

Seiko Holdings Corporation

FY2020 Q2 Consolidated Results Presentation Summary of Q&A

- ◆ Date : Wednesday, November 11, 2020, from 3:00-4:00 p.m.
- ◆ Place : <Web conference>
- ◆ Respondent : Yoshinobu Nakamura, President
Shimesu Takizawa, Executive Director and CFO
Itsuko Akashi, General Manager, Finance & Corporate
Strategy Planning Department
- ◆ Summary of Q&A :

Q1. Is the decrease in SG & A expenses for 1H20 due to a decrease in activity to date, or is it a reduction that will remain in 2H20? In 2H20, you expect the operating profit margin to be roughly the same as 2H19 despite sluggish sales growth. Are there any other factors?

A1. The reduction related to SG & A expenses was greater in the 1Q20 than 2Q20. Excluding the amount transferred to extraordinary losses, the reduction was actually less than 4.0 billion yen. In 2Q20, the reduction was down to 1.4 billion yen due to increased activity. In 2H20, overseas business trips will continue to be difficult and sports events will be cancelled, resulting in a reduction in promotional investments compared to 2H19. Meanwhile, we believe that the reduction will not be the same as before, because we will be increasing our digital marketing activities. As for other areas of improvement, we have factored in improved profitability in line with relatively steady sales of in-house mechanical watches.

Q2. What is your approach to advertising expenses for 2H20 and for FY21? While advertising expenses were restrained in 1H20, activities are expected to increase in 2H20. What kind of changes do you expect to see year on year? As you shift to digital marketing, are your marketing efforts becoming more efficient?

A2. Currently, advertising activities have not returned to normal across all markets. Our policy is to hold back investment in areas where the market recovery is slow and inefficient. Thus, we do not think the amount of advertising expenses will reach the level of FY19. In addition to product advertising, sports events in which we were planning to support timekeeping have been cancelled, causing slower growth in expenses. In terms of efficiency, we think that digital marketing is more efficient. We

believe that by creating a variety of information in so called “target marketing,” we should be able to conduct marketing activities at points closer to potential watch purchasers. For the Company, we cannot say that we are seeing results in terms of efficiency yet, but we are working on it.

Q3. In terms of capital investment, what kind of real estate investment occurred in 2Q20, and what kind of capital investment do you think is necessary for the post-coronavirus era in order to expand sales of Global Brands (GB) in the Watches Business going forward?

A3. The real estate acquisition that occurred in 2Q20 concerned land and a building in Ginza, valued at approximately 6.0 billion yen, which is adjacent to a property leased to the Company as well as real estate owned by the Company.

As for future capital investment, the Company will need to undertake capital investment not only for assembly but also for parts and components for the production of high-end products. We believe there is enough room for investment not only in high-end products but also in affordable-priced mechanical watches.

Q4. In terms of inventories, you estimated that you would proceed with inventory adjustments of watch movements during 2Q20. How did this proceed in practice? In addition, the Watches Business seems to have shown a steady recovery in profits compared to the recovery in sales from 1Q20 to 2Q20. Were you able to improve profits after making inventory adjustments?

A4. Inventories of watch movements were a factor for deteriorating profit due to lower production during 2Q20. However, the impact was reduced by transferring fixed costs to the manufacturing of other products. The production of analogue quartz (AQ) movements will need to be reduced in 2H20 as well. In particular, standard AQ movements still need to be adjusted. However, inventories of some products, such as added-value AQ movements, have been reduced to a level where they are insufficient. If anything, we are at the point where we need to increase the production of mechanical movements, including those in the affordable and higher price ranges. It is necessary to make purchase adjustments in order to reduce inventories of completed watches. We will also make adjustments not only for FY20 but also for FY21, in order to optimize inventories of completed watches, rather than taking short-term measures.

Q5. What was the reason for the deterioration in income from investment in affiliates compared to 1H19?

A5. Income from investment in affiliates turned to a loss. However, sales of shares in ABLIC Inc., which marked a gain in 1H19, broke even, avoiding a loss. Of the entities accounted for using equity method, OHARA INC., which is a listed company, is experiencing a decline in performance. If you do the calculation based on OHARA INC.'s already disclosed 1H20 financial results and the Company's equity in OHARA INC., you can estimate income from investment in affiliates turning to a loss.

Q6. You announced a dividend forecast of 25 yen per share for FY20. Can you please explain again your approach to dividends?

A6. The Company has paid stable dividends in the past. FY20 experienced unusual conditions, and the Company's forecast for the full-year final profit is 1.0 billion yen. If you assume that 1.0 billion yen is returned entirely to shareholders, the annual dividend would be 25 yen per share. After repeated deliberations by management, we decided to put all of our profits into dividends. We will continue to aim to pay stable dividends rather than using the dividend payout ratio as an indicator.

<Watches Business>

Q7. I get the impression that watch sales in 2Q20 (July to September) are recovering, mainly in overseas markets. You explain that GB are performing favorably, with a particular focus in the U.S. and other countries. Can you tell me about the background to this and the outlook for 2H20?

A7. Sales have recovered in 2Q20 in many overseas countries and regions, led by GB, mainly Grand Seiko (GS) and Seiko Prospex (Prospex). The distinctive background to this is that, in comparison to the Japanese market, we have been engaged in digital marketing for the past few years overseas in relation to GS and others. We believe that the demand from our target users for digital marketing activities was relatively easy to capture as well as to recover, even during the coronavirus situation. Meanwhile, due to the larger scale of the domestic market, we have a wide range of users and various distribution channels. Thus, it will take time for sales in Japan as a whole to recover.

Q8. The novel coronavirus started spreading again in Europe from the beginning of November. Will the momentum be maintained?

A8. In terms of the outlook for 2H20, we are keeping a close eye on whether the recent European lockdowns since the beginning of November will be lifted by December. If they end in November, I think we can look forward to

Christmas sales in December, including a rebound from lockdowns. However, when considering the repeat orders we are expecting in 4Q20, I think we will have to slow down from the speed we were hoping for. Policies that are compatible with economic activities are expected not only in Europe but also in the U.S. and Japan.

Q9. Regarding the strategy for the Watches Business, I recognize that you have been communicating the benefits of GS and other watches through direct sales Boutiques and appealing events. I got the impression that this has changed along with the shift to digital marketing. Going forward, will there be any changes in your strategy in terms of closing Boutiques and spending on events?

A9. The novel coronavirus has changed the way we sell, but we are not planning to close Boutiques. We consider the presence of Boutiques to be important, as we deal with high-end watches. At the same time, we will continue to strengthen our digital strategy, as an online channel is unavoidable.

Q10. In the Watches Business, how were sales of watches other than GB in 1H20? Going forward, do you plan to make any strategic changes to your product portfolio, such as reducing non-GB watches?

A10. Net sales of GB in Japan as a percentage of total sales did not increase that much for 1H20. Sales of both GB and non-GB watches saw almost the same pattern. In Japan, GS has not recovered, mainly due to sluggish growth in consumption among senior customers. However, there are strengths and weaknesses even within GB, such as strong performance of Prospex. Meanwhile, the GB ratio is growing overseas. As a result of our focus on digital marketing, GB, which had potential to grow, has grown. Given the fact that overseas sales have not reached the level of 1H19 overall, it can be said that the growth of watches other than GB is sluggish.

However, I think it is not necessarily true that we will be downsizing non-GB watches more than we have been doing until now as a product strategy. We have to develop product strategies based on new sales methods and consumption trends, and we do not just decide on strategies based on the categories of GB and others.

Q11. How were net sales in China in 2Q20? If sales were strong, what are the reasons for such performance?

A11. The growth of net sales for 2Q20 in China was in high double digits.

Consumption in China is booming. The aggressive promotion of e-commerce sales since FY19, such as by incorporating digital marketing and other measures, led to these results. Furthermore, GS has been growing well in physical stores. While the e-commerce ratio has remained high, GS has been able to grow in both e-commerce and physical store distribution channels, and not just one or the other. We believe that the growth of GS in the U.S. has had a positive impact on the Chinese market, as it has been highly regarded on SNS.

<Systems Solutions Business>

Q12. The size of the Japanese market for time stamps in the Systems Solutions Business is not large, but I hear that the Company has a 60% share. How do you see its potential as a current business?

A12. The market is growing, not only for time stamps, but also for digital contracts and others, and we want to be proactive in this area. The market is expected to grow rapidly in the future as the government's intentions come into play, so we want to take advantage of this opportunity to expand.
