COMPANY RESEARCH AND ANALYSIS REPORT

Wacom Co., Ltd.

6727

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Summary

In FY3/22, although a surge in stay-at-home demand accompanying the COVID-19 pandemic has ended, results exceeded the plan due to demand for professional products and from OEM partner manufacturers. The Company focused on using new core technologies and preparing to launch new business models

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. FY3/22 results

In the FY3/22 consolidated results, both net sales and final profit reached new record highs, with net sales increasing 0.2% YoY to ¥108,790mn and operating profit decreased 2.9% to ¥13,024mn, exceeding the plan. In net sales, while there was a decline in sales in the Branded Business due to the end of a surge in stay-at-home demand associated with the spread of the novel coronavirus (hereinafter "COVID-19"), sales of professional display products and so forth grew steadily as economic activity resumed. Meanwhile, in the Technology Solution Business, sales increased despite restrictions on the production supply chain caused by COVID-19 due to an increase in demand from finished product manufacturers of smartphones, tablets, and so forth (OEM partner manufacturers), leading net sales to a new record high. The uptick in overall net sales was due in large part to the impact of the yen's depreciation in foreign exchange. In earnings, operating profit decreased due to the impact of the product mix and high prices for materials, as well as R&D expenses and advertising and promotion expenses for the future; however, the operating profit margin was 12.0%, (compared to 12.4% in the previous fiscal year), only a small decrease due to optimization of expenses and the impact of the yen's depreciation in foreign exchange.

2. FY3/23 results outlook

In its consolidated forecasts for FY3/22, the Company is projecting a significant increase in sales and an increase in operating profit, with net sales to increase by 17.7% YoY to ¥128,000mn, operating profit to increase 5.2% to ¥13,700mn. However, the Company's earnings forecasts are based on a baseline scenario (conservative assumptions) and reflect a certain level of consideration for procurement risk of major components, as well as envisaging proactive research and development investment. Net sales reflects envisaged growth in the Branded Business and the Technology Solutions Business, respectively. In the Branded Business, the strengthening of the product portfolio, mainly in the second half, contributes to increased sales. In the Technology Solutions Business, the Company's policy is to maintain and expand relationships with its main customers while also working to develop and implement new use cases for digital pens. For earnings, while the Company forecasts an increase in operating profit through the impacts of higher sales, foreign exchange rates (yen depreciation), and optimization of SG&A expenses, factoring in expansion in R&D expenses and soaring raw materials and logistics costs, the Company expects the operating profit margin to decrease slightly to 10.7% (12.0% in FY3/22).

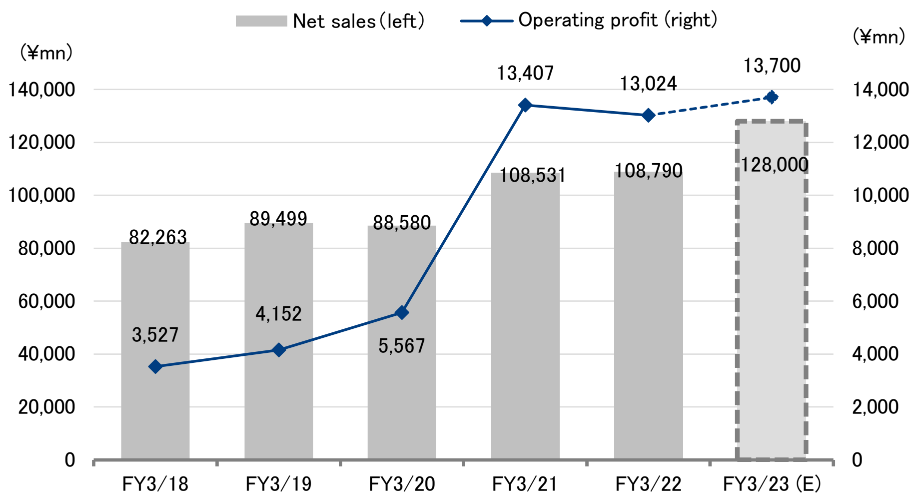
3. Growth strategy

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 FY3/22, although a surge in stay-at-home demand accompanying the COVID-19 pandemic has ended, results exceeded the plan due to demand for professional products and from OEM partner manufacturers. The Company also proactively worked to acquire treasury stock
- In addition to digital content, the Company is also focusing on preparations to launch new business models through use of new core technologies in AI, XR, and Security, including the fields of education DX and work-flow DX
- In FY3/23, the Company expects a significant increase in sales and an increase in operating profit driven by growth in both the Branded Business and the Technology Solutions Business, while giving a certain level of consideration to component procurement risk, etc.
- The new medium-term business direction Wacom Chapter 3 started from FY3/22. 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 mid- and low-priced product categories and evolution of user needs and workflow, as well as the spread of online education and teleworking accompanying advances in digital technologies (IoT, 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 FY3/22 consolidated results, the U.S. accounts for approximately 33% of the total, Asia and Oceania approximately 29%, and Europe (Germany) approximately 25%.

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. As a result, in FY3/22, the Company recorded temporary cost of sales improvement effects equivalent to approximately ¥0.9bn, including the impact of the avoidance of additional tariffs on Chinese imports to the 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 in digital handwriting (drawing) users and demand shift from Pen Tablets), it released multiple new models including a 16-inch entry model with an actual sales price in the ¥60,000 to 70,000 range (tax exclusive; same below) in January 2019, a 22-inch model (actual sales price in the ¥100,000 to 110,000 range) in July 2019, and a 13-inch model for beginners (actual sales price in the ¥30,000 to 40,000 range) in January 2020. The Company is gaining a stronger presence even in the entry model segment where it faces tough price competition from other companies (Chinese manufacturers, etc.).

* 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 mid- and low-priced category where it is difficult to achieve differentiation. Furthermore, since the Company has strategically shifted management resources in response to a demand shift toward Displays with better operability and lower prices, sales were steadily trending downward in the few years prior to the COVID-19 pandemic.

* Sometimes referred to as "opaque pen tablets" 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, opening bank accounts, concluding insurance policies, etc.) and medical (medical document management and electronic medical records, informed consent etc.) areas, as well as the public field (government administration services such as application forms at service desks, emergency assistance, electronic voting support, etc.).

2. Technology Solution Business

This business is divided into two segments, AES Technology Solution and EMR Technology Solution, others sales based on digital pen technologies*. It supplies pen sensor systems to smartphone and tablet and notebook PC manufacturers. In particular, the Company is expanding sales to Samsung Electronics <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 FY3/22, although a surge in stay-at-home demand accompanying the COVID-19 pandemic has ended, results exceeded the plan due to demand for professional products and from OEM partner manufacturers. Net sales and final profits reached new record highs

1. FY3/22 results

In the Company's FY3/22 consolidated results, sales and final profit reached new record highs, as net sales increased 0.2% YoY to ¥108,790mn, operating profit decreased 2.9% to ¥13,024mn ordinary profit increased 1.8% to ¥14,351mn, and profit attributable to owners of parent increased 7.1% to ¥10,955mn. In addition, net sales and each level of profit were all higher than even the second upwardly revised earnings forecast (announced January 31, 2022).

Net sales in the Branded Business decreased from the previous fiscal year, when there was a sharp increase in stay-at-home demand associated with COVID-19, but sales of professional display products, etc., grew steadily as economic activity resumed. Meanwhile, net sales in the Technology Solutions Business reached a new record high due to an increase in demand from OEM partner manufacturers, despite production supply chain restrictions associated with COVID-19. The uptick in overall net sales was due in large part to favorable sales in the Branded Business, including the new product effect in displays for professionals, as well as the impact of the yen's depreciation* in foreign exchange.

* According to the Company's calculations, the factor increased net sales by approximately ¥6.4bn.

In earnings, the gross profit margin decreased to 36.4% (compared to 38.2% in the previous fiscal year), despite a reduction in costs*1 from avoiding additional US tariffs on China, mainly due to the impact of the product mix*2 and recording of valuation loss on inventories, etc.*3 Meanwhile, in SG&A expenses, although R&D expenses and advertising and promotion expenses increased, optimization of various expenses and the impact of the yen's depreciation in foreign exchange*4 resulted in new record low ratio of SG&A expenses to net sales. As a result, the decrease in the operating profit margin was only small at 12.0% (compared to 12.4% in the previous fiscal year).

*1 The main production processes for some of the product lines in the Branded Business have been relocated to areas outside of mainland China (surrounding Southeast Asia, 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 reduced cost of sales by approximately ¥0.9bn.
*2 The low compositional ratio of Pen Tablets in the Branded Business, which have a relatively high gross profit margin, was a factor that deteriorated the overall profit margin.
*3 In the Technology Solution Business, the Company recorded loss on valuation of inventories and loss on disposal as customers changed their production plans and so forth while the Company was strategically increasing inventory assets by increasing lead times on advanced orders in order to prepare for component shortages.
*4 According to the Company's calculations, this factor increased operating profit by approximately ¥1.5bn.

Looking at the Company's financial position, total assets increased by 3.0% from the end of the previous fiscal year to ¥73,332mn, mainly reflecting a strategic increase in inventories to prepare for supply chain impacts (component shortages, etc.) and an increase in non-current assets, despite a decrease in cash and deposits. Meanwhile, shareholders' equity increased 15.4% to ¥43,503mn due to accumulation of in internal reserves, even as the Company proceeded to acquire treasury stock*, and the equity ratio improved to 59.3% (compared with 52.9% at the previous fiscal year-end). Meanwhile, although capital efficiency indicators decreased, with ROE falling to 27.0% (31.3% at the previous fiscal year-end) and ROIC to 29.7% (39.4% at the previous fiscal year end), they retained a high level, and the Company's finances exhibit an excellent balance between safety and efficiency.

* Based on the policy on acquisition of treasury stock dated May 12, 2021, the Company acquired a total of 3.52 million shares (¥3.0bn) through the fiscal year. Treasury stock acquisitions have the effect of reducing shareholders' equity.

FY3/22 financial results

(¥mn)

	FY3/21		FY3/22		Change	
	Results	% of sales	Results	% of sales	Amount	%
Net sales	108,531		108,790		259	0.2%
Branded Business	56,678	52.2%	52,641	48.4%	-4,037	-7.1%
Technology Solution Business	51,853	47.8%	56,149	51.6%	4,296	8.3%
Cost of sales	67,124	61.8%	69,180	63.6%	2,056	3.1%
SG&A expenses	28,000	25.8%	26,586	24.4%	-1,414	-5.1%
Operating profit	13,407	12.4%	13,024	12.0%	-383	-2.9%
Branded Business	9,096	16.0%	8,712	16.6%	-384	-4.2%
Technology Solution Business	9,260	17.9%	8,888	15.8%	-372	-4.0%
Adjusted amount	-4,949	–	-4,576	–	373	–
Ordinary profit	14,091	13.0%	14,351	13.2%	260	1.8%
Profit attributable to owners of parent	10,226	9.4%	10,955	10.1%	729	7.1%

	End of March 31, 2021	End of March 31, 2022	Change	
			Amount	%
Total assets	71,181	73,332	2,151	3.0%
Shareholders' equity	37,689	43,503	5,814	15.4%
Equity ratio	52.9%	59.3%	6.4pt	–
ROIC*	39.4%	29.7%	-9.7pt	–
ROE	31.3%	27.0%	-4.3pt	–

*ROIC=operating profit after tax / (net working capital + business assets)
Source: Prepared by FISCO from the Company's financial results

Breakdown of SG&A expenses

(¥mn)

	FY3/21	FY3/22	Change	
			Amount	%
Personnel expenses	12,464	10,205	-2,260	-18.1%
R&D expenses	4,663	5,477	814	17.5%
Sales promotion and advertising expenses	2,490	2,652	162	6.5%
Freight and packing expenses	1,422	1,454	33	2.3%
Outsourcing expenses	1,347	1,331	-17	-1.2%
Depreciation and amortization	647	435	-212	-32.7%
Other	4,967	5,033	65	1.3%
Total	28,000	26,586	-1,414	-5.1%
SG&A expenses ratio	25.8%	24.4%	-1.4pt	–

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

2. Results overview by business

(1) Branded Business

The segment recorded lower sales and profits, with net sales down 7.1% year on year to ¥52,641mn and segment profit down 4.2% to ¥8,712mn. Net sales dropped sharply in the Creative Solution product category (particularly, mid- and low-priced Pen Tablet products) as stay-at-home and other types of demand subsided. On the other hand, in the Business Solution category, despite growth in sales accompanying the resumption of economic activities, it was not sufficient to cover the decrease in Creative Solution, which has a larger overall scale of sales. Earnings decreased due to downward pressure on profits from lower sales as well as aggressive R&D investment, and so forth, despite a reduction in costs due to avoiding additional US tariffs on China.

Earnings breakdown in the Branded Business

(¥mn)

	FY3/21	FY3/22	Change	
	Results	Results	Amount	%
Creative Solution	52,937	48,245	-4,692	-8.9%
Displays	23,393	23,548	155	0.7%
Pen Tablets	27,581	22,901	-4,680	-17.0%
Mobiles, others	1,963	1,796	-167	-8.5%
Business Solution	3,741	4,396	655	17.5%

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

a) Creative Solution sales

Net sales decreased 8.9% YoY to ¥48,245mn. By product, in Displays sales of entry models faltered, while sales of professional products grew significantly, capturing expansion in creative demand (anime, movies, games, etc.). Pen Tablets saw modest sales growth in professional products, despite the impacts of aging, while mid- and low-priced models experienced 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 grew significantly 17.5% year on year to ¥4,396mn. 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

The segment recorded higher sales but lower profits, with net sales increasing 8.3% YoY to ¥56,149mn, and segment income decreasing 4.0% to ¥8,888mn. Net sales reached a new record high atop sales growth in the AES Technology Solution and the EMR Technology Solution product categories, despite production supply chain restrictions. On the earnings front, overall profits declined as profits were decreased by inventory valuation loss, etc., as well as R&D investment for development of next-generation products, and so forth. Net sales of each product category are as follows.

Earnings breakdown in the Technology Solution Business

(¥mn)

	FY3/21	FY3/22	Change	
	Results	Results	Amount	%
AES Technology	18,727	22,142	3,415	18.2%
EMR Technology, others	33,126	34,007	881	2.7%

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

a) AES Technology Solution sales

Net sales increased significantly by 18.2% YoY to ¥22,142mn, as sales increased dramatically atop growth in demand from OEM partner manufacturers.

b) EMR Technology Solution, others sales

Net sales grew, increasing 2.7% YoY to ¥34,007mn. The Company achieved the increase in sales despite temporary impacts such as changes in the product portfolio of OEM partner manufacturers.

3. Key takeaways of FY3/22 results

Comprehensively assessing the results for FY3/22 above, negative factors included the end of a surge in stay-at-home demand, component shortages and material price increases associated with production supply chain disruption, and impacts on consumer sentiment due to expansion of the COVID-19 pandemic in Southeast Asia, lockdowns in China, and the increase in resource prices resulting from the situation in Russia and Ukraine (although the direct impacts are negligible). These combined with positive factors such as the effect of the yen's depreciation and the Company's avoiding the additional U.S. tariffs on China, making it difficult to grasp the actual situation in the financial results. However, the Company maintained a high level of performance, continuing from FY3/21, when earnings increased sharply due to stay-at-home demand and advances in online education, and so forth, and recorded new record highs in net sales and final profits. This is a noteworthy achievement, showing that Company has not just captured special demand, but has firmly captured demand expansion across all sectors. In terms of its activities, also, as noted below, the Company has also made significant strides towards the future, with the investment in R&D for the new core technologies–the focus areas of AI, XR, and Security which are discussed below–as well as progress on preparing for the launch of new business models through collaboration with partners, such as initiatives in the growth fields of education and work-flow DX.

Main results of activities

Strengthening community ties with collaborating partners towards the use of new core technologies and the launch of new business models

1. Main activities in the field of digital content

1) Successful trial demonstration of remote drawing
To support remote creation (building new digital work-flows), which continues to see demand expansion even after the COVID-19 pandemic, a four-company joint demonstration project between the Company, khara, inc., Splashtop Inc., and NTT DOCOMO INC. succeeded in demonstrating remoted drawing through 5G communications, screen transmission, and an LCD pen tablet. Now the partners will work towards commercializing the concept.

2) Development of digital copyright protection service
The Company also succeeded in developing a system for protecting digital copyrights of creators and artists (a system that uses a blockchain to verify authorship and issue a history). The Company plans to release a prototype of a service using this system during FY3/23.

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." The companies held a joint exhibition of concept works in the open event, "Connected Ink 2021,"* 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.

2. Major initiatives in the field of education (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. At the aforementioned "Connected Ink 2021" event, the CEOs of both companies announced a "Joint Declaration on the Path of Learning (KISEKI)."* 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.

* The declaration describes the development and deployment, etc. of new educational services that get closer to learnings by visualizing the individual learning paths of students through joint research into new education services using digital ink.

3. Digital pen technology featured in the world's first foldable smartphone

The Company's digital pen technology was adopted for the "S Pen" for the "Galaxy Z Fold 3 5G," the world's first foldable 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. It was also adopted as the S Pen for the Samsung's flagship model Galaxy S22 Ultra smartphone, announced on February 10, 2022. The Galaxy S22 Ultra integrates the Galaxy Note, which had previously been popular with users, into the S series to provide the first model in the S series with a built-in S Pen that can be stored onboard. As a result, the S Pen is now featured on each of the revived Note type (built-in pen), foldable, and tablet models. Furthermore, the S Pen continues to be used for the Galaxy Tab S8, S8+, and S8 Ultra tablets as well.

4. Capital and business alliances, etc.

1) Capital and business alliance with the parent company of CELSYS, Inc.

In April 2022, the Company concluded a capital and business alliance* with ArtSpark Holdings Inc. <3663>, the parent company of CELSYS, Inc., which provides CLIP STUDIO PAINT and other apps for creating illustrations, manga, and animation. The Company has collaborated with CELSYS, Inc. for over 20 years in supporting the creative community together, and the new alliance is intended to deepen the collaboration between the two companies. While retaining independence, the companies intend to share a joint development policy, and promote a long-term collaborative relationship, strategic, concentrated investment of development and marketing resources, and consideration of joint services.

* The Company purchased new shares of ArtSpark Holdings issued through the third-party allocation (approx. 5%) for around ¥1.6bn and plans to make additional purchases, ensuring that the share-holding ratio does not exceed 10%.

2) Additional investment in sdtech Inc. and strengthening of cooperation

The Company concluded a capital and business alliance with sdtech Inc.*1 on March 16, 2021 and started joint development to realize new services incorporating "Handwriting × Digital" using Artificial Intelligence (AI). The Company has now made an additional investment*2 and strengthened the cooperative relationship further by dispatching a director. In particular, the Company has established a "Wacom Division" within sdtech with a 10-strong team of engineers and set up a structure for joint development with this team. As with CELSYS INC. mentioned above, the cooperation and utilization of external resources is to play an important role in the R&D strategy of the Company in its effort to create new value.

*1 sdtech has been pursuing manufacturing based on human-centered design with its "Design Engineering" approach that brings together capabilities in design, technology, and data science to develop an advanced automobile HMI (human-machine interface) and Karaoke control tablet UI (User Interface).
*2 Share acquisition totaling around ¥0.2bn (approx. 10%).

Outlook

A significant increase in sales and an increase in operating profit expected for FY3/23. Aggressive R&D investment for the future to continue

1. FY3/23 results outlook

For the FY3/23 consolidated results outlook, the Company expects a significant increase in sales and an increase in operating profit, with net sales to increase 17.7% YoY to ¥128,000mn, operating profit to increase 5.2% to ¥13,700mn, ordinary profit to decrease 4.5% to ¥13,700mn, and profit attributable to owners of parent to decrease by 6.9% to ¥10,200mn.

However, the Company's results outlook is based on a baseline scenario (conservative assumptions with minimized downside risk). The assumptions include 1) certain level of consideration for procurement risk of main components in the Technology Solution Business, 2) non-recording* of sales from direct shipments to Russia and Ukraine, given the situation there, 3) aggressive R&D investment to promote technology leadership, and 4) continued optimization of SG&A expenses.

* However, sales to the two countries accounted for only around 1% of consolidated net sales (results for FY3/22). Furthermore, the Company has no business sites in these countries.

Net sales are expected to grow respectively in the Branded Business and the Technology Solution Business. In the Branded Business, strengthening the product portfolio, mainly in the second half, will contribute to higher sales. In particular, by providing value not only in terms of hardware, but also in services, the Company's policy is to strengthen all product offerings, including high-end as well as entry level to middle zone, by including services that connect with education and work-flow DX. Meanwhile, in the Technology Solution Business, the Company's policy is to maintain and expand relationships with his main customers while giving a certain level of consideration to procurement risk for major components in the production supply chain, and to work on developing and implementing new use cases for digital pens. The outlook for a significant increase in sales also includes the impacts of foreign exchange (yen depreciation).*

* In foreign exchange rates for FY3/23 (full-year average), the Company is assuming US$1=¥120 (depreciation of ¥7.1 YoY), €1=¥132 (depreciation of ¥1.0), CNY1=¥18.8 (depreciation of ¥1.2). This depreciation is expected to increase net sales by approximately ¥6.2bn.

In earning, the Company expects to realize an increase in operating profit, mainly due to higher profits on higher sales, foreign exchange impacts (yen depreciation)*, and optimization of SG&A expenses; however, the operating profit margin is expected to decrease slightly to 10.7% (compared with 12.0% in FY3/22) after factoring in expanded R&D investment for the future, increase in depreciation and amortization expense (dies for mass production of products, etc.), as well as high raw material and logistics costs. R&D expenses are expected to increase 22% YoY to approximately ¥6.7bn and depreciation and amortization expenses to increase 19% to approximately ¥1.7bn.

* The Company expects foreign exchange (yen depreciation) impact to increase operating profit by approximately ¥0.8bn YoY.

Forecasts for FY3/23

(¥mn)

	FY3/22		FY3/23		Change	
	Results	% of sales	Forecast	% of sales	Amount	%
Net sales	108,790		128,000		19,210	17.7%
Branded Business	52,641	48.4%	63,000	49.2%	10,359	19.7%
Technology Solution Business	56,149	51.6%	65,000	50.8%	8,851	15.8%
Operating profit	13,024	12.0%	13,700	10.7%	676	5.2%
Branded Business	8,712	16.6%	9,000	14.3%	288	3.3%
Technology Solution Business	8,888	15.8%	9,900	15.2%	1,012	11.4%
Adjustment	-4,576	–	-5,200	–	-624	–
Ordinary profit	14,351	13.2%	13,700	10.7%	-651	-4.5%
Profit attributable to owners of parent	10,955	10.1%	10,200	8.0%	-755	-6.9%

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

Below we review results outlooks and activity policies by business.

(1) Branded Business

Net sales are forecast to increase 19.7% YoY to ¥63,000mn, and segment profit to increase 3.3% to ¥9,000mn. Strengthening of the product portfolio, mainly in the second half, is expected to contribute to the increase in sales. In earnings, segment profits are expected to increase atop higher sales, but the segment profit margin is forecast to fall to 14.3% (compared to 16.6% in FY3/22), due to aggressive R&D investment for the future (including strengthening the product portfolio, developing 3D designs functions for use with VR/MR).

(2) Technology Solution Business

Net sales are forecast to increase 15.8% YoY to ¥65,000mn and segment profit to increase 11.4% to ¥9,900mn. The Company expects to secure an increase in sales by strengthening relationships with major customers and developing and implementing new use cases for digital pens, while giving a certain level of consideration to procurement risk for major products. In earnings, the outlook is the same as for the Branded Business, with impacts expected from aggressive R&D investments for the future.

2. FISCO's view

We also see a need to make careful judgements of the external environment, which has a high degree of uncertainty, such as procurement risk for major components and rising prices, including energy prices. However, provided that risk occurrences are within the expected range, we believe the Company's base-level earnings can be increased even further, due to the expansion in demand for digital content as well as the education field and work-flow DX, and the development of new use cases for digital pens. Therefore, the key point to note is the degree to which the Company's performance can exceed its baseline scenario. Furthermore, the use of new core technologies in AI, XR, and Security and the formation of new business models combining hardware with services have the demonstrable potential for gradual commercialization from FY3/24 onward, and we also intend to monitor these developments.

Results trends in past years

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

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

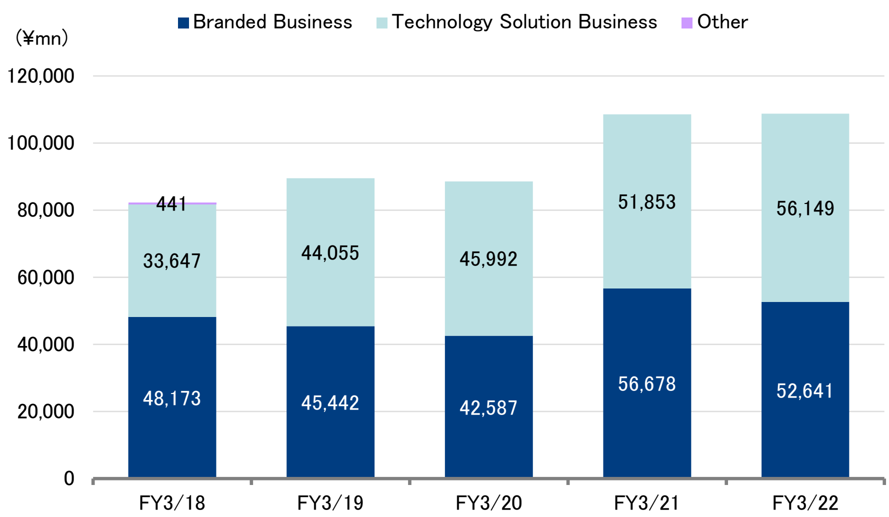
The main reason for the contracting trend in the Branded Business sales through to FY3/20 had been the need for time to fully compensate for growing competition in mid- and low-priced products in Pen Tablets, which had been a mainstay product, through a strategic demand shift to Displays. However, Displays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

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

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

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

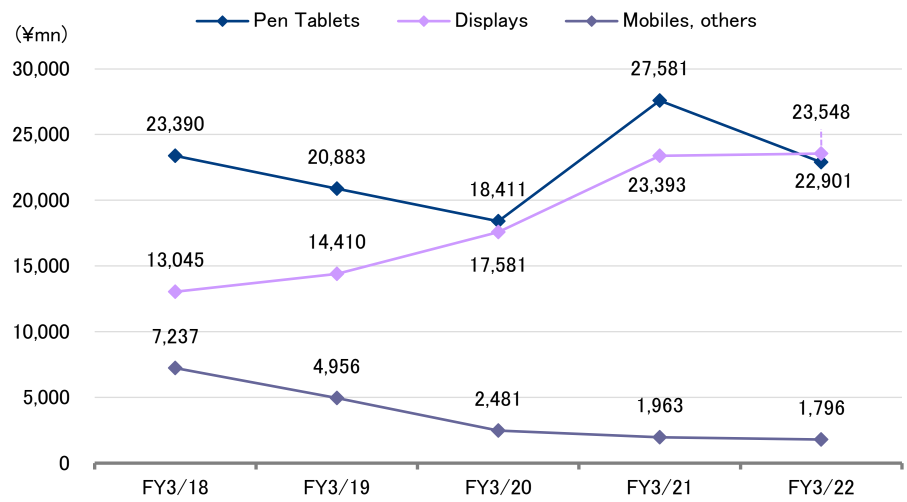
Trends in net sales by business



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

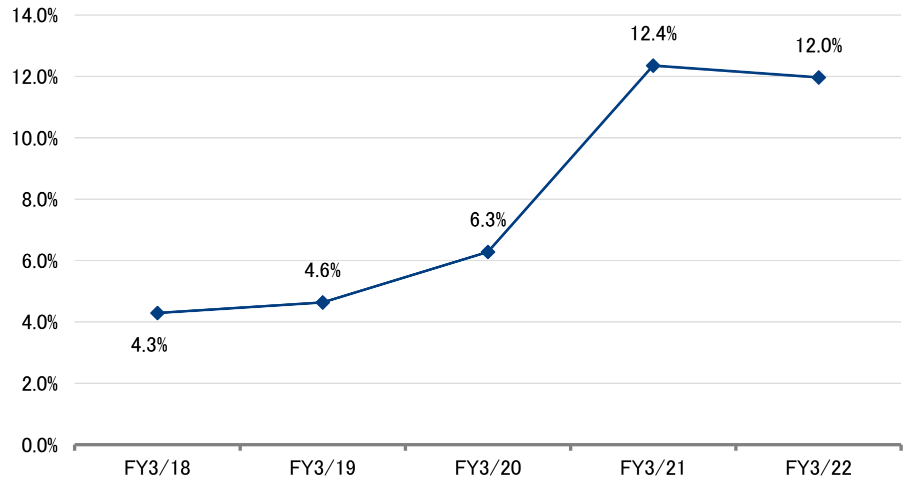
Results trends in past years

Sales trends in major products

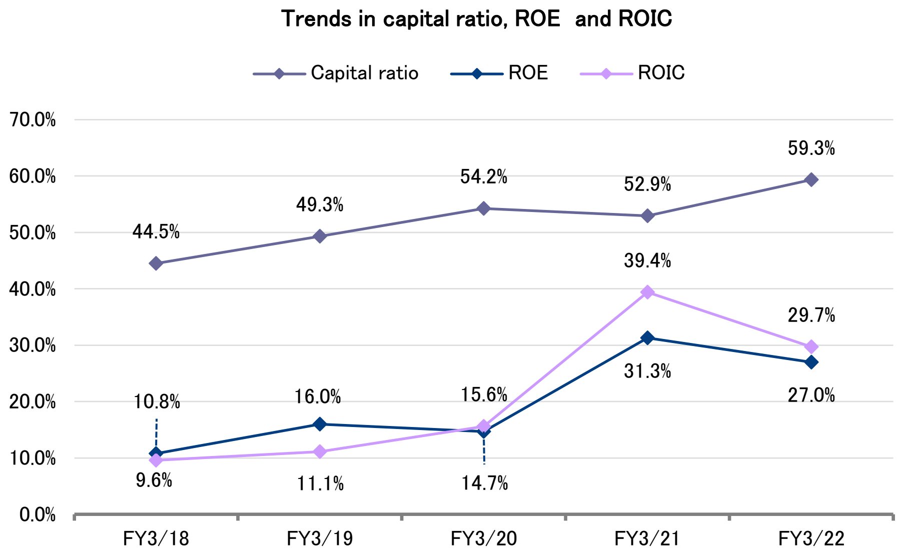


Source: Prepared by FISCO from the Company's financial results

Trends in operating profit margin



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



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

Growth strategy

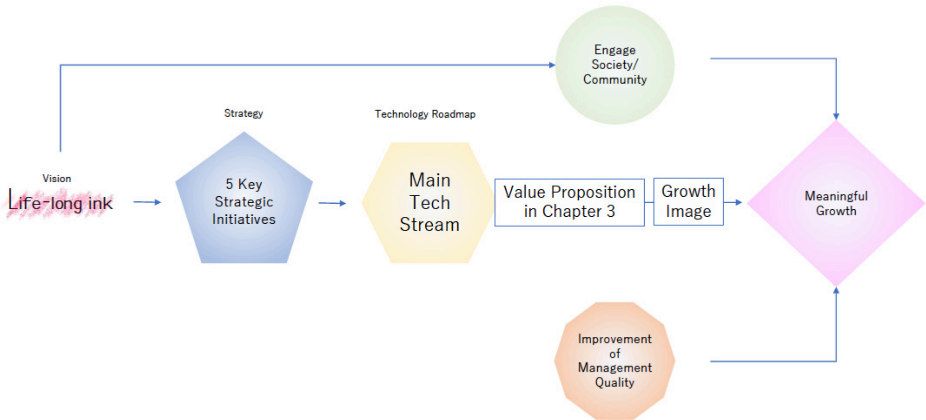
Start of Wacom Chapter 3, the new medium-term business direction

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 the creative field (digital content creation), education field, various types of digital transformation (DX) of workflows (public service desk procedures, document filing, and writing on PDFs in workflows, as well as digital voting, etc.), along with inclusion in various advanced devices and digital stationery, etc., and incorporation in smart home solutions. Now, the Company intends to continue providing the highest level of "pen, paper, and ink experience" through technology development spanning hardware, software, and services.

(2) Community Engagement

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

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

(3) New Core Technology, New Value Proposition

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

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

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

(4) Technology Innovation for Sustainable Society

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

(5) Meaningful Growth

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3. Growth potential of target markets

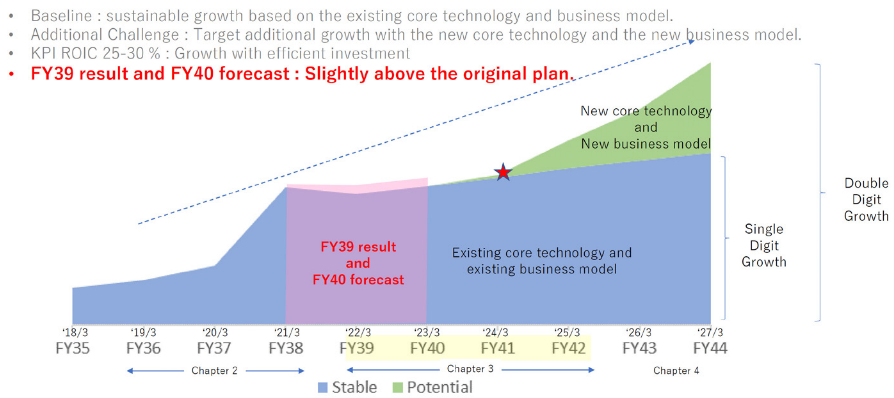
The Company sees business opportunities for digital pens and ink in three large-scale markets with high growth potential*, adding the education DX market and the work-flow DX market to the creative market (digital content production and creation), which it has targeted to date. The Company recognizes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

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

4. 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 the final fiscal year, but has set out expectations for the Company's growth direction and progress for each fiscal year on its strategic initiatives. 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 around 25–30% as a new indicator and will target 2) ROE around 20%, and 3) dividend payout ratio around 30%. In addition, the Board of Directors will engage in frank and active discussion, keeping a close eye on the efficiency of business activities and capital efficiency in order to increase the feasibility of growth. Furthermore, in FY3/22, as noted above, the Company's performance has exceeded the plan.

Envisaged growth scenario under Wacom Chapter 3 (operating profit) and progress



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

5. Focus points identified by FISCO

We see Wacom Chapter 3, as an important basis for forecasting the Company's direction and future potential, as it establishes three new technologies (AI, XR, security) and new business models during the target period and has a major focus on how the Company will go about creating a platform for accelerating growth. The Company's success is likely to be determined not only by its 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 are likely to become much greater. If it can achieve this, it can be expected to expedite collaboration with leading partners. Despite the temporary impacts of the pandemic over the past two years, the widening range of entry-user products and capture of new demand should be steadily widening the base of users with experience of digital pens and digital ink. If the launch of new core technologies and new business models succeeds in the medium term, synergy effects between hardware and services can also be expected. Furthermore, in terms of new business models, the Company seems likely to focus on providing Software as a Service (SaaS), and an important point to focus on will be how the shift to a fee-based revenue model will impact 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 contribute to ESG improvements and a sustainable society. It posts information on the "Social Initiatives" section of the Company website and discloses its fundamental views and specific activities. We think the Company's use of a concept of "lifelong ink" to describe its technology stands out. This reflects awareness of the origins of its significance and value creation in support for a sustainable society by facilitating "writing and drawing" experiences that accumulate throughout a person's life and communicating them to future generations. Together with various community partners, the Company is pursuing the potential of "lifelong ink*," not only in people's everyday lives, but also in fields ranging from the creative to business and education. In this way, the Company's direction should lead to sustainable growth for users and for the Company itself.

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

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

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

The Company considers responding to climate change to be an important issue in environmental management. It has joined the Japan Climate Initiative (JCI) and announced CO_2 emissions targets to be reached by fiscal 2030 by reducing its CO_2 emissions by an annual rate of 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.

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

Returns to shareholders

The Company paid a record high dividend of ¥20 per share for FY3/22. It also proactively purchased treasury stock

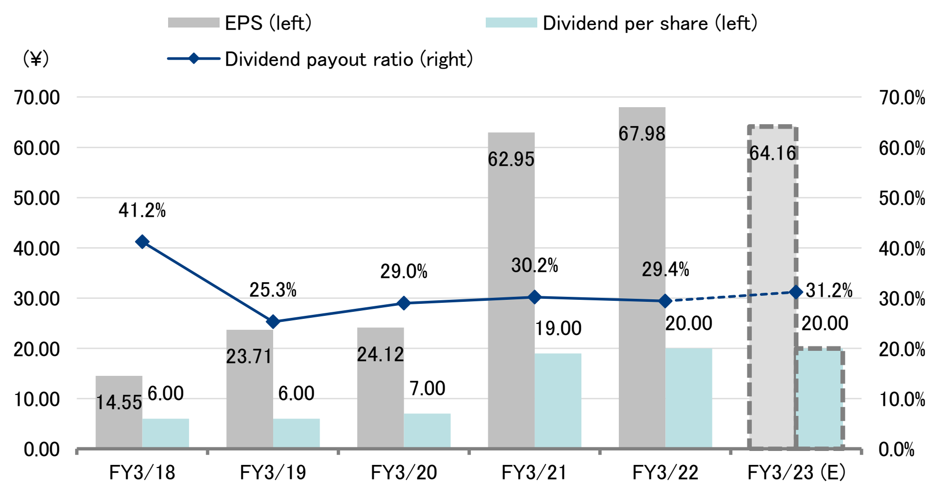
The Company's basic policy towards shareholder returns is to pay steady dividends on its profits after considering the amount of funds to be retained for future business development and a sound financial base. With regard to dividends in particular, the Company has set a guide for consolidated dividend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

For FY3/22, dividends per share were revised upward from an initial forecast of ¥15.0 to a record high ¥20.0 (dividend payout ratio of 29.4%). Compared to the dividend results for FY3/21 of ¥19.0 (ordinary dividend of ¥13.5 and special dividend of ¥5.5), this represents an increase of ¥6.5 on an ordinary dividend basis (¥1.0 if the special dividend is included). For FY3/23, the Company is currently forecasting a dividend of ¥20.0 per share (dividend payout ratio of 31.2%), the same as the previous fiscal year.

With regard to treasury stock, the Company made cumulative acquisitions totaling ¥3.0bn (3.52 million shares) in accordance with the Company's treasury stock acquisition policy announced on May 12, 2021. Furthermore, the Company cancelled 2 million shares of its treasury stock holdings (approximately 7.57 million shares at the end of the fiscal year) on March 26, 2022. In FY3/23, the Company plans to acquire treasury stock up to a limit of ¥2bn (upper limit of 4 million shares).

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

Trends in EPS, dividend, and dividend payout ratio



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

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. (From April 2022, the Company transitioned to the Tokyo Stock Exchange's Prime Market).

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