Seiko Holdings Corporation

FY2019 3rd Quarter Consolidated Results Presentation Summary of Q&A

- Date : Friday, February 14th, 2020, from 3:00-4:00 p.m.
- Place : Seiko Holdings Corporation, Head Office
- Summary of Q&A :

Q1. How much did the consolidated results fall below the internal plan in the 3rd quarter?

A1. The downside amount in the 3rd quarter is roughly the same as the downward revision of the financial forecast. The downward revision was made because we judged that it would be difficult to recover the 3rd quarter downside in the 4th quarter.

Q2. In the Watches Business for the 3rd quarter, low- and mid-priced market conditions were structurally severe, as sales to mass retailers worsened in Japan due to a reaction that was more serious than a surge in demand before the consumption-tax hike. Should we assume that these conditions will continue in the 4th quarter and into the next fiscal year?

A2. In addition to the effect of the consumption-tax hike, even mid-priced products that are close to the affordable-priced product range are also facing a harsh environment. As a countermeasure, we are working to raise the average price of mid-priced products, mainly focusing on Global Brands. We think that the severe market sentiment in the affordable-priced market will remain unchanged. However, more time will be necessary to ascertain whether or not to position this as a risk from the next fiscal year onwards, as our efforts are expected to have an effect. Among affordable-priced products, we consider some aspects of these conditions to depend on merchandising and marketing, such as releasing products with a solid concept, as seen in Seiko 5 Sports, which was relaunched in August 2019 and has been performing very strongly. However, fundamentally, we feel that those markets below the mid-priced market are set to be weak.

Q3. In the Watches Business, operating profit for the 3rd quarter (three months) decreased by approximately 2.3 billion yen year on year, excluding an improvement of more than 0.2 billion yen due to a change in the allocation method of expenses related to headquarters for some subsidiaries. Quantitatively, what are the main factors for this decrease?

A3. In the 3rd quarter, selling, general and administrative expenses increased by approximately 0.5 billion yen year on year. The main factor responsible for this was an increase in advertising and promotion expenses. Meanwhile, net sales did not reach the approximate 3.7 billion yen of the same period of the previous fiscal year. When this decrease in revenue is multiplied by the consolidated gross margin of 40%, it corresponds to an approximately 1.5 billion yen downward impact on gross profit. When adding the increased selling, general and administrative expenses of approximately 0.5 billion yen, the impact on operating profit is approximately 2.0 billion yen. While some other factors are also present, such as a slight difference between the gross profit margin of the Watches Business and the overall gross profit margin, which do not quite add up to match the 2.3 billion yen, this does not mean that other factors that worsen profit are occurring. While the products we have focused on sold well, and production efficiency improved from the first half of the fiscal year, the monetary impact was limited in the 3rd quarter, as net sales did not pick up. In addition, in a sluggish market in Japan, sales of Global Brands increased year on year, and profitability continued to improve due to an enhanced product mix. While there is no change in the fact that production efficiency is improving due to an increase in mechanical watches, the year-on-year improvement is becoming less noticeable.

Q4. The impact from the novel coronavirus is not included in the revised financial forecast. Can you please comment on the associated impact on sales, manufacturing, and supply chains, to the extent possible?

A4. We are currently examining the amount of impact, and the situation is changing constantly.

Regarding the extent of the impact, in the Watches Business, firstly, sales of watches are expected to decline in the Chinese market. However, because the sales volume in China for our Company is modest in scale, the impact of this decrease will also be modest. The sales company for watches in Shanghai was able to resume operations on February 10. We believe that if shipments of those products that could not be shipped up to February 10 proceed smoothly, sales can be recovered to some degree. Regarding the Chinese domestic market business, logistics are also struggling, and this impact needs to be considered, as well. In B to C, and in particular in the Watches Business, it is possible that Japanese domestic demand will weaken due to the impact from a reduction in tourists to Japan, and Japanese people also avoiding crowds and refraining from going out. In addition, we believe that similar phenomena may occur in Asian markets with many Chinese tourists. At the moment, it is very difficult to determine how long this situation will last.

With regard to B to B business and manufacturing, the Company owns several locations in China, each of which was essentially closed until February 10. Although these locations resumed operations from February 10, not all employees are necessarily able to go to work. For instance, employees are required to wait at home for two weeks, if returning from their home town in another province. Currently, the situation is that we have not yet reached full operations.

In addition, we are also collecting information from our suppliers. As of yet, no location has become unable to operate due to a lack of parts. Currently, we are carrying out production activities using in-stock inventories, while continuing to collect information.

Q5. Affordable-priced products have faced severe conditions in the Japanese watch business. How did Global Brands perform?

A5. Due to a surge in demand in September, sales of Grand Seiko (GS) and other Global Brands were depressed in October, as expected. Although the recovery seemed to be slightly weak in November as well, Global Brands, and in particular GS, recovered in December. Usually, sales begin to increase significantly from the second half of November, toward the Christmas shopping season. The current fiscal year, despite sluggish growth in November, Global Brands, centered on GS, began to recover going into December.

Q6. Regarding sales of Global Brands in Japan, although they did not deviate largely from the forecasts, was growth slightly weak and not as expected? What was the situation for Global Brands in each region in the overseas market?

A6. Overseas, Global Brands centered on GS grew the most in the U.S. Because we restricted the supply of affordable-priced products, overall growth in the U.S. was modest. However, Global Brands performed favorably, beyond our expectations each month in the 3rd quarter. In Europe, sales of Grand Seiko were in addition to existing sales. On a local currency basis, net sales at local subsidiaries in the Netherlands, France, and Germany increased year on year. Only in the U.K., the affordable-priced market was severe, and year-on-year sales were negative. However, even in the U.K., both mid- and high-priced products grew. Net sales of Seiko brands, including GS grew year on year at many other local subsidiaries. In China in particular, sales in the 3rd quarter grew significantly, mainly on Singles' Day in November.

Q7. What is the position of Grand Seiko and other Global Brands, in comparison to competitors?

A7. Overseas, it varies from country to country. In the U.S., Grand Seiko entered the top ten ranked brands two years ago, in a watch brand research study conducted by a third party. In the first half of the current fiscal year, the ranking rose further to become fifth. This is the situation in the U.S., which is our most favorable market. While other countries have not yet attained this level, each is progressing smoothly.

Q8. Regarding quartz movements in the watch movements business, what is the current status and future outlook for the market, and the operational status of production lines?

A8. When comparing the three types of what we call added-value watch movements, standard movements of analogue quartz, and mechanical movements, standard movements of analogue quartz were the weakest. While mechanical movements progressed at a faster pace than in the previous fiscal year, analogue quartz fell year on year, and standard movements also performed poorly. One factor is believed to be a cessation of growth in the Indian market, which at one time was experiencing growth. In India, we have heard that domestic personal consumption is slightly down due to unusual weather. Although we believe that continued growth is possible in some markets, going forward, the markets in which we can grow are limited, and expansion will be difficult, overall. In addition, we believe that the current downward trend will continue.

Q9. Was the reason for the downward revision of the financial forecast in the Watches Business: sluggish growth in mid- and high-priced products or a decline in sales of products below affordable-priced products?

A9. The revision was fundamentally a revision of the portion of the plan that was not achieved in the 3rd quarter. While mid- and high-priced products, including Global Brands did not grow as expected, we think that, on balance, the decline in affordable-priced products was a larger factor.

Q10. With regard to affordable-priced watches, if we consider that there was no substantial reaction, given the absence of a surge in demand before the consumption-tax hike, it seems that the poor conditions in the affordable-priced market represented a significant factor in the worsening of affordable-priced watches in the 3rd quarter. Because high-priced watches performed steadily, although not as well as expected, is it fair to assume that results can be expected if you take measures that focus on mid- and high-priced watches in the 4th quarter?

A10. There is no change in the Company's policy of strengthening mid- and high-priced products centered on Global Brands, and we do not consider this policy to be out of place, when looking at the current situation. We aim to achieve the announced 4th quarter targets, based on this policy. While it is possible that our expected activities may deviate slightly from this financial forecast, in part due to the impact from the novel coronavirus, we will continue with this policy, going forward.

Q11. Are promotions to increase revenue and profit in the 4th quarter focused on Japan, on a regional basis?

A11. Promotions will be implemented mainly in growing regions such as the U.S. and China, as well as in Europe, and will not be limited to Japan. However, expectations for the Japanese market, which has a larger proportion of net sales, remain high.

Q12. Advertising and promotion expenses increased by 15% in the 3rd quarter, on a cumulative basis. What are the details of such expenses? Are there any items that are unique to the current fiscal year? On a regional basis, where are expenses increasing?

A12. There are no unique items. One factor for this increase is investment depreciation and the activity costs necessary to establish additional locations, such as Seiko Dream Square. On a regional basis, we are increasing expenses overseas, such as in the U.S., where sales are growing. In addition, we are also increasing the distribution of digital marketing. However, advertising expenses in the 3rd quarter (three months) did not increase significantly, year on year.

Q13. How are you planning to spend sales promotion expenses for the current fiscal year and the next fiscal year (FY2020)?

A13. We expect advertising and promotion expenses for FY2020, which is the second year of the Mid-Term Management Plan, to increase relative to the current fiscal year, as planned, in order to achieve the final year of the Mid-Term Management Plan targets.

Q14. You have announced the integration of the watches businesses of Seiko Watch Corporation (SWC) and Seiko Instruments Inc.(SII) Can you please explain the objective once again? In addition, what are the possible impacts of this integration on the results for the next fiscal year (FY2020)?

A14. We announced that we will transfer mainly the manufacturing subsidiaries of the watches business of the SII Group to SWC (making them subsidiaries of SWC) on April 1, 2020. On April 1, 2019, we already transferred the design and development units of SII's watches business to SWC, which have now been operating for ten months. As the next step, we aim to transfer the manufacturing department, and have production and sales of our Group's watches businesses act within the same decision-making boundaries, in order to make various processes move more smoothly and speedily. April 2019 was the first step in this process, and the newly-announced integration represents the second step.

The effects that are expected in the next fiscal year involve speedy decision-making with respect to investments, products, and development, which will not immediately have a significant effect on business performance.

Q15. As the affordable-priced market is contracting in North America, going forward, what sales composition ratio are you aiming for between mid- and high-priced products, mainly Global Brands, and affordable-priced products in the U.S.? In addition, how much progress is being made with respect to that goal?

A15. In the U.S., while holding back on launching new affordable-priced products, we are working to expand mid- and high-priced products. In April of the current fiscal year, we ceased handling Pulsar watches, which are in a price range below that of Seiko. Meanwhile, having established Grand Seiko Corporation of America in October of the previous fiscal year, we are strengthening Global Brands, centered on Grand Seiko. However, we believe it will take from three to five years to obtain the expected results. While progress has exceeded our expectations, it has been just over a year, the current fiscal year. Please consider our progress against the target within that range.

Q16. In the Electronic Devices Business, operating profit has continued on a downward trend. In the 7th Mid-Term Management Plan, this was understood to be a field that was initially going to grow significantly. Can you please explain, to the extent possible, what recovery measures you are planning for the next fiscal year?

A16. With regard to the Electronic Devices Business, despite net sales of roughly 50.0 billion yen, the Business consists of many product groups, in which no single product accounts for a significantly large portion. Under such circumstances, by growing each product, we think that, conversely, it will not be the case that when a product performs poorly, it will be unable to recover without some form of recovery measures. The businesses that have not progressed as expected recently are automobile components and hard disk-related products, both of which are precision components. These are gradually recovering, and we think that we can make capital investments to increase production from the next fiscal year. In addition, quartz crystal and silver oxide batteries have performed relatively favorably the current fiscal year. Thermal printers are a business in which demand is rising in various parts of the world, and ensuring a supply of new products is an important point, which is progressing well. Market recovery for inkjet print heads in Europe has been slightly delayed, and it is difficult to clearly project a forecast for this business, primarily due to market conditions. Other than this, we feel that we are seeing signs of a relative recovery.

Q17. In the Wako Business, the current situation may be severe due to a decrease in demand from tourists to Japan toward the next fiscal year.

Under such a severe external environment, what measures will be taken to secure sales for the next fiscal year? Can you explain the current situation and the direction to follow?

A17. As of December, both overall net sales and profit in Others increased year on year, largely due to a surge in demand for Wako. While it has performed relatively favorably in the current fiscal year, the demand from tourists to Japan has recently seen a sudden drop, and measures will also be needed. However, these circumstances are due to the novel coronavirus, measures for which will change depending on when the virus abates. Basically, the majority of Wako customers are from Japan, and many have been with Wako for a very long time. We believe that it is most important to value the connections with our customers and firmly maintain Wako's superior hospitality cultivated through a long history of tradition.

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