to Displays. However, Displays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

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

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

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

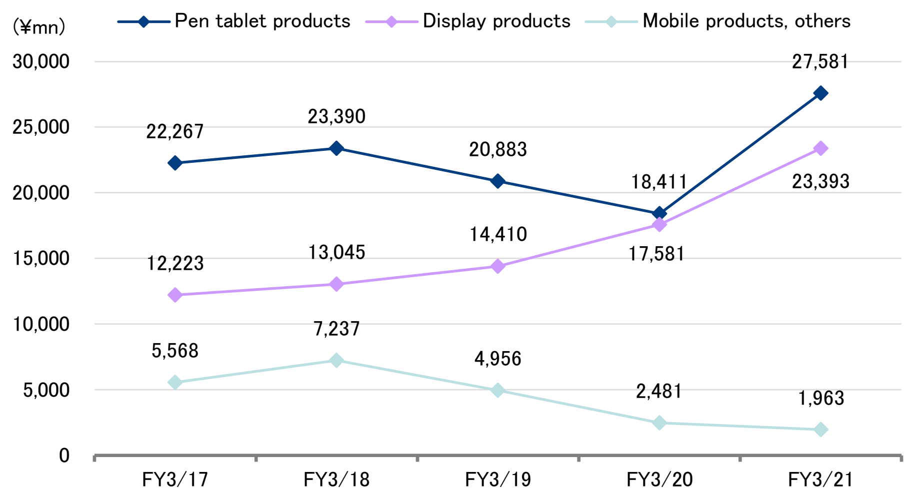
Trends in net sales by business



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

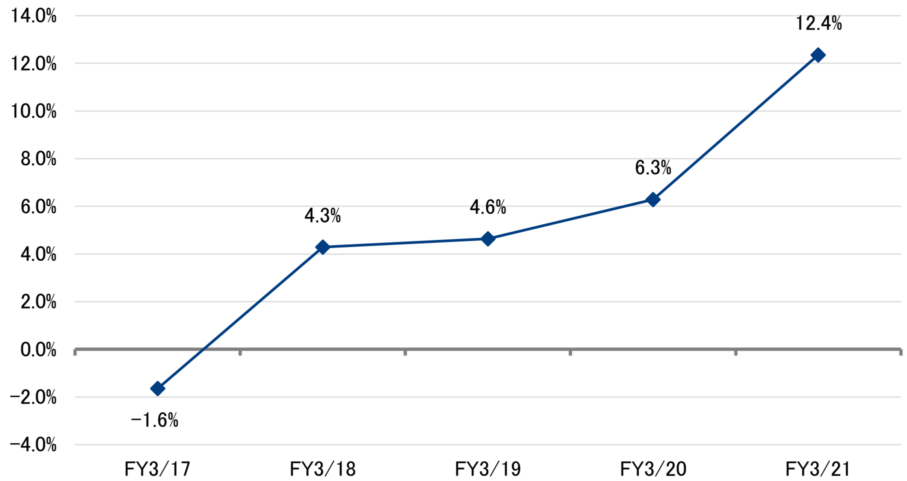
Results trends in past years

Sales trends in major products



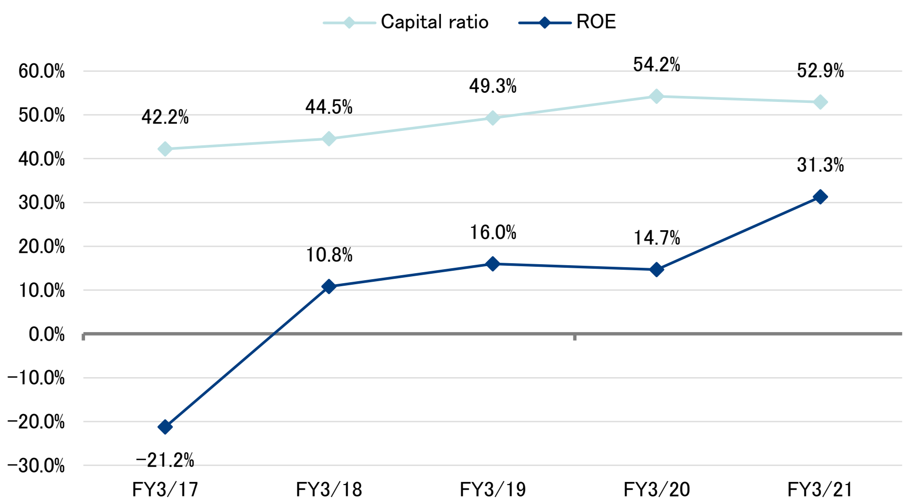
Source: Prepared by FISCO from the Company's financial results

Trends in operating profit margin



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

Trends in capital ratio and ROE



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

Growth strategy

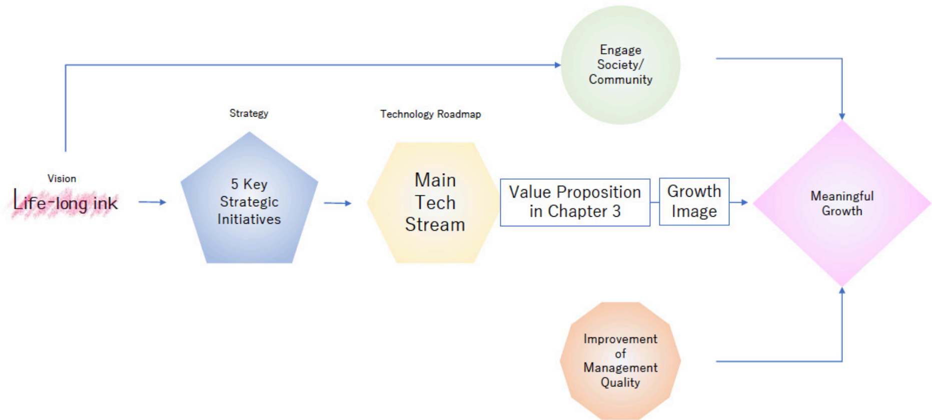
Start of Wacom Chapter 3, the new medium-term business direction

The Company has been progressing Wacom Chapter 2, its medium-term business plan through to FY3/22. However, having achieved the key performance indicators on year in advance, it has started a new medium-term business direction, Wacom Chapter 3 (FY3/22 to FY3/25).

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

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

Storyline of Wacom Chapter 3



Source: From the Company's results briefing materials

1. Five key strategic initiatives

(1) Technology Leadership

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

(2) Community Engagement

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

* For three days from May 22, 2021, the Company held the Drawfest live-streamed viewer-participation event. Popular illustrators and manga creators around the world gave online seminars and workshops on drawing and held participative programs for viewers to complete drawings all together within the time frame. Furthermore, from July 28 to 30, 2021, the Company held "Manga & Anime Days."

(3) New Core Technology, New Value Proposition

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

*1 The Company entered a comprehensive business alliance agreement with Z-kai Group for the use of Handwriting x Digital in the education field and has also been working on joint development with sdtech Inc. towards use of AI in Handwriting x Digital, among others.

*2 A system that uses digital signature authentication technology to certify digital art works by incorporating a signature into the digital artwork and its certificate, thereby preserving and circulating the copyright of the creator.

*3 New creation experiences that involve joint creation by multiple and remote creators, as well as free exchange between 2D and 3D.

(4) Technology Innovation for Sustainable Society

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

(5) Meaningful Growth

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

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

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

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

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

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

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

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

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

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

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

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

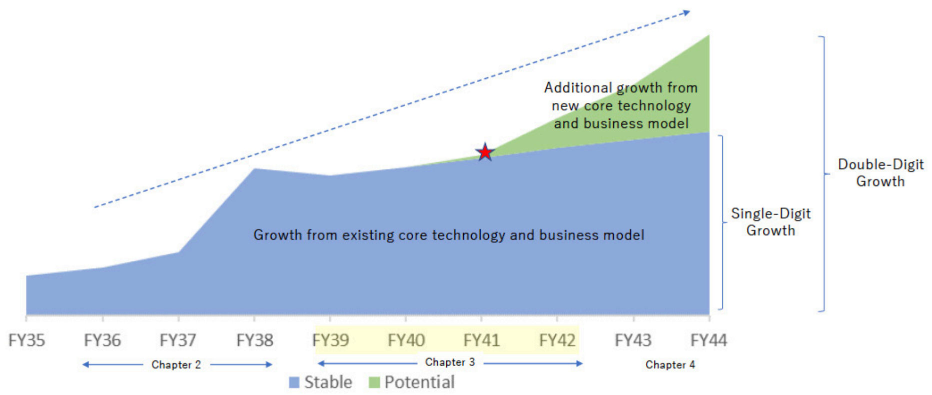
(6) Security x Digital ink (new core technologies/ new business models)

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

3. Envisaged growth and financial policy

Through the new medium-term business direction, Wacom Chapter 3, the Company will further promote its current core technologies and business model, while working to accelerate growth in the next stage by taking a strategic focus on establishing new core technologies and business models. The direction does not set numerical targets for a single point in four years' time but has set out expectations for the Company's growth direction and progress on its strategic initiatives. However, in its envisaged growth scenario, the Company has a baseline of stable growth through its current core technologies and business models, with plans to establish new core technologies and business models in the second two years, and then increase growth into the double-digit range in the next stage, starting from the fifth year onward. Furthermore, for its financial policies, the Company has 1) set ROIC of 25–30% as a new indicator and will target 2) ROE around 20%, and 3) dividend payout ratio around 30%. In addition, the Board of Directors will engage in frank and active discussion, keeping a close eye on the efficiency of business activities and capital efficiency in order to increase the feasibility of growth.

Envisaged growth scenario under Wacom Chapter 3 (operating profit)



Note: Timeline from FY39 to FY42 shows the period from FY3/22 to FY3/25
Source: From the Company's results briefing materials

4. Focus points identified by FISCO analysts

We see Wacom Chapter 3, as an important basis for forecasting the Company's direction and future potential, as it establishes three new technologies (AI, XR, security) and new business models during the target period and has a major focus on how the Company will go about creating a platform for accelerating growth. 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. However, the Company's policy of avoiding red oceans with harsh competition and aiming to create value in new markets (blue oceans) is reasonable. From another perspective, the very fact that the Company is in a position to attempt this can also be seen as a significant advantage. In particular, with regard to new value propositions using digital ink and AI, movement has already started in the education sector, and there is potential for various other sectors as well. If the Company can accumulate data and expertise ahead of other companies, the chances of it being able to establish an unrivaled position in innovative domains becomes much greater. If it can achieve this, it is also likely to expedite collaboration with leading partners. Against a backdrop of widening the base of entry user products and progress on cost reduction, the base of users with experience of digital pens and digital ink is certainly expanding even while caught up in the coronavirus pandemic. Furthermore, in terms of new business models, the Company seems likely to focus on providing Software as a Service (SaaS), and an important point to focus on will be how the shift to a fee based revenue model will impact on the Company's growth and earning potential.

Initiatives for society

Supporting a sustainable society through provision of "lifelong ink"

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

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

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

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

The Company considers responding to climate change to be an important issue in environmental management. It has joined the Japan Climate Initiative (JCI) and announced CO_2 emissions targets to be reached by fiscal 2030 by reducing its CO_2 emissions by an annual rate of 2.5% (reference year: 2014). This initiative includes efforts to publish environmental performance information, such as the reduction of greenhouse gases (GHGs) and CO_2 emissions (Scope 1, Scope 2). At the same time, the Company conducts business activities based on analysis of the risks and opportunities to the business environment created by climate change. In addition, as an action that leads to a reduction in CO_2 emissions in the value chain as a whole, it requires that its suppliers support and implement the Wacom Supplier Code of Conduct. The Company is also progressing the formulation of a BCP to respond to the risk of a restriction to corporate activities due to floods and other natural disasters, which are increasing year by year.

Returns to shareholders

The forecast dividend for FY3/22 is ¥15 per share. The Company will also actively acquire treasury shares

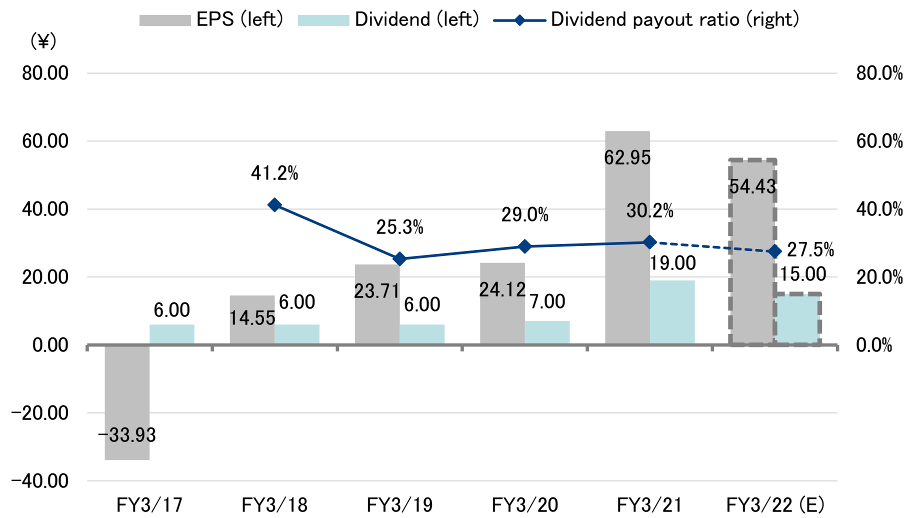
The Company's basic policy towards shareholder returns is to pay steady dividends on its profits after considering the amount of funds to be retained for future business development and a sound financial base. The Company had previously set a dividend payout ratio of around 40% as the standard for the dividend level, but from FY3/18, it lowered it to around 30%. This was in order to solidify the foundations for growth in the future and was necessary to increase its financial soundness, while the background is the fact that it has set a target to aim for at the present time of around 60% for the equity ratio (it was 52.9 % at the end of FY3/21). Also, the Company only pays dividends once at the end of the fiscal period in consideration of keeping down administrative costs.

The Company is targeting a ¥1.5 hike to a ¥15/share dividend in FY3/22 on an ordinary dividend basis, and at the current time it has left the initial forecast unchanged.* While closely observing the progress made in results, in the event that an environment is in place in which it can revise the dividend forecast, the Company has indicated that it will quickly disclose the revised amount. In any case, the Company has started the first fiscal year of Wacom Chapter 3 by increasing the dividend on an ordinary dividend bases, and it appears that it intends to further increase the dividend in line with medium- to long-term growth.

* The dividend for FY3/21 was ¥19/share (ordinary dividend of ¥13.5 and special dividend of ¥5.5).

On May 12, 2021, the Company announced its intention to conduct a treasury stock acquisition for a total amount of ¥10.0bn over the period until March 31, 2025, and accordingly it acquired approximately ¥1.0bn of treasury stock (1.35 million shares) over the period from August 2 to August 10, 2021. In addition, on October 29, 2021, the Company resolved to acquire treasury stock up to a limited of ¥2.0 billion or 4 million shares (acquisition period: November 1, 2021 to January 28, 2022). The initiative appears to be intended as a use for cash flow, giving consideration to a balance between investment and shareholder returns.

Trends in EPS, dividend, and dividend payout ratio



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

Company profile

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

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

In 1991, it entered into the pen sensor components field (currently, the Technology Solution Business). The Company conducts OEM supply of digital pens, control ICs, touch panels, and other parts and modules to finished product manufacturers. It has been achieving 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.

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