Wacom Co., Ltd.
6727 Tokyo Stock Exchange First Section

27-Dec.-16

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Recovery expected by new products in the Creative Business despite weak H1 FY3/17

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

In the first half of the fiscal year through March 2017, i.e., in H1 FY3/17, the Company generated consolidated net sales of ¥33,796mn but suffered an operating loss of ¥897mn. At the beginning of the fiscal year, the Company had projected an operating income of ¥100mn for H1 FY3/17, so it undershot this forecast by almost ¥1.0bn. Most of this underperformance was due to the appreciation of the Japanese yen against other currencies, particularly the euro. In the Brand Business, sales of product lines close to the end of their model lives declined, and profitability worsened as the product mix deteriorated accompanying a shift to lower-priced goods resulted from an increase in sales to developing markets and expansion of entry-level users. Excluding the impact of yen appreciation, the Technology Solution Business performed well in H1.

The Company foresees an increase in sales in the Brand Business for H2 FY3/17, turning around from Q2, led by sales of new products. However, the Company projects a large drop in sales and profits in the Technology Solution Business because of a sharp downturn in shipments of pen sensor components for smartphones after leading customer Samsung Electronics stopped producing its Galaxy Note 7 smartphone. In August, Wacom lowered its forecasts for FY3/17, and in November, the Company again lowered its forecasts for several reasons: 1) the business environment for Business Solution, part of the Brand Business, had become very challenging, 2) the Company was behind schedule in launching new displays for creative users, 3) sales of styli to general consumers had been anemic, and 4) sales and profits in the Technology Solution Business turned to be weaker than previous forecast as mentioned above. For FY3/17, the Company is projecting a 9.4% y-o-y drop in consolidated sales to ¥70.3bn and an operating loss of ¥500mn.

The Company displayed its strengths again even in Q2 FY3/17. In the Creative Business of the Brand Business, overall sales volumes increased y-o-y, except for products at the end of their model change cycles. In the Consumer Business of the Brand Business, FISCO foresees high sales growth potential for smartpads, which transform handwritten notes into digital versions. In the Technology Solution Business, new demand is arising for digital pens. FISCO believes that if sales in the Brand Business improve in H2 FY3/17 as the Company anticipates, this could support a recovery of sales and profits from FY3/18.

It is difficult to project the Company's business performance in FY3/18 because of uncertainty about shipments by the Technology Solution Business to Samsung Electronics. In the worst case, there could be no such. However, the Company could ship components to Samsung Electronics for an improved version of its Galaxy Note smartphone or for Samsung's next-generation smartphone. The recovery of sales in the Brand Business foreseen for H2 FY3/17 could persist throughout FY3/18. This is because FY3/18 is when the full effect of new products can be felt across the entire year. To verify this possibility, FISCO will monitor the trend of sales of new products in H2 FY3/17.

Check Point

- In H1 FY3/17, sales declined and the company suffered an operating loss due largely to yen appreciation against the euro after Great Britain decided to leave the European Union
- Sales volumes of some brand products grew in H1, reflecting strong markets for these products
- All three lines of Creative Business products will sell new products in FY3/18

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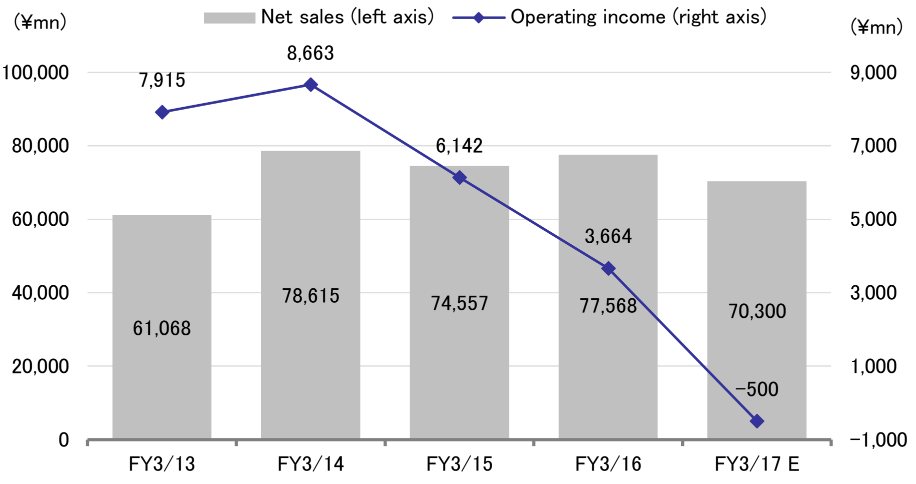
Results Trends



Analysis of H1 FY3/17 results

In H1 FY3/17, sales declined and the company suffered an operating loss due largely to yen appreciation against the euro after Great Britain decided to leave the European Union

Overall results

In H1 FY3/17, consolidated sales fell 13.2% y-o-y to ¥33,796mn, and the Company logged an operating loss of ¥897mn, reversing an operating income of ¥2,053mn in H1 FY3/16, an ordinary loss of ¥1,021mn, versus an ordinary income of ¥2,098mn in H1 FY3/16, and a loss attributable to owners of parent of ¥1,226mn, against a net profit of ¥1,261mn in H1 FY3/16.

Summary of the H1 FY3/17 Results

(¥mn)

	FY3/16	FY3/17			
	H1 Results	Initial forecast for H1	Revised forecast for H1	H1 Results	y-o-y growth rate
Net sales	38,956	37,230	34,180	33,796	-13.2%
Gross profit	15,056	-	-	13,240	-12.1%
SG&A expenses	13,003	-	-	14,138	8.7%
Operating income	2,053	100	-1,070	-897	-
Operating income margin	5.3%	0.3%	-3.1%	-2.7%	-
Recurring income	2,098	70	-1,140	-1,021	-
Profit attributable to owners of parent	1,261	50	-870	-1,226	-

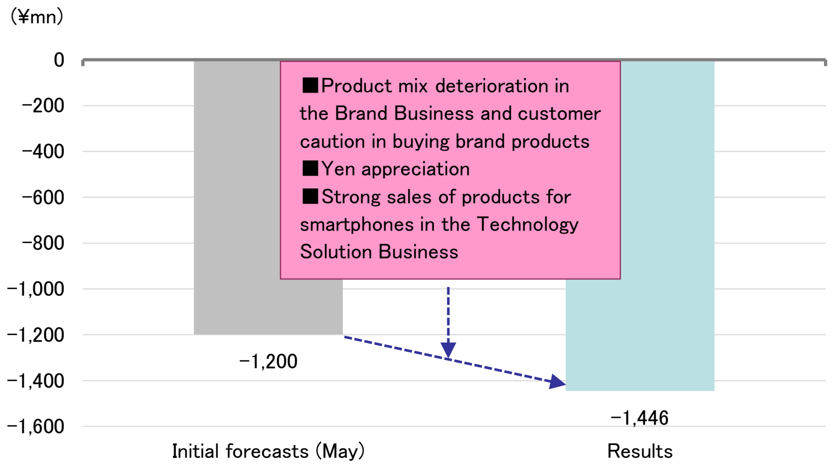
Source: prepared by FISCO from the financial results summary

FISCO believes that it is appropriate to understand and evaluate the Company's H1 FY3/17 results relative to Company forecasts, rather than to results in H1 FY3/16, and that it is informative to examine these results by quarter. Wacom's sales vary by season. Usually, sales in the first half of a fiscal year barely exceed the break-even level, and the Company earns most of its profit in the second half, when its sales to creative users rise accompanying drives in holiday selling season and an upturn in purchases by companies toward fiscal year-end.

For Q1 FY3/17, the Company reported a consolidated operating loss of ¥1,446mn. At the start of the fiscal year, the Company said that it expected to suffer an operating loss in Q1 FY3/17 similar in size to its operating loss in Q4 FY3/16, of ¥1,169mn. Thus, we estimate that the Company expected an operating loss of about ¥1,200mn for Q1. In fact, the operating loss in Q1 FY3/17 was ¥246mn larger than ¥1,200mn.

FISCO believes that the Q1 operating loss was larger than expected by the Company for two reasons: 1) the product mix in the Brand Business deteriorated more than the Company had expected, and 2) sales of mobile equipment and other products in the Creative Business of the Brand Business approaching the end of their model change cycles fell. The Company's average effective exchange rates for business in Q1 FY3/17 were ¥109.07 per US dollar and ¥122.47 per euro, which were close to the Company's initial assumptions for FY3/17 of ¥110 per US dollar and ¥125 per euro. Thus, exchange rate variations from expectation had little impact on Q1 results.

Q1 FY3/17 Operating loss versus Company forecasts



Source: prepared by FISCO from the financial results summary

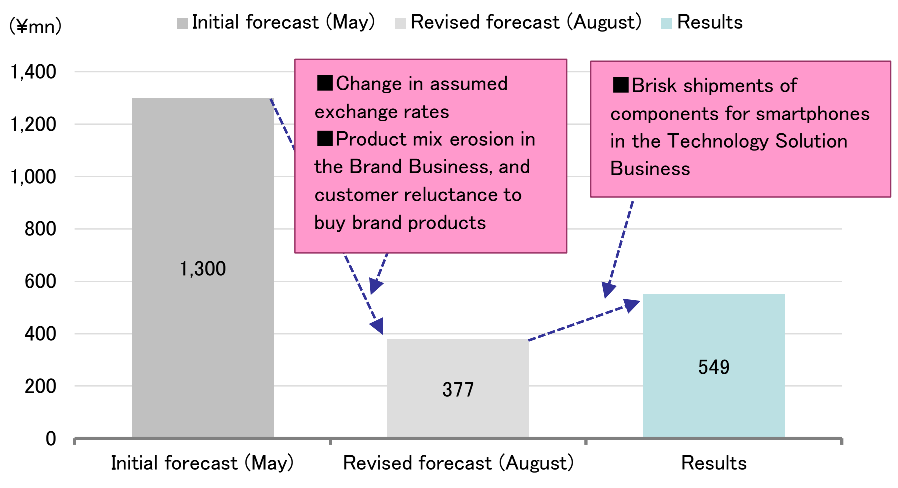
FISCO believes that the Company's biggest miscalculation about Q1 was not about the business environment, but about the extent of yen appreciation against the euro after the UK decided to leave the EU. Based on experience, the excess operating loss reported for Q1, relative to our estimate of the Company's planned loss, could be offset by profit in the final three quarters of FY3/17. However, the large appreciation of the yen against the euro forced the Company to lower its forecasts for the rest of the fiscal year.

When the Company first forecasted its results for FY3/17, we estimate that it planned to earn an operating income of ¥1.3bn in Q2 (we derived this estimate by subtracting from the Company's initial forecast of operating income for H1 our estimate of the Company's projection of its operating loss for Q1). However, when the Company announced its Q1 results, it cut its forecasts for H1, and its new forecast of H1 operating income indicated that it projected an operating income of only ¥377mn for Q2, or ¥923mn less than our estimate of its original projection.

The biggest reason for these downgrades of forecasts is a change in the exchange rates assumed by the Company for Q2–4 from ¥110 per US dollar to ¥103 and from ¥125 per euro to ¥114. FISCO estimates that these changes in assumed exchange rates would have lowered the Company's operating income by about ¥600mn. Furthermore, FISCO believes that the Company expected two factors that affected Q1 results to persist in Q2. These factors were a deterioration of the product mix and a reluctance of customers to buy products approaching the end of their model change cycles. These three factors together probably accounted for the ¥923mn cut in the Company's forecast of Q2 operating income, based on FISCO estimates.

For Q2 FY3/17, the Company reported an operating income of ¥549mn. This surpassed our estimate of the Company's expectation mainly because of brisk shipments of pen sensor components for smartphones and tablet PCs in the Technology Solution Business. The Company's average effective exchange rates for Q2 were close to its revised rate assumptions, so exchange rates had little impact on the over-performance of operating profit.

Q2 FY3/17 Operating income versus Company forecasts



Source: prepared by FISCO from the financial results summary

The Company reported an operating loss of ¥897mn for H1 FY3/17. At the beginning of the fiscal year, the Company had projected an operating income of ¥100mn for H1 FY3/17, so it undershot this forecast by almost ¥1.0bn. Most of this underperformance was due to the appreciation of the Japanese yen against the euro. In the Brand Business, sales of product lines close to the end of their model lives declined, and profitability worsened as the product mix deteriorated accompanying a shift to lower-priced goods. Excluding the impact of yen appreciation, the Technology Solution Business performed well in H1.

■ H1 FY3/17 Results by Business and Product Line

Sales volumes of some brand products grew in H1, reflecting strong markets for these products

(1) Brand Business

In the Brand Business, net sales dropped by 15.4% y-o-y to ¥19,326mn in H1 FY3/17, and operating income fell by 43.7% to ¥2,051mn. Details of this outcome follow below, but the sales volumes of some products in this business grew y-o-y, reflecting market growth. However, yen appreciation and product mix deterioration caused sales and income to decline. Sales of mobile products, which command high prices, fell 52.4% y-o-y in H1 FY3/17, greatly affecting overall sales and profits.

Brand Business results

(¥mn)

	FY3/17											
	H1		H2		H1		H2		Full fiscal year			
	Results	y-o-y growth rate	Results	y-o-y growth rate	Results	y-o-y growth rate	November forecasts	y-o-y growth rate	Initial forecasts	August forecasts	November forecasts	y-o-y growth rate
Net sales	9,262	-13.9%	10,064	-16.8%	19,326	-15.4%	29,073	11.5%	56,200	53,200	48,400	-1.1%
Operating income	986	-40.2%	1,064	-46.5%	2,051	-43.7%	5,248	19.5%	11,400	9,660	7,300	-9.2%
Operating income margin (%)	10.7%	-	10.6%	-	10.6%	-	18.1%	-	20.3%	18.2%	15.1%	-

Source: prepared by FISCO from the financial results summary

The largest component of the Brand Business is the Creative Business, which sells three kinds of products to creative users: pen tablets, mobile products, and displays.

A pen tablet is a tablet device with an digital pen used to input data into the device, the most basic type of input device. The Company offers a broad range of pen tablets, from entry-level to professional-use. In H1 FY3/17, the Company's sales of pen tablets fell by 12.3% y-o-y. In volume, sales of advanced models were basically unchanged y-o-y, but the value of sales decreased because of yen appreciation. The sales volume of medium-zone models also unchanged while low-priced models increased y-o-y, accompanying mix increase of the models due to greater sales to entry-level users in China, India, and South America.

Mobiles are pen tablets (mentioned above) with tablet PCs. These tablet devices are capable of functioning as personal computers with similarity to other companies' tablet PCs using digital pens for input, making Wacom's products susceptible to competition. However, Wacom's mobile products are specialized in pen input for top creators. In H1 FY3/17, sales of mobile products fell by 52.4% y-o-y because Apple and Microsoft released similar products. Wacom's mobile products are still superior to the products offered by Apple and Microsoft in terms of input capability by top creators, but sales of some of Wacom's mobile products for mid-level users decreased because of competition from Apple and Microsoft. Furthermore, sales of Wacom's leading models of mobile products were hurt by the fact that these models were near the end of their model lives.

Displays are pen tablets with LCD screens. They are similar to mobile products in that input is written on LCD screens, but they lack an operating system and a memory device, so they function the same as pen tablets as peripherals to PCs. The Company's mobile products need to be replaced rather frequently because the devices that comprise these products tend to become obsolete in general, but its displays can be used for a longer time because of their flexible connectivity to PC systems and other equipment. In H1 FY3/17, the Company's sales of displays declined by 4.2% y-o-y, a modest fall, given the impact of yen appreciation. In volume, display sales grew almost 20% y-o-y, supported by firm demand from top creators and strong sales growth of small displays in Asia. However, this growth in sales volume also seemed to be affected by product mix shifting to low-priced models.

The Consumer Business division of the Brand Business designs and sells 1) the Bamboo series of digital pens functioning on tablet devices made by companies with which Wacom has no business tie and 2) the smartpads for digitalizing handwritten notes such as the Bamboo Spark. In H1 FY3/17, sales in the Consumer Business dropped by 31.4% y-o-y. Sales of the Bamboo Spark, the Company's first-generation smartpad, grew, but sales of styli for iPads fell substantially reflecting changed market conditions and the approaching end of the model life.

Business Solution products are pen tablets for commercial use. Representative products include terminals for digital signatures on credit cards, terminals for opening accounts at financial institutions, for the guest books of accommodation facilities, and for education and medical treatment. In H1 FY3/17, the Company's sales of Business Solution decreased by 14.4% y-o-y. Sales of some models increased in volume in Japan, India, and some other markets, but sales in Europe, which account for more than half of total sales, fell due to a worsening of economic sentiment.

Sales in the Brand Business by product line

(¥mn)

	FY3/17				
	H1 Results	y-o-y growth rate	November forecasts for H2	y-o-y growth rate	November forecasts for full fiscal year
Brand Product Business	19,326	-15.4%	29,073	11.5%	48,400
Creative business	16,876	-15.0%	24,924	13.5%	41,800
Pen tablets	9,794	-12.3%	13,306	2.5%	23,100
Mobile	1,224	-52.4%	4,176	121.9%	5,400
Display	5,858	-4.2%	7,442	4.7%	13,300
Consumer business	465	-31.4%	1,135	-22.9%	1,600
Business solution	1,986	-14.4%	3,014	14.3%	5,000
Operating income	2,051	-43.7%	5,249	19.5%	7,300
Operating income margin	10.6%	-	18.1%	-	15.1%

Source: prepared by FISCO from the financial results briefing materials

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For FY3/17, the Company forecasts a 1.1% y-o-y decline in net sales in the Brand Business to ¥48.4bn and a 9.2% fall in operating income to ¥7.3bn. These forecasts imply that the Company expects net sales of ¥29,073mn (up 11.5% y-o-y) and operating income of ¥5,249mn (up 19.5% y-o-y), or an operating income margin of 18.1%, for the business in H2 FY3/17.

The main reason that the Company projects a recovery of sales and profit growth for the business in H2 is that all three product lines in the Creative Business of the Brand Business plan to launch new models in H2. As stated above, one reason for weak sales in the Brand Business in H1 was that customers declined to buy products that were approaching the end of their model lives. Many customers who love Wacom's products are repeat buyers, and we suspect that these customers are well aware of the timing of new products from the Company.

The mobile product line, which saw a large drop in sales in H1 FY3/17, released new products in early November. Data on the sales of new products are not yet available, but the Company's top priority for this product line is to protect its virtually 100% share of the market for mobile products for top creators and heavy users of such equipment. Therefore, new mobile products can produce 3D designs and have more advanced color management ability than previous models. The pen tablets product line plans to market new products in early 2017. The displays product line is behind schedule in developing new products, but its products are likely to be launched before the end of FY3/17.

The Consumer Business plans to market the next generation of its smartpads in H2 FY3/17, which should support a y-o-y rise in sales in this business, and year-end sales and other seasonal factors are likely to improve profits in the business in H2, relative to H1.

The Company also expects profits in the Business Solution to grow h-o-h in H2, reflecting sales increases in Asia and other growing markets and seasonal factors. However, because of the likelihood of increased competition in the business and continued weak sales in Europe, the Company's forecasts for this business in H2 and the full fiscal year are much smaller than its initial forecasts.

The sharp recovery in operating income h-o-h in H2 projected by the Company may seem extreme, but it would not be strange if sales grew as forecast because most of the Company's SG&A expenses are fairly fixed, so they should not change much even if sales grow. The increase in gross profit stemming from sales growth should flow straight into operating income, lifting the operating income margin.

(2) Technology Solution Business

In the Technology Solution Business, net sales fell by 10.4% y-o-y to ¥14,141mn in H1 FY3/17, while operating income dropped by 15.4%to ¥1,788mn. This performance is discussed in detail below, but sales of products for smartphones, which account for a large portion of total sales in this business, were brisk, and sales of products for tablet PCs also advanced. Total sales declined due mainly to yen appreciation, but the business apparently performed as the Company had anticipated.

Technology Solution Business results

(¥mn)

	FY3/17											
	H1		H2		H1		H2		Full fiscal year			
	Results	y-o-y rate of change	Results	y-o-y rate of change	Results	y-o-y rate of change	November forecasts	y-o-y rate of change	Initial forecasts	August forecasts	November forecasts	y-o-y rate of change
Net sales	3,828	-9.7%	10,313	-10.7%	14,141	-10.4%	7,058	-42.1%	25,100	23,900	21,200	-24.2%
Operating income	-95	-	1,884	-0.7%	1,788	-15.4%	-888	-	1,600	1,390	900	-71.2%
Operating income margin (%)	-2.5%	-	18.3%	-	12.6%	-	-12.6%	-	6.4%	5.8%	4.2%	-

Source: prepared by FISCO from the financial results summary

In the Technology Solution Business, all sales for smartphones are of pens for the Galaxy Note series manufactured by Samsung Electronics. In Q1, mass shipments of products for the new Galaxy Note 7 smartphone started promisingly, and in Q2, these shipments expanded. Furthermore, shipments for the Galaxy Note 5 remained firm. Because of yen appreciation against the US dollar, however, sales for smartphones dropped by 10.5% y-o-y in H1 FY3/17.

The mass production of AES digital pens for tablet PCs increased in H1. Sales increased to existing customers, including Hewlett-Packard, Dell, Toshiba <6502>, and Fujitsu <6702>, and the business started selling to Huawei Technologies of China. Market demand continued to shift from notebook PCs to 2-in-1 tablet PCs in H1, benefiting this business through market expansion for Wacom. As a result, sales of digital pens for tablets grew by 0.2% y-o-y in H1 FY3/17, despite yen appreciation and a sales decline in response to strong demand from the Turkish government in H1 FY3/16.

Recently, new models of tablet PCs with digital pens, such as Lenovo's Yoga Book product, have become hit products. If tablet PCs with digital pens become common, the demand for digital pens for smartphones may also expand, allowing the Company to escape its sole dependence on Samsung Electronics in the market for digital pens for smartphones.

Sales of products for notebook PCs plummeted by 55.3% y-o-y in H1 FY3/17 because of the market shift from notebook PCs to tablet PCs. Currently, sales of products for notebook PCs have fallen to about one-tenth of sales of products for tablet PCs.

Sales in the Technology Solution Business by product line

(¥mn)

	FY3/17				
	H1 Result	y-o-y growth rate	November forecasts for H2	y-o-y growth rate	November forecasts for full fiscal year
Technology Solution Business	14,141	-10.4%	7,058	-42.1%	21,200
For smartphones	8,435	-10.5%	2,065	-70.2%	10,500
For tablet PCs	5,162	0.2%	4,138	-5.6%	9,300
For notebook PCs	545	-55.3%	855	-1.7%	1,400
Operating income	1,788	-15.4%	-888	-	900
Operating income margin	12.6%	-	-12.6%	-	4.2%

Source: prepared by FISCO from the financial results summary

For FY3/17, the Company forecasts net sales of ¥21.2bn (down 24.2% y-o-y) for the Technology Solution Business and operating income of ¥900mn (down 71.2%). These forecasts imply net sales of ¥7,058mn and an operating loss of ¥888mn for H2. Both these figures would be down substantially y-o-y and relative to H1.

These falls in net sales and operating income in the Technology Solution Business in H2 will be due to a large drop in sales of products for smartphones after Samsung Electronics stopped producing its Galaxy Note 7 smartphone. The Company expects its sales of products for smartphones to fall to ¥2,065mn in H2 FY3/17 from ¥8,435mn in H1. H2 sales would result from sales for the Galaxy Note 5 model of smartphone and the liquidation of remaining components for the Galaxy Note 7 model.

The Company expects its sales of AES digital pens for tablet PCs to continue to grow in H2, but it foresees a continued drop in sales of digital pens for notebook PCs, reflecting the shift in market demand toward tablet PCs.

Company Forecasts for FY3/17

Basic demand for the Company's products remains firm despite second downward revision of forecasts for FY3/17

As described previously, the Company lowered its forecasts for FY3/17 in August, when it announced its Q1 results and in November, when it announced its H1 results. For the current fiscal year, it now projects consolidated net sales of ¥70.3bn (down 9.4% y-o-y), an operating loss of ¥500mn, reversing an operating income of ¥3,664mn in FY3/16, an ordinary loss of ¥650mn versus an ordinary income of ¥3,776mn in FY3/16, and a loss attributable to owners of parent of ¥1.5bn against a profit of ¥2,309mn a year earlier.

The forecast downgrade in August was due mainly to yen appreciation against other currencies. The downgrade in November was attributed mainly to a delay in developing new brand products and a bleak outlook for the Technology Solution Business following Samsung Electronics' decision to stop producing its Galaxy Note 7 smartphone, virtually ending the Company's shipments of pen sensor components for this model.

Although the development of new brand products has been delayed, the Company projects y-o-y rises in sales in the Brand Business for H2 FY3/17, led by an increase in sales volume. Its products for creative users are competitive, and the basic demand for most of its products remains solid. Sales of advanced, high-priced mobile equipment fell notably in H1, but the Company is particularly optimistic about an upturn in these sales in H2.

Consolidated Net Sales and Operating Income by Business

(¥mn)

		FY3/17					
		H1		H2		Full fiscal year	
		Results	y-o-y growth rate	November forecasts	y-o-y growth rate	November forecasts	y-o-y growth rate
Net sales	Brand Business	19,326	-15.4%	29,073	11.5%	48,400	-1.1%
	Technology Solution Business	14,141	-10.4%	7,058	-42.1%	21,200	-24.2%
	Other Businesses	327	4.1%	372	7.0%	700	5.6%
	Subtotal	33,796	-13.2%	36,503	-5.5%	70,300	-9.4%
	Total net sales	33,796	-13.2%	36,503	-5.5%	70,300	-9.4%
Operating income	Brand Business	2,051	-43.7%	5,248	19.5%	7,300	-9.2%
	Technology Solution Business	1,788	-15.4%	-888	-	900	-71.2%
	Other Businesses	-13	-	113	-	100	-
	Subtotal	3,826	-33.9%	4,473	-17.3%	8,300	-25.9%
	Adjustments	-4,724	-	-4,075	-	-8,800	-
	Total operating income	-897	-	397	-75.3%	-500	-

Source: prepared by FISCO from the financial results summary

It is too early to project whether the Company is likely to achieve its revised forecasts for FY3/17, but the yen has recently been weaker against the euro than the rate assumed by the Company, which supports this likelihood. FISCO sees little risk of sales and profits in the Technology Solution Business falling below the Company's current forecasts because sales of products for the Galaxy Note 7 smartphone have essentially dropped to zero. Therefore, FISCO believes that the key to achieving the current forecasts for the entire company is the development and sale of new products in the Creative Business of the Brand Business.

Although Company sales of mobile products fell sharply in H1 FY3/17, a reassuring point is that there has been no change in the Company's plan to maintain its almost 100% share of the market for top creators and heavy users by taking advantage of its strength in specialized products. As noted earlier, its new mobile products will enable 3D design and will possess greater color management ability than previous products. These new products are likely to appeal to professional designers more than previous products, leading to increases in replacement demand and in demand for more advanced products. Accompanying a probable increase in the market for mobile products for mid-level users, the Company is likely to lose some of its share of this market to new competitors, such as Apple and Microsoft, but the Company has assumed such a market share decline in making its latest forecasts. Therefore, FISCO considers the brisk replacement sales of high-end products to top creators more important than the erosion of the Company's share of the market for mid-level users. This depends on the Company's self-reliant efforts of promoting brisk replacement sales of its high-end products, so FISCO believes that the Company could finally achieve its sales target for the Creative Business, main pillar of the Brand Business, as planned, although we should note possibility of slower emergence of demand for the products in the high-end market, which is a matter of timing issue.

Prospects for FY3/18

New products in all three product lines of the Creative Business will contribute to growth in FY3/18

At this point, it is impossible to predict the Company's business performance in FY3/18 because the prospects for its sales of pen sensor components for Samsung Electronics' smartphones are unknown. The Company could have no sales to Samsung Electronics in FY3/18.

The performance of the Brand Business in H2 FY3/17 should provide a hint of its likely performance in FY3/18 because the Creative Business of the Brand Business plans to launch new products for all three of its product lines before the end of FY3/17. In general, new products sell quickly after they are marketed, but Wacom's products tend to take time to amass sales as they are purchased to replace older products. Therefore, the new products launched in FY3/17 should contribute fully to sales growth in FY3/18. The displays product line of the Creative Business intends to launch new products in the end of 2016 to first three months of 2017. Thus, the new products in the Creative Business are likely to contribute more to sales and profit growth in FY3/18 than in FY3/17.

For the Technology Solution Business, the worst-case scenario would be the total absence of shipments to Samsung Electronics in FY3/18, as mentioned above. However, it is realistic to expect Samsung Electronics to improve its Galaxy Note smartphone or to market a more advanced smartphone. Wacom is developing digital pen technology for the next generation of smartphones, so it will be prepared to provide these products. New models of smartphones normally appear every 6–12 months, so Samsung Electronics is likely to announce a new model in the first three months of 2017. Therefore, when Wacom announces its results for FY3/17 and its forecasts for FY3/18, it should be able to estimate its sales to Samsung Electronics with some degree of certainty, FISCO contends.

FISCO believes that the Company's SG&A expense could increase y-o-y in FY3/18. Over the past three years, the Company has been investing heavily in its computer systems, and it plans to complete the installation of an ERP system in Japan and Asia in the final nine months of 2017. This is likely to result in a y-o-y increase in depreciation costs in FY3/18. This increase in indirect depreciation costs may probably more than offset a likely y-o-y drop in R&D expenses and other SG&A expenses in FY3/18. In FY3/19 and following years, the Company's depreciation cost should decline, however we should note that temporal increase of SG&A expenses in FY3/18 may bring negative impression to market participants.

The Income Statement and the Main Indicators

(¥mn)

	FY3/14	FY3/15	FY3/16	FY3/17		
				H1	H2 (F)	Full fiscal year (F)
Net sales	78,615	74,557	77,568	33,796	36,503	70,300
y-o-y	28.7%	-5.2%	4.0%	-13.2%	-5.5%	-9.4%
Gross profit	29,931	30,050	30,735	13,240	-	-
Gross margin	38.1%	40.3%	39.6%	39.2%	-	-
SG&A expenses	21,268	23,907	27,071	14,138	-	-
Ratio of SG&A expenses to net sales	27.1%	32.1%	34.9%	41.8%	-	-
Operating income	8,663	6,142	3,664	-897	397	-500
y-o-y	9.5%	-29.1%	-40.3%	-	-75.3%	-
Operating income margin	11.0%	8.2%	4.7%	-2.7%	1.1%	-0.7%
Recurring income	8,282	6,064	3,776	-1,021	371	-650
y-o-y	9.6%	-26.8%	-37.7%	-	-77.9%	-
Profit attributable to owners of parent	5,248	3,473	2,309	-1,226	-274	-1,500
y-o-y	10.0%	-33.8%	-33.5%	-	-	-
EPS after adjustment for share-split (¥)	31.31	20.86	14.00	-7.48	-1.76	-9.24
Dividends after adjustment for share-split (¥)	17.50	18.00	18.00	-	6.00	6.00
BPS after adjustment for share-split (¥)	196.14	202.14	188.22	150.42	-	-
Capital investment amount	3,464	4,082	4,862	1,701	2,099	3,800
Depreciation and amortization	1,812	1,970	2,004	1,240	1,360	2,600
R&D expenses	2,863	3,180	4,342	2,265	2,335	4,600

FISCO

Wacom Co., Ltd.
6727 Tokyo Stock Exchange First Section

27-Dec.-16

Balance Sheet

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17 Q2
Current assets	42,751	40,073	40,187	37,873	40,822
Cash and deposits	21,596	15,393	16,686	14,365	14,678
Notes and accounts receivable	10,601	11,388	9,875	10,161	12,626
Inventories	5,483	9,329	10,216	10,097	9,144
Fixed assets	7,372	10,785	11,269	13,692	13,537
Tangible fixed assets	4,409	5,332	4,608	4,538	4,281
Intangible fixed assets	2,407	3,221	5,441	8,131	8,201
Investments and other assets	554	2,231	1,219	1,023	1,054
Total assets	50,124	50,859	51,456	51,566	54,359
Current liabilities	19,596	16,239	15,880	16,478	18,369
Accounts payable	11,818	9,429	9,203	6,102	9,049
Short-term debt	600	600	600	4,000	3,000
Fixed liabilities	1,316	1,820	1,717	3,991	11,425
Shareholders' equity	29,926	31,939	32,617	30,770	25,844
Capital	4,203	4,203	4,203	4,203	4,203
Capital surplus	7,573	7,563	7,550	7,513	6,098
Retained earnings	18,353	21,710	22,318	21,629	17,442
Treasury stock	-204	-1,538	-1,455	-2,576	-1,900
Total accumulated other comprehensive income	-810	712	1,061	188	-1,420
Net assets, total	29,211	32,799	33,858	31,096	24,564
Total liabilities and net assets	50,124	50,859	51,456	51,566	54,359

Cash Flow Statement

(¥mn)

	FY3/13	FY3/14	FY3/15	FY3/16	FY3/17 H1
Cash flow from operating activities	5,894	733	6,782	2,009	-755
Cash flow from investing activities	-1,611	-4,415	-3,277	-4,878	-1,338
Cash flow from financing activities	4,336	-3,255	-2,849	1,209	3,303
Gain or loss on translation of foreign currency cash and deposits	1,006	735	637	-661	-896
Change in cash and deposits balance	9,626	-6,202	1,292	-2,321	312
Cash and deposits balance at start of fiscal year	11,969	21,596	15,393	16,686	14,365
Cash and deposits balance at end of fiscal year	21,596	15,393	16,686	14,365	14,678

■ Progress of SBP-2019 Strategic Business Plan

Company is revising this plan and its business targets

The Company is implementing its current Strategic Business Plan, SBP-2019, which it announced in April 2015. The plan covers the four fiscal years FY3/16–FY3/19 and aims to achieve consolidated net sales of ¥120bn, operating income of ¥14.4bn, and an ROE of 20% in the final year.

However, given the Company's large downgrades of its forecasts for FY3/17, including its changed assumptions about foreign exchange rates, the Company is apparently revising its strategic business plan and its performance targets.

FISCO expects the Company to announce its revised business plan in May 2017, when it releases its results for FY3/17. We do not expect the Company to change its basic strategy or direction, but just to alter its list of tasks to undertake to establish more realistic goals than those in the current plan.

Reorganization is one of the goals of the SBP-2019 plan. Through FY3/15, the Company was organized by geographical market, but it is attempting to convert to an organization of global business units to expedite decision-making and reduce unnecessary costs. After a year and a half of reorganization, the effort has not gone smoothly in some parts of the Company which are now virtually a mixture of decision-making partially by regional functions in each geographical market and partly by global business units. In some instances, this overlap of organization has resulted in cost increases due to ineffective disciplines. At Company meetings to explain the latest business results, Company President Masahiko Yamada has said that he is directly involved in reorganization of Creative Business and insisted that the Company will thoroughly reorganize and promote cost cuts in entire company. Given the current declines in the Company's net sales, it is more important than before to reduce SG&A expenses. We are interested in how the Company will achieve such reductions.

Returns to Shareholders

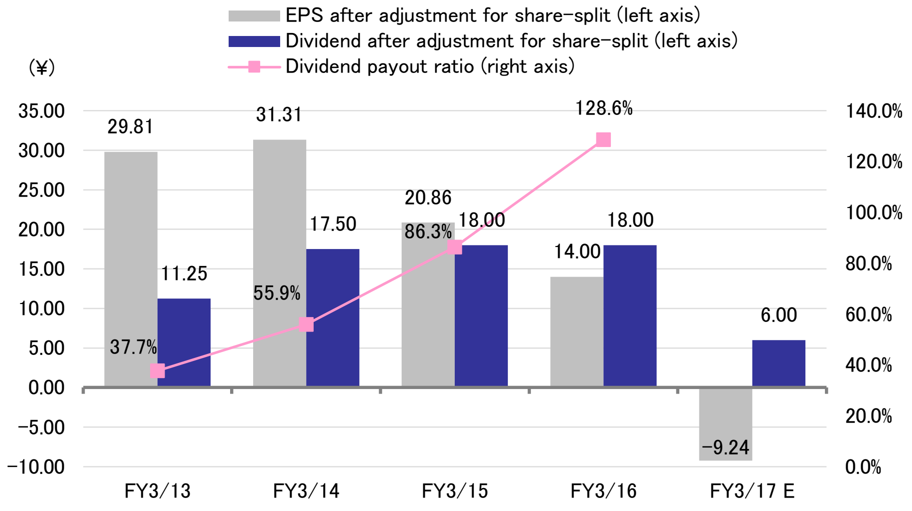
To maintain its financial soundness, the Company has lowered its planned dividends for FY3/17 to ¥6 per share

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

At the start of FY3/17, the Company planned to pay dividends of ¥18 per share for the year, but in August, when it lowered its forecasts, the Company also cut its planned dividends to ¥12 per share, and in November, when it again reduced its forecasts, it cut its planned dividends to ¥6 per share. The Company said that it needed to reduce its dividend payments to maintain its financial soundness, and FISCO believes that this was an appropriate decision.

The Company has also acquired some of its treasury stocks, though not on a fixed schedule like dividend payment. In August-September 2011, it bought 2 million shares; in October-December 2013, it purchased 2 million more, and in May-June 2015, it bought 2.3 million shares. It had originally planned to buy up to 5 million shares in FY3/17, and it bought 2,156,500 shares through November 8, 2016. On November 9, it announced that it would not buy any more shares in FY3/17, given its weaker forecasts of results. FISCO believes that the Company is likely to resume purchases in coming fiscal years after its businesses recover.

Trends in Net Income Per Share, Dividend, and Dividend Payout Ratio



Source: prepared by FISCO from the financial results summary