

Seiko Group Corporation

FY22 Q4 Consolidated Results Presentation - Q&A

- ◆ Date : Wednesday, May 10, 10:30-11:30, Tokyo, Japan
- ◆ Location : Keidanren Hall (hybrid style – virtual + real)
- ◆ Respondents : Shinji Hattori, Chairman & Group CEO & Group CCO
Shuji Takahashi, President
Akio Naito, Director, Senior Executive Vice President
Jun Sekine, Director, Senior Executive Vice President
Shimesu Takizawa, Director, Executive Vice President

Summary of Q&A

Q1. Consolidated gross profit (GP) began to improve in the 1Q but remained unchanged year-on-year in the 4Q. Including the results of the Watches Business, what factors contributed to this outcome? You set a target of one percentage point improvement in GP margin for this fiscal year. How do you expect to achieve that in each business segment?

A1. In the 4Q, GP was stagnant due to production adjustments in both the Devices Solutions Business (DS) and the Watches Business. If we consider only at the Watches Business, the GP margin for the 4Q was unchanged from the previous year.
We aim to improve the GP margin by one percentage point again this fiscal year. However, we will not achieve that by increasing the ratio of our high-margin, retail-oriented Watches Business and WAKO Business, but rather, by steadily improving the GP margin of the DS Business, Emotional Value Solutions Business (EVS), and Systems Solutions Business (SS) by one percentage point each.

Q2. It seems that advertising expenses in the 4Q were above the pre-COVID level. Was that because of the delayed posting of expenses for the watch trade show (Watches & Wonders Geneva 2023) or something similar, or because you began to accelerate investment in advertising in the 4Q?

A2. Until the 3Q, we projected increasing advertising expenses by approximately 10% from the previous year. However, that figure rose by 15% in the 4Q. This was due mainly to significant expenses (millions of dollars) related to the WWG trade show. It does not mean that we are accelerating our investment in advertising.

Q3. You forecast net sales in the EVS domain for this fiscal year to increase 2.5% year-on-year. Although sales of watch movements and sales in the mass-market price range are

slightly weak, it seems reasonable to expect that the price increase in GS and the strong performance in North America would offset that weakness. Why are you being so conservative in your estimates?

A3. Indeed, watch movements remain in a slump in this fiscal year. However, we are executing a major business model transformation in China, where we struggled last fiscal year. This is a strategic shift from selling mid-price-range products online to selling higher-value products at brick-and-mortar stores to increase our brand value. Because this strategy will take some time to produce tangible results, we are taking a cautious view of our Chinese business this year.

We believe that demand from Japan-bound tourists will gradually turn into a significant positive factor. Unlike products in the mass-market range, GS is gaining popularity overseas, and an increasing number of visitors to Japan now purchase GS products here. To some extent, this demand from Japan-bound tourists may be cannibalizing local sales in other Asian countries.

Our restrained forecast was based on continuing strong results in the high price range being offset by ongoing sluggishness in mass-market sales, watch movements, and the Chinese market.

Q4. You mentioned rising demand from inbound tourists helping to underpin sales in the Watches Business. What is your forecast for the impact of these tourists in the current fiscal year?

A4. Chinese tourists are just starting to return to Japan, so their demand has not yet produced a serious impact. While we do not expect sales to Chinese tourists to return to their peak level, they may account for as much as 10% of domestic sales, which would be significant.

Q5. When do you expect the production adjustment of watch movements and DS to end?

A5. With regard to watch movements, demand for analog quartz movements in the mass-market price range has been declining. We completed a production adjustment in the last fiscal year to respond to that trend. However, if market conditions continue to worsen, we will have to consider another adjustment this year, although we have no plan to do so at this time.

Turning to DS, we already completed a production adjustment of crystals and other products, and will now raise production levels while keeping a careful eye on market demand. For hard disk drive components, we will need to continue adjusting production, as we did in the last fiscal year.

Q6. Do you expect the DS production adjustment in the first half of this year to depress operating profit, and will that improve in the second half?

A6. Yes on both counts. We expect DS operating profit in the first half of this fiscal year will be much lower than in the previous fiscal year, but it should begin to recover together with the market recovery in the second half.

Q7. Is the increasing price of GS in the second-hand market one of the reasons why overseas customers come to Japan to purchase GS?

A7. No, we do not believe that tourists are coming to Japan to buy Grand Seiko because of the rising price of pre-owned products. In the first place, there are very few good quality, pre-owned GS products available in the secondary market. And more than that, Grand Seiko's recent increasing popularity overseas is not based on our older models (the kind that might end up in the secondary market). Rather, Grand Seiko's appeal has been growing in tandem with a growing interest in Japan and Japanese culture, and also thanks to our marketing strategy, which focuses on the *Nature of Time*. This strategy differentiates GS from the European luxury brands by highlighting Grand Seiko's uniquely Japanese sense of aesthetics and the legacy of Japanese hand-made craftsmanship, which is even more evident in recently released models.

Of course, the fact that GS won awards at the Geneva Watchmaking Grand Prix for two consecutive years has been a big plus, as were our efforts to expand digital communications during the pandemic years. We worked hard to show global markets what the Grand Seiko brand philosophy is all about and to display our newest designs, which were inspired by the beautiful scenery of the Japanese countryside where GS is made.

Q8. What is your current-term outlook for the Watches Business in the North American market?

A8. We are taking a cautious view of future demand due to inflation. Over the past few years, we have been establishing a high-end distribution system for GS and for global brands priced above US\$1,000. We do not believe that the weakening of macro demand will have a significant negative impact on this market segment. However, we do expect demand to slow somewhat compared to the past two years.

Q9. Could you explain your business model transformation in China and also give us an idea of your timetable for that shift?

A9. In the Watches Business, our business model in the Chinese market used to focus on mass selling using local influencers to advertise our products, both on the Internet and via other media. This strategy has changed due to "common prosperity" policies in the PRC, and more recently, to the zero-COVID policy, which caused us to struggle in the last fiscal

year.

It is clear that GS has a lot more room to grow in the Chinese market, so we are creating new distribution channels for high-end products. To transform our business model, we need to strengthen the GS team, adding people who are skilled in things like distribution and high-end product marketing. As to timing, we aim to build a strong foundation for this business during the current fiscal year and begin an aggressive campaign in the following year.