Wacom Co., Ltd.

6727

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Summary

In 1H FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand. The Branded Business continues to struggle due to changes in the market environment, but overall the Company has revised its full-year forecast upward and expects a significant increase in profit

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 has high brand clout and market share, supported by professional creators such as designers and animators who work in studios for movie production or industrial design studios. Its two business segments are the Branded Business, in which it sells its proprietary Displays (LCD pen tablets) and Pen Tablets and other products, and the Technology Solution Business, in which it supplies proprietary digital pen technology as a component to manufacturers of finished products, including smartphones and tablet PCs.

1. 1H FY3/24 results

In 1H FY3/24, sales and profits increased, with net sales increasing 2.7% YoY to ¥55,591mn and operating profit increasing 7.6% to ¥2,457mn. The result reflected a contribution from growth in sales of the Technology Solution Business supported by the effect of the yen's depreciation and brisk OEM demand. However, the Branded Business experienced declining demand for professional display products (existing models) while low-priced models continued to struggle due to a deterioration in consumer sentiment. On the earnings front, operating profit increased due to growth in the Technology Solution Business, including the impact of the yen's depreciation, and the reduction of expenses, despite a decrease in the gross profit margin, mainly due to recording expenses for a provision for liquidation of negative legacy assets and proactive R&D investments.

2. FY3/24 results outlook

For the FY3/24 consolidated results outlook, the Company announced a second results revision on October 31, taking account of a revision in the assumed foreign exchange rate and an upturn in the Technology Solution Business. Net sales are expected to decrease 3.3% YoY to ¥109,000mn, operating profit to increase 123.5% to ¥4,500mn, for a significant increase in profit despite the decrease in sales. As with 1H, the Branded Business is expected to continue struggling, while growth in the Technology Solution Business drives overall performance. The forecast for a decrease in sales YoY is the result of careful judgement looking ahead to continued uncertainty in the market environment and moves to promote business structure transformation in the Branded Business. On the earnings front, the Company expects to realize a significant YoY increase in profit due to improvement in gross profit in the Branded Business and growth in the Technology Solution Business, despite continuing to make proactive investments in R&D.

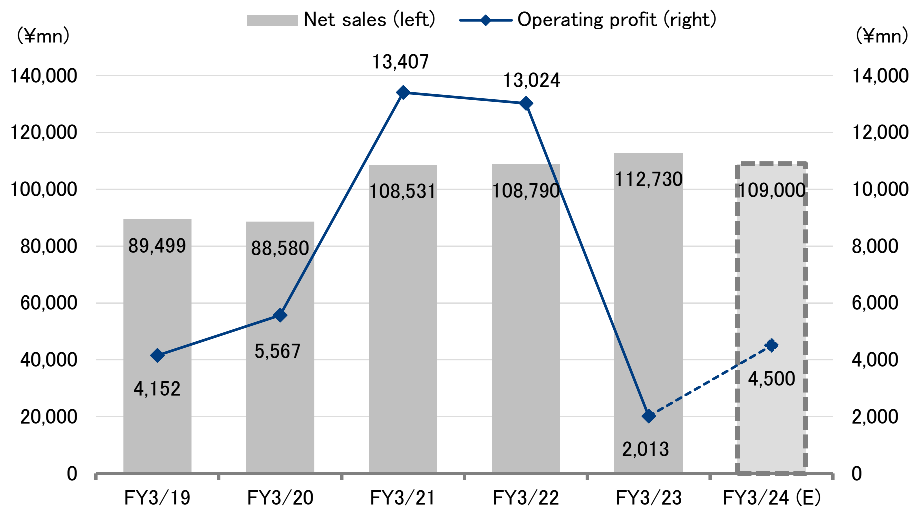
3.Revision of update on "Wacom Chapter 3," the medium-term business direction

The Company has been promoting initiatives under "Wacom Chapter 3" (FY3/22 to FY3/25), its four-year medium-term business direction. The new direction will promote the specific value propositions and sustainable growth, inheriting the vision of "lifelong ink," and redefining five key strategic initiatives as well as six main streams for technology innovation to implement the policy. In particular, the Company's leading strategy is to select three fields that have a high affinity with its existing technologies–AI, XR, and Security–and realize new value propositions in these fields using new technologies and business models; and this basic direction has not been revised. However, in addition to responding to external factors with the recent sharp deterioration in the economic environment, the Company recognizes that it is likely to have room for improvement in its own structure, such as strengthening its product portfolio and sales channel management. Accordingly, the Company has positioned the next two years (FY3/24 to FY3/25) as a period for transformation of business structure that will lead to business growth in the next phase, "Wacom Chapter 4," and has established a policy of focusing on improving gross profit and building a growth platform (the update plan; announced in May 2023). Furthermore, now that six months has passed since the announcement of the update plan, the Company judges that it needs to implement additional structural transformation in the Branded Business, and has announced a schedule for announcing the specific revision plan (the Company plans to announce a progress report around January 2024, as well as next-term and mid-term business outlook reflecting the restructuring plan around May 2024).

Key Points

- In 1H FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand, while the Branded Business continued to struggle from the previous fiscal year, impacted by changes in the market environment
- The Company announced a second revision of the earnings forecast for FY3/24. A significant increase in profit is forecast due to the continued impact of the yen's depreciation and growth in the Technology Solution Business from 1H
- Additional structural transformation is needed in the Branded Business, so the Company plans to announce a revision plan and business outlook in the update of the medium-term business direction, "Wacom Chapter 3" (progress report to be announced around January 2024 and final report to be announced around May 2024)

Result Trends



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

Business overview

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

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

The Company is also striving to create new growth opportunities by rebuilding product line-ups and further evolving the business model amid major changes in the market environment, including tougher competition in mid- to low-priced models and evolution of user needs and workflow, as well as the spread of online education and teleworking accompanying advances in digital technologies (VR/MR, AI, and others) and the communications environment (mobile, cloud, 5G, and others).

Its two business segments are the Branded Business, which sells the Company's proprietary Displays, Pen Tablets and other products, and the Technology Solution Business, which supplies proprietary digital pen technology as a component to manufacturers of finished products, including smartphones and tablet PCs. Recently, the Branded Business has continued to struggle due to factors such as a rapid cooling of consumer sentiment and structural changes in the market environment, but the two businesses have so far been more or less balanced.

With the overseas sales ratio (overseas local entity sales ratio excluding the Technology Solution Business) at about 84%*, careful attention should be given to the impact of foreign exchange market fluctuations on earnings (fluctuations in the euro-yen rate have a bigger impact on operating profit than fluctuations in the US dollar-yen rate. A stronger yen has a negative impact).

* According to 1H FY3/24 consolidated results, the United States accounted for 34.9% of the total net sales, Europe (Germany) 26.4%, and Asia and Oceania 22.9%

While development sites are practically all concentrated in Japan, excluding developments of digital ink and security-related software (which are mainly in Europe) and driver software (which is mainly in the US), the Company consigns production to multiple overseas partners (which are mostly major electronics manufacturing service companies owned by either Japanese or Taiwanese with production sites in mainland China). However, from a perspective of mitigating regional concentration risk in the supply chain, the Company is proceeding to disperse its production sites into the surrounding Southeast Asia region, such as its site in Vietnam.

Business and major product features

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

1. Branded Business

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

(1) Creative Solution

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

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

a) Displays

This category covers products that use an LCD panel as the tablet* and allow the user to directly write on an LCD screen with a digital pen. Meanwhile, they are also known as PC peripherals, similar to Pen Tablets as an input device that does not have an OS or storage feature. Prices for larger products range from around ¥300,000 to ¥500,000. Users are mainly professionals and advanced amateurs, and the Company holds an overwhelming share in this market. In response to market changes (such as expanded scope in digital handwriting (drawing) users and demand shift from Pen Tablets), it released multiple new models including an approximately 16-inch entry 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 an approximately 13-inch model for beginners (actual sales price in the ¥30,000 to ¥40,000 range) in January 2020. The Company is gaining a stronger presence even in the entry model segment where it faces tough price competition from other companies (Chinese manufacturers, etc.). In the domain for professional creators, where there is a growing need for the ability to use cloud-based workflows, in September 2022, the Company announced an approximately 27-inch sized flagship model (sold at the ¥500,000 to ¥600,000 level together with a specialized stand).

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

b) Pen Tablets

The most basic device* consists of a digital pen and tablet (blackboard type) and has contributed to the Company's results as a mainstay product. It is a PC peripheral used over a connection to a PC, similar to a mouse or keyboard. The Company offers a broad lineup that ranges from professional to beginner products thanks to a simple configuration. While it is sustaining competitiveness in the professional high-end market, competition has intensified in the mid- to low-priced category where it is difficult to achieve differentiation. Furthermore, the Company has strategically shifted its management resources toward Displays, where demand is shifting due to their better operability and lower prices than Pen Tablets.

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

(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*1 based on digital pen technologies*2. It supplies pen sensor systems to smartphone and tablet and notebook PC manufacturers. Business has been growing, centered on sales for the Samsung Electronics (Galaxy series), which has adopted EMR. Moreover, its deals with major PC manufacturers is steadily growing, including Lenovo <HKG:0992> and Fujitsu <6702>, which have adopted AES, along with customers in China, such as Xiaomi Corp <HKG:1810>. The Company aims to expand business scale through promotion of its proprietary digital pen technology as a de facto standard, while expanding the scope of users. Manufacturers also appear to highly rate the Company's technology, which includes implementing foldable devices (folding-type smartphones and PCs, etc.) and compatibility with devices that use electronic paper technology.

*1 To facilitate an explanation of performance more suited to the changed environment, the segment names were partially changed from FY3/24, and the others previously included in EMR Technology Solution, others sales has been omitted.
*2 The Company's technologies consist of Active ES (proprietary electrostatic coupling, battery required for pen) format technology and EMR (electro-magnetic resonance) rapid, high-precision positioning sensors (battery not required).

Financial highlights

In 1H FY3/24, sales and profits increased due to growth of the Technology Solution Business with the impact of the yen's depreciation and growth in OEM demand, while the Branded Business continued to struggle due to changes in the market environment

1. 1H FY3/24 results

In the 1H FY3/24 consolidated results, sales and profits increased, as net sales increased 2.7% YoY to ¥55,591mn, operating profit rose 7.6% to ¥2,457mn, ordinary profit climbed 18.7% to ¥4,990mn, and profit attributable to owners of parent grew 17.7% to ¥3,804mn.

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

* This factor increased the Company's overall sales by approximately ¥3.0bn

On the earnings front, operating profit increased due to growth in the Technology Solution Business, including the impact of the yen's depreciation,*1 and the reduction of expenses, despite continued proactive R&D investment*2. In the Branded Business, the segment continued to report an operating loss following the same period of the previous fiscal year, reflecting a decline in earnings due to lower sales as well as a factors decreasing the gross profit margin, such as posting of valuation reserve for inventory purchase commitments.*3 Nevertheless, the gross profit margin improved overall, reflecting a decrease in the cost of sales resulting from reduction in logistics volume and U.S. custom duty expenses, and the impact of reduced SG&A expenses. As a result, the deterioration of operating loss was limited.

*1 This factor boosted overall operating profit by approximately ¥0.4bn (most of which was due to the Technology Solution Business). Furthermore, in non-operating income the Company recorded gain on foreign exchange difference (approximately ¥2.5bn) due to the yen's depreciation.
*2 R&D expenses increased to ¥3,641mn (up ¥485mn YoY).
*3 Valuation reserve for inventory purchase commitments is a liability reserve, allocating the amount of expected losses following a deterioration in market conditions, etc. against long-term purchase commitments for inventories aimed at generally ensuring stable procurement of materials. In the case of the Company's Branded Business, we consider that the Company has already taken a conservative accounting treatment in preparation for structural changes in the market, based on the decline in demand under its current model.

Looking at the Company's financial position, total assets increased by 13.5% from the end of the previous period to ¥85,420mn, mainly reflecting increases in cash and deposits and in accounts receivable–trade due to higher sales, despite a decrease in inventories due to progress on inventory management. Equity increased only slightly, by 1.8%, to ¥41,213mn, as positive factors (increase in retained earnings and increase in foreign currency translation adjustment) outweighed negative factors (acquisition of treasury stock). As a result, the equity ratio fell to 48.2% (53.8% at the end of the previous period).

1H FY3/24 financial results

(¥mn)

	1H FY3/23		1H FY3/24		Change	
	Results	% of sale	Results	% of sale	Amount	%
Net sales	54,138		55,591		1,453	2.7%
Branded Business	20,425	37.7%	17,078	30.7%	-3,347	-16.4%
Technology Solution Business	33,713	62.3%	38,513	69.3%	4,800	14.2%
Cost of sales	37,251	68.8%	38,580	69.4%	1,329	3.6%
SG&A expenses	14,604	27.0%	14,554	26.2%	-50	-0.3%
Operating profit	2,284	4.2%	2,457	4.4%	173	7.6%
Branded Business	-1,852	-9.1%	-2,017	-11.8%	-165	-
Technology Solution Business	6,552	19.4%	6,915	18.0%	363	5.5%
Adjusted amount	-2,417	-	-2,442	-	-25	-
Ordinary profit	4,203	7.8%	4,990	9.0%	787	18.7%
Profit attributable to owners of parent	3,231	6.0%	3,804	6.8%	573	17.7%

	End of March 31, 2023	End of September 30, 2023	Change	
			Amount	%
Total assets	75,279	85,420	10,141	13.5%
Shareholders' equity	40,490	41,213	723	1.8%
Equity ratio	53.8%	48.2%		-5.6pt

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

Breakdown of SG&A expenses

(¥mn)

	1H FY3/23	1H FY3/24	Change	
			Amount	%
Personnel expenses	5,620	5,575	-45	-0.8%
R&D expenses	3,156	3,641	485	15.4%
Sales promotion and advertising expenses	1,241	876	-365	-29.4%
Freight and packing expenses	796	644	-152	-19.1%
Outsourcing expenses	762	718	-44	-5.8%
Depreciation and amortization	206	228	22	10.7%
Other	2,822	2,872	50	1.8%
Total	14,604	14,554	-50	-0.3%
SG&A expenses ratio	27.0%	26.2%		-0.8pt

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

2. Results overview by business

(1) Branded Business

Sales and profits decreased, and the Company recorded a segment loss, with sales down 16.4% to ¥17,078mn and segment loss of ¥2,017mn (loss of ¥1,852mn for the same period of the previous fiscal year). Net sales declined, reflecting lower sales of display products and pen tablet products in the mainstay Creative Solution due to changes in the market following deterioration in consumer sentiment, and so forth. These impacts were partially offset by the beneficial effect of the yen's depreciation (approximate ¥0.9bn increase in sales). In Business Solution, also, sales declined slightly, impacted by changes in the fluid market conditions and progress on projects. On the earnings front, the segment continued to report a loss, reflecting a depressive effect on earnings from lower sales, and recording of expenses for valuation reserve for inventory purchase commitments. However, the deterioration of the loss was limited by decreases in logistics volume and U.S. custom duty expenses, and cost reduction factors, such as SG&A expense reduction. On the other hand, in its activities, the Company introduced new products (three models)* towards revamping its product portfolio as part of business structure transformation.

* Wacom One Series (entry-level model) with new functions and services

Earnings breakdown in the Branded Business

(¥mn)

	1H FY3/23	1H FY3/24	Change	
			Amount	%
Creative Solution	18,180	14,898	-3,282	-18.1%
Displays	10,473	9,310	-1,163	-11.1%
Pen Tablets	7,707	5,588	-2,119	-27.5%
Business Solution	2,245	2,180	-65	-2.9%

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

a) Creative Solution sales

Net sales decreased 18.1% YoY to ¥9,310mn. By product, Displays sales decreased, due to declining demand for existing professional models and mid-priced models, while low-priced new and existing models contributed to sales. In Pen Tablets also, sales decreased due to declines in demand for existing professional models due to the length of time since launch and existing low priced models, despite a contribution to sales from mid-priced new products and existing models.

b) Business Solution sales

Net sales decreased slightly by 2.9% YoY to ¥2,180mn. It was affected by fluctuating changes in market conditions and progress on projects.

(2) Technology Solution Business

This segment recorded increases in sales and profits, which net sales rising 14.2% YoY to ¥38,513mn and segment profit increasing 5.5% to ¥6,915mn. Net sales benefitted from the impact of the yen's depreciation (approximately ¥2.1bn increase in sales), while increase in demand for OEM partners in EMR Technology Solution contributed to the increase in sales. AES Technology Solution saw a slight decrease in sales driven by changes in the market environment. On the earnings front also, profits increased due to a boost from increase sales and from the impact of the yen's depreciation (approximately ¥0.5bn increase in profit).

Earnings breakdown in the Technology Solution Business

(¥mn)

	1H FY3/23	1H FY3/24	Change	
			Amount	%
AES Technology Solution	12,748	12,564	-184	-1.4%
EMR Technology Solution	20,965	25,949	4,984	23.8%

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

3. Key takeaways of 1H FY3/24 results

To summarize 1H FY3/24, while the Company achieved higher sales and profits due to growth in the Technology Solution Business, supported by brisk OEM demand; excluding the effect of the yen's depreciation, the results also indicate a continued adverse environment in real terms, mainly for the Branded Business. In particular, looking at the situation six months on from the update of the medium-term business direction, Wacom Chapter 3, a key point is how to evaluate the continued struggle in the Branded Business. As described later, 1) a delay in recovery of the "future demand consumption" during spread of the COVID-19 virus (hereinafter, the "COVID-19 pandemic"), 2) a continued trend of "purchasing restraint" among consumers, and 3) a trend of demand shifting to other categories (diversification of user options) can be cited as factors. However, it is necessary to discriminate clearly between business cycle factors such as 1) and 2), and structural changes such as 3). Wacom itself has proposed the need for additional structural transformation in the Branded Business through further revision of the update plan, and has adopted a policy of rapidly promoting countermeasures for 3) in particular. Its initiatives to liquidate negative legacy assets, such as recording a valuation reserve for inventory purchase commitments and reducing inventories can also be viewed as part of these countermeasures for 3).

On the activity front, the Company's accumulated steady results in preparing a foundation for the future are highly commendable, such as introducing new products, concentration on creative education, strengthening B2B channels, and preparing for the launch of the Digital Ink Service.

Outlook

Based on revision of the expected foreign exchange rate and brisk performance in the Technology Solution Business, the Company has revised its earnings forecast for FY3/24 upward. It is expecting a significant increase in profit despite a decline in sales over the full year

1. FY3/24 results outlook

For the FY3/24 consolidated results outlook, the Company announced a second revision of its earnings forecast on October 31.* It expects an increase in profit despite a decline in sales, with net sales to decrease 3.3% YoY to ¥109,000mn, operating profit to increase 123.5% to ¥4,500mn, ordinary profit to increase 81.3% to ¥5,200mn, and profit attributable to owners of parent (hereinafter, “final profit”) to increase by 120.4% to ¥3,950mn.

* In the first earnings forecast revision (July 31, 2023), the Company revised its forecast for net sales downward based on a downturn in the Branded Business. The second revision (October 31, 2023) revises upward the forecasts for net sales, ordinary profit, and final profit, by revising the depreciation of the yen in the foreign exchange rate and taking account of brisk growth in the Technology Solution Business. Adding together both earnings forecast revisions, the upward revisions compared to the initial forecasts were up ¥3,000mn for net sales, up ¥700mn for ordinary profit, and up ¥650mn for final profit. Moreover, the expected foreign exchange rates for 2H FY3/24 were revised to reflect depreciation of the yen to US$1=¥138.0 (previous forecast ¥130.0), €1=¥151.0 (¥140.0), and CNY 1=¥19.2 (¥19.0).

As in 1H, with the impact of changes in the market environment, the Branded Business is expected to struggle, mainly in existing models, while brisk growth in the Technology Solution Business is expected to drive overall performance. However, at FISCO we see the forecast for lower sales YoY as the result of careful judgement looking ahead to continued uncertainty in the market environment and moves to promote business structure transformation in the Branded Business.

On the earnings front, the Company expects to realize a significant increase in profit, mainly reflecting improved gross profit in the Branded Business with the addition of growth in the Technology Solution Business, including the effect of the yen’s depreciation, despite continuing proactive R&D investment. However, although the operating profit margin is expected to improve to 4.1% (1.8% in the previous fiscal year), the Company’s FY3/24 forecast appears to include more of a profit-boosting effect from continued sales promotion activities associated with price reduction, centered on inventories of existing models that were written down at the end of the previous period, than a profit-creation effect from actual business activities. Such activities include price policy (a price reduction impact in FY3/24 appears to have offset a price increase effect), and revamping of the product portfolio (there is a possibility that the Company is prioritizing cash flow by conducting sales promotions over certain existing model inventories and carefully promoting the market launch of related new products). Even so, the Branded Business is not expected to achieve full-year profitability, and recovery from the sharp slowdown in the previous period appears to be only half way complete.

Forecasts for FY3/24

(¥mn)

	FY3/23		FY3/24				Change	
	Results	% of sales	Initial forecast	Revised forecast (July 31)	Revised forecast (October 31)	% of sales	Amount	%
Net sales	112,730		106,000	102,500	109,000		-3,730	-3.3%
Branded Business	41,161	36.5%	41,500	38,000	37,000	33.9%	-4,161	-10.1%
Technology Solution Business	71,569	63.5%	64,500	64,500	72,000	66.1%	431	0.6%
Operating profit	2,013	1.8%	4,500	4,500	4,500	4.1%	2,487	123.5%
Branded Business	-3,981	-9.7%	200	200	-1,300	-3.5%	2,681	-
Technology Solution Business	10,756	15.0%	9,500	9,500	11,000	15.3%	244	2.3%
Adjustment	-4,762	-	-5,200	-5,200	-5,200	-	-438	-
Ordinary profit	2,868	2.5%	4,500	4,500	5,200	4.8%	2,332	81.3%
Profit attributable to owners of parent	1,792	1.6%	3,300	3,300	3,950	3.6%	2,158	120.4%

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

(1) Branded Business

Net sales are expected to increase 10.1% YoY to ¥37,000mn, and segment loss be ¥1,300mn (segment loss of ¥3,981mn in the previous period). By working to improve gross profit through the revamping of the product portfolio, including new products launched in 1H (three models), and the pricing policy, the Company expects to be able to realize a significant improvement in profit and loss (return to profitability in 2H). However, considering the Company's action in response to existing models, for which it recorded a large amount of inventory write-downs at the end of the previous period due to the impact of changes in the market environment, it will continue to be obliged to make difficult decisions in business management in FY3/24.

(2) Technology Solution Business

Net sales are expected to increase 0.6% YoY to ¥72,000mn, and segment profits to increase 2.3% to ¥11,000mn. Brisk OEM demand is expected to continue driving earnings growth, and the segment profit margin is also expected to surpass the previous period at 15.3% (15.0% in the previous period).

2. Focus points identified by FISCO

The Company's revised earnings forecast rationally reflects the current market environment, such as unstable economic conditions, foreign exchange rate trends, and an uncertain business environment, as well as the likelihood of the Company's own initiatives, including revamping the product portfolio and the pricing policy in the Branded Business. We see the forecast as being very achievable. To accomplish the full-year forecast, the Company needs only to achieve 2H net sales of ¥53,409mn, operating profit of ¥2,043mn, and ordinary profit of ¥210mn; however, considering the brisk activity in the Technology Solution Business and the current status of the foreign exchange rate, the potential for upside seems strong (in particular for operating profit). On the other hand, it is necessary to pay sufficient attention to the delay in recovery of the Branded Business, which continues to struggle, and the temporary negative factors for an early recovery (additional disposal and write-down of unprofitable inventories, etc.). The key point to observe is progress towards improvement of gross profit in the Branded Business. While responding to changes in the market environment (including inventory management), it is important to note how the price policy and the product portfolio revamp are progressing and leading to gross profit improvement. In addition, the Company also needs to continue investing for the future, and appears to be entering a phase where the balance and timing of such investment is extremely difficult. Whatever happens, in terms of determining whether the Company has liquidated negative legacy assets and set a firm course for future growth, we are interested to see the details of the additional structural transformation plan and its progress report scheduled to be announced in January 2024.

From a medium- to long-term perspective, we would like to focus on the progress of the transformation of business structure set forth in the "Wacom Chapter 3" update. The need has emerged for additional structural transformation in the Branded Business, but excluding this, the update also lays out more specifically what the Company should do going forward, and we would like to follow up on the results of each of these efforts to see how they will be linked to growth acceleration in "Wacom Chapter 4." In particular, the combination of the three new core technologies (AI, XR, and Security) and the launch of a new business model is an important basis for forecasting the Company's medium- to long-term direction and future prospects. For this reason, the Company's success is likely to be determined not only by its inhouse technology development, but also by the degree to which it can deliver value through new services based on collaboration with other companies. With regard to new value propositions using digital ink and AI, movement has already started in the education field, and there is potential for various other sectors as well. If the Company can accumulate data and expertise ahead of other companies, the chances of it being able to establish an unrivaled position in innovative domains becomes much greater.

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

The Company will promote business structure transformation to accelerate growth in the next "Wacom Chapter 4." It plans to announce additional structure transformation (revision plan) in the Branded Business

1. Basic direction and history to date

The Company has been promoting initiatives in line with the four-year medium-term business direction "Wacom Chapter 3"(FY3/22 to FY3/25). The new direction will continue the vision of "lifelong ink*1," and redefine five key strategic initiatives. In addition, the new direction has defined six main streams for technology innovation to implement the direction, and will promote specific value propositions and sustainable growth.*2 In particular, the Company's leading strategy is to select three fields that have a high affinity with its existing technologies–AI, XR, and Security–and realize new value propositions in these fields using new core technologies and new business models. Moreover, the direction also calls for initiatives to increase the quality of management through corporate governance reforms and for engagement with society and communities through the Company's unique approaches. There has been no change in these basic directions (storyline).

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

However, as we approach the fourth year of Wacom Chapter 3 (FY3/25), the Branded Business (mid- to low-priced models) has experienced a greater downturn than expected, mainly due to a sharp decrease in consumer sentiment following the current deterioration of the economic environment. Moreover, the Company's own structure appears to have room for improvements, including strengthening the product portfolio and sales channel management. Based on this, the coming two years (FY3/24–FY3/25) have been positioned as a period for business structure transformation to ensure business growth in the following "Wacom Chapter 4," and the Company has announced a policy (the update plan) of focusing on gross profit improvement and growth foundation construction (announced May 2023).

In addition, six months after the announcement of the update plan, the Company has judged that further structural transformation is needed in the Branded Business, and has announced a specific schedule for announcing a revision plan.

2. Revision of update on "Wacom Chapter 3"

(1) Background to the revision

In the background to the revision is a recognition of three environmental factors: 1) Recover of the "consumption of future demand" that occurred during the COVID-19 pandemic (FY3/21–FY3/22) is delayed further than expected, 2) in overall market conditions in certain areas (China, etc.) there is a persistent ongoing trend of "purchasing restraint" among consumers and a lower purchasing priority on the pen tablet and display product categories, and 3) in the entry zone for pen tablet products, alternative options other than pen tablet products have diversified, causing a slight shift in demand towards other categories (however, not significant change is observed in the Company's position within the pen tablet and display product category market).

(2) Redefinition of goals and revision actions

While carefully observing the above environmental changes, the Company will redefine the profitability improvement scenario for the Branded Business and further explore the three initiatives set out under the update plan, implementing additional structural transformation with a view to optimizing the product lineup, sales channel management, and business operation organization structure. Furthermore, the Company will accelerate structural transformation by improving and strengthening the operational structures related to implementing reforms, and plans to transition steadily to Wacom Chapter 4.

(3) Specific revision plan and schedule

After reporting on the content and progress of the operational structures and additional structural transformation plan around January 2024, in around May 2024, the Company plans to update its specific management plan for FY3/25 and outlook for Wacom Chapter 4, reflecting the effects of the revision.

3. Initiatives and progress on update on "Wacom Chapter 3"

(1) Branded Business

1) Product portfolio renewal and gross profit improvement

The Company is working to improve its cost structure through i) new value proposition (entry level to professional), ii) pricing policy to improve gross profit, and iii) value engineering. With regard to i), the Company is sequentially introducing a new product portfolio that provides a new value proposition. In 1H, it introduced three new product models. With regard to ii), the Company has achieved a one point increase in its gross profit margin compared to the previous fiscal year through implementing pricing strategies (net result of offsetting the price reduction impact from priority management of existing model inventory for entry users with the price increase effect of professional models). The measure in iii) is currently in progress.

2) Market development in focused area

The Company is working on i) concentrating on the creative area, ii) responding to new work flows (virtualization / remote), and iii) systems for providing solution based value propositions. With regard to i), the Company introduced its products to a Florida State technical college and is expanding its education program for training Webtoon* creators through collaboration with KENAZ. With regard to ii), the Company has released a beta-version solution into the market and is working towards commercialization. With regard to iii), the Company is also examining solution-based value propositions for each region.

* A full-color manga with vertical scrolling

3) Enhance sales channel management

Here, the Company is working i) to enhance B2B channels (cultivation of direct customers for provision of solution-based value propositions) and ii) to enhance its e-store channel (maximize user engagement through experience based services, etc.). With regard to i), the Company has had successes in introducing solutions for an online school in Pennsylvania State and providing workflow support for hospitals and support for online banking services, etc. In 1H, the Company is gradually approaching the target B2B ratio of around 30% (around 25% in the previous period). With regard to ii), the Company launched "Wacom Adventure Service," which delivers continuous service experience (tutorial, customization, accessories, etc.), and has secured channels for introduction through a dedicated e-store version and services. In 1H, the e-store ratio improved to around 12% (from around 10% in the previous full-year period).

(2) Technology Solution Business

1) Expanding customers and applications

The Company is working i) to drive further de facto standardization in the industry and ii) to develop proprietary hardware (main units, pens, and services) to expand applications. With regard to i), the Company is focusing mainly on compatibility with foldable displays and introduction of a universal pen. With regard to ii), the Company is currently considering plans for development of proprietary hardware.

2) Business development in the field of general education

The Company is working i) to develop solutions for general education and ii) to develop services in addition to hardware. With regard to i), the company is currently developing next-generation solutions for general education. With regard to ii), it is planning and developing an updated version of its commercial education services.

(3) Companywide

1) Improving inventory management

The Company is working i) to reduce the inventory balance at the end of December 2022 (approximately ¥30bn) by approximately one third (¥20bn at the end of FY3/24), ii) to pare down additional new purchasing, and iii) to strengthen the monitoring of excessive ordering. With regard to i), as of the end of September 2023, the balance had already been reduced to ¥20.6bn (book value). However, this reduction also includes inventory write-downs, and the real reduction that leads to cash flow improvement was limited to approximately ¥4.5 billion. By reducing the remaining ¥5.5bn (excluding write-downs), the Company aims to generate ¥10.0bn in cash. With regard to ii) and iii), the orders of existing products are almost nil, and the Company will continue working to strengthen monitoring over ordering.

2) Capital policy/Shareholder returns

The Company is working i) to invest in future technology and pursue its capital policy and ii) to acquire treasury stock. In regard to i), the Company's budget for R&D in FY3/24 is ¥8.0bn (in 1H, ¥3.6bn). With regard to ii), in line with its policy of acquiring a total amount of up to ¥20.0bn during the period of "Wacom Chapter 3" (four-year period up to the end of FY3/25), by the end of September 2023, the Company had acquired a cumulative total of ¥6.0bn in treasury stock. In FY3/24, together with the announcement of the recent financial results, the Company has decided to acquire a further amount of up to ¥6.5bn in treasury stock by the end of FY3/24.

3) Digital Ink Service launch and investment

The Company is working i) to launch businesses in three core value fields (AI, XR, and Security), and ii) to recover its investments in technology development. With regard to i) in particular, in addition to the three fields of AI (started commercialization in the education field), XR (final PoC product announced in November 2023), and Security (Wacom Yuify beta version currently released in the market), the Company is also promoting projects in remote technology (beta version of remote solution currently released in the market).

Results trends in past years

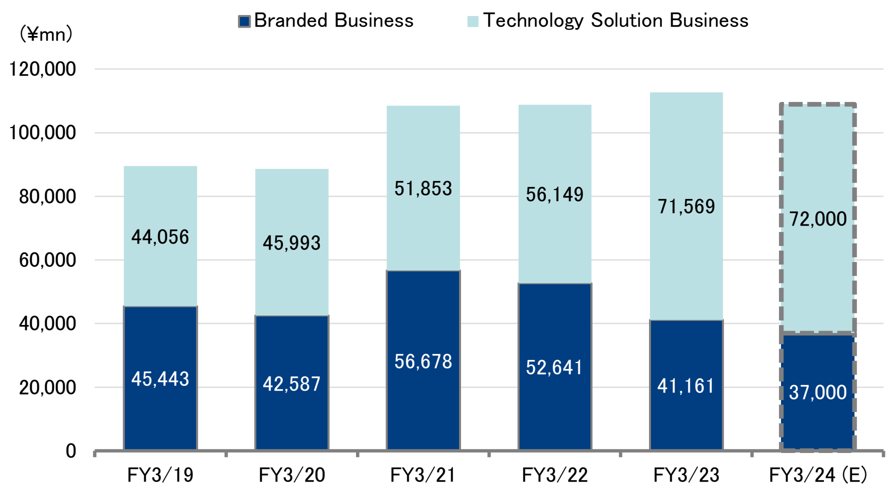
Technology Solution Business driving growth over the past few years due to increase in demand from OEM partner manufacturers for smartphones, etc.

Looking at how sales trended up to FY3/20, prior to the COVID-19 pandemic, the sudden, large slump in FY3/17 occurred because of the combined impacts of yen appreciation, excessive internal IT infrastructure investment, product cycle movement, and other factors. Since then, however, sales recovered with growth in the Technology Solution Business. Nevertheless, Branded Business sales have been trending lower with the structure of positive growth in the Technology Solution Business continuing to offset its decline. The Branded Business experienced rapid growth in sales in FY3/21, mainly for online education due to the COVID-19 pandemic, while in FY3/22 despite the end of a surge in stay-at-home demand, growth in display products for professionals and the Technology Solution Business resulted in and achieved new record high net sales for a second consecutive year. Since entering FY3/23, the Branded Business (especially low- to mid-priced models) experienced a significant downturn due to a sharp drop in consumer sentiment caused by the global economic slump and decline of special demand related to COVID-19, but the growth of the Technology Solution Business secured an increase in sales.

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

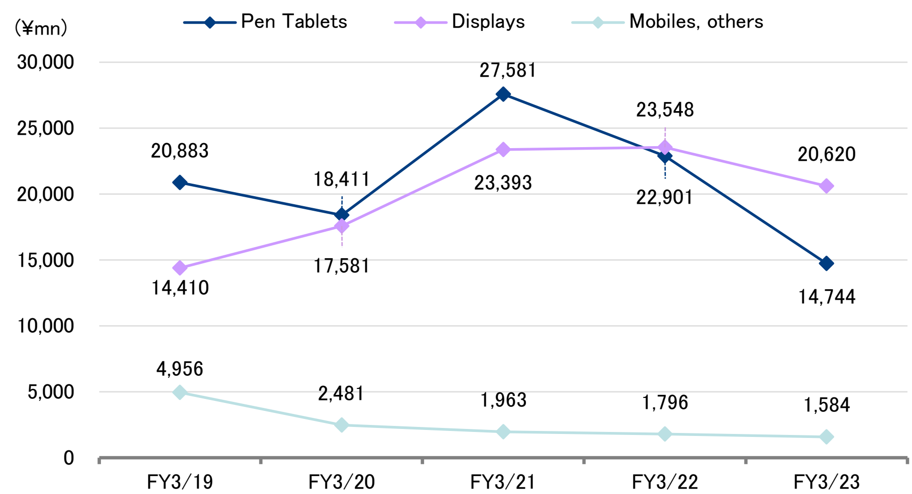
In financial standing, while the capital ratio temporarily slipped in FY3/17 on a hefty net loss due to recording impairment losses on IT assets, it has steadily improved since then with buildup of retained profits and has moved close to 60%. However, the capital ratio declined slightly in FY3/23 due to the acquisition of treasury stock and other factors. ROE, which reflects capital efficiency, and ROIC, which reflects efficiency of business activities, have been at high levels, but declined significantly in FY3/23 along with the drop in profits. The Company has indicated that it intends to promote business management with awareness of capital efficiency through the use of financial leverage up to a D/E ratio of around 0.3x to 0.5x from FY3/24 to FY3/25, while ensuring financial soundness. As of the end of 1H, the D/E ratio stood at just over 0.3x, which the Company has retained a good balance. Going forward, allocation of cash flow generated through management of operating capital, particularly inventories and business profits to investments and shareholder returns will also be important financial indicators for determining if the Company is maintaining its sound financial state, and should be monitored in conjunction with the D/E ratio.

Trends in net sales by business

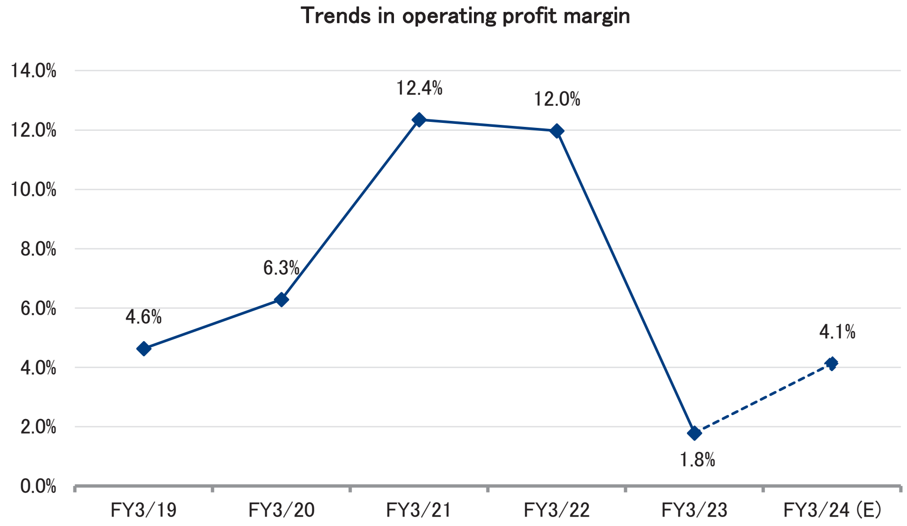


Source: Prepared by FISCO from the Company's financial results and results briefing materials

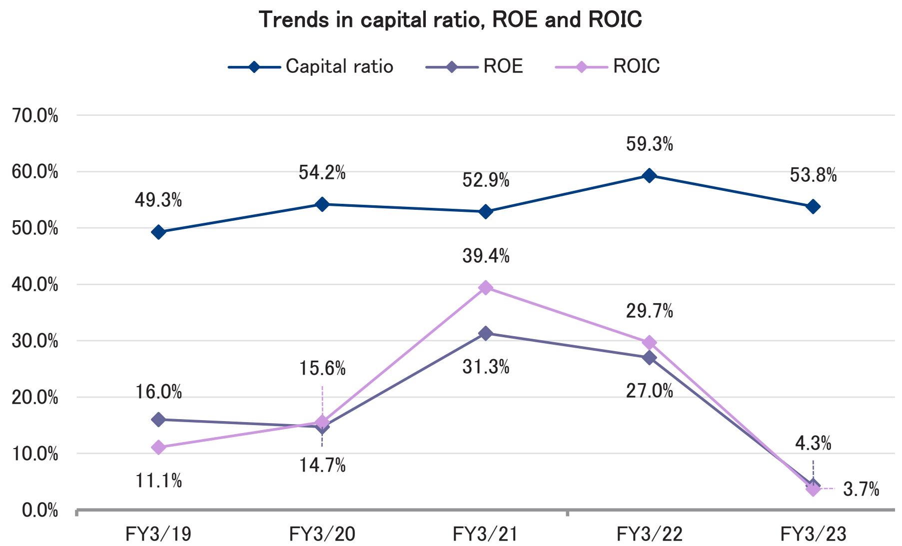
Sales trends in major products



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



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



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

Initiatives for society

Supporting a sustainable society through provision of “lifelong ink”; Publishing the Wacom Story Book in May 2023 to communicate the Company’s philosophy and value creation mechanisms

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

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

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

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

The Company also considers responding to climate change to be an important issue in environmental management. It has joined the Japan Climate Initiative (JCI) and announced CO_2 emissions targets to be reached by fiscal 2030 by reducing its CO_2 emissions by an annual rate of 4.0% (reference year: FY2014. This initiative will include efforts to publish environmental performance information, such as the reduction of greenhouse gases (GHGs) and CO_2 emissions (Scope 1, Scope 2, and Scope 3). At the same time, the Company will conduct business activities based on analysis of the risks and opportunities to the business environment created by climate change. In addition, as an action that will lead to a reduction in CO_2 emissions in the value chain as a whole, it requires that its suppliers support and implement the Wacom Suppliers Code of Conduct. The Company is also progressing the formulation of a BCP to respond to the risk of a restriction to corporate activities due to floods and other natural disasters, which are increasing year by year. Based on these activities, the Company announced its support for the TCFD (Task Force on Climate-related Financial Disclosures) recommendations on April 13, 2023.

The Company launched the "Wacom Story Book"* in May 2023, a booklet that covers some elements from the integrated report, primarily ESG, and tells a series of stories about the Company's philosophy, the thoughts of its employees, and the feedback of its users.

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

Returns to shareholders

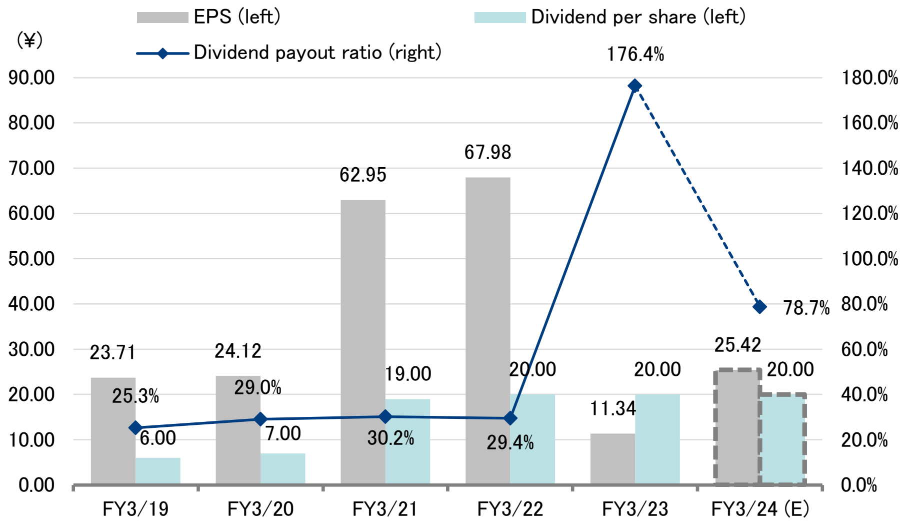
The Company plans to pay a dividend of ¥20 per share for FY3/24, the same amount as the previous period. A treasury share acquisition with a total acquisition amount of up to ¥6.5bn was decided on October 31, 2023.

The Company's basic policy towards shareholder returns is to pay steady dividends on its profits after considering the amount of funds to be retained for future business development and a sound financial base. With regard to dividends, the Company has set a guide for consolidated dividend payout ratio of around 30%, keeping in mind the need to ensure financial soundness. Even if dividends exceed that level, the Company intends to maintain steady dividends per share in principle and aims to return profits through increasing dividends per share over the medium to long term. Also, the Company only pays dividends once at the end of the fiscal period in consideration of keeping down administrative costs. With regard to dividends for FY3/24, the Company plans to pay a dividend of ¥20.0 per share, the same amount as the previous fiscal year (dividend payout ratio of 78.7%).

With regard to acquisition of treasury stock, the Company intends to execute a flexible capital policy in response to changes in the management environment, giving consideration to investment opportunities and its financial status, among other factors. For the period covered by "Wacom Chapter 3" (FY3/22 to FY3/25), the Company's treasury stock acquisition policy has an upper limit of ¥20bn in total (by September 30, 2023, the Company had completed the acquisition of a total of ¥6bn in treasury stock). On October 31, 2023, the Company decided to acquire treasury stock up to a total amount of ¥6.5bn (up to 13.00 million shares; acquisition period from November 1, 2023 to March 29, 2024).

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

Trends in EPS, dividend, and dividend payout ratio



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

Company profile

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

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

In 1991, it entered into the pen sensor components field (currently, the Technology Solution Business). The Company conducts OEM supply of digital pens, control ICs, touch panels, and other parts and modules to finished product manufacturers. It has achieved rapid growth amid expansion of tablet, notebook PC, and smartphone markets.

In the securities market, after listing on the Japan Securities Dealers Association's JASDAQ market in April 2003, the Company became listed on the Tokyo Stock Exchange's First Section in December 2005, where it remains today. (From April 2022, the Company transitioned to the Tokyo Stock Exchange's Prime Market.)

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