Seiko Holdings Corporation

FY22 Q1 Consolidated Results Presentation - Summary of Q&A

- Date : Wednesday, August 10, from 15:00 - 16:00
- Place : Online Web conference
- Respondent : Shuji Takahashi, President
  Shimesu Takizawa, Director, Executive Vice President

- Summary of Q&A :

Q1. Could you discuss the situation in the domestic market after Q2?

A1. In general, our business situation in July looked better than it did last July when Japan was in a state of emergency as a result of COVID-19. Even so, we recently learned that the number of customers visiting our domestic outlets, including Wako, began to decline in the latter half of the month.
Last year's results were poor until a turnaround began in October, so we expect this year's results will look better year-on-year, at least until October.

Q2. Could you please explain why the overseas GB ratio is higher than the domestic GB ratio? In addition, how do you account for the difference between the domestic and overseas ratios of GS in your total product lineup?

A2. The GB ratio is lower in the domestic market because we launched two non-GB models here — the ladies' model Lukia and the men's model Brightz. These watches have a particularly strong appeal to Japanese consumers and account for a significant percentage of the product composition in Japan, which lowers the ratio of GB products.
As for GS, until last year the domestic ratio was much higher than that overseas, but now that situation has turned around, and the overseas GS ratio is exceeding that in the domestic market. Since the Japanese watch market accounts for only about 10% of the global market, and since GS is our prime Global Brand, we want to continue expanding the overseas ratio of GS. There is still huge room for GS to grow overseas.

Q3. With respect to the seasonality of your business, have there been any changes in this term? Are there factors that will increase costs in the future or any factors that will make it easier to generate earnings in Q1?

A3. In general, seasonality seems to be unchanged in this fiscal year, especially for the EVS Domain and the Watch business. Despite some seasonal fluctuations in general purpose products and consumer products, we see no important seasonal variations in this fiscal year compared with previous years.
In the Group as a whole, earnings were concentrated in the Christmas season (i.e., Q3), with no profits posted in Q4. However, as the watch business is becoming more focused on high-end products, seasonal sales are starting to level off, and we expect this trend to accelerate in the future.

Q4. GP ratios for all business segments are improving on a year-to-year basis. However, if we look at Q1 results, we see that the growth in GP ratio for the EVS domain is less pronounced than that for other domains. You mentioned that the GB weight is growing steadily, but how do you see the change in the EVS GP rate in Q1?

A4. The growth of the EVS Domain was indeed less than we'd hoped for in Q1. There are two main factors behind this: One is that the retail watch business, which is less profitable than the wholesale business, was improving in Q1, and the percentage of retail business in EVS grew significantly. The other reason is that the unrealized profits on inventories in the consolidation process were postponed, which had an impact of about 1 percentage point. We believe we will be able to recover these profits in the second half of the fiscal year.

Q5. Could you give us a rough estimate of increases in SG&A expenses (labor, advertising, etc.) for the current fiscal year?

A5. Advertising expenses in Q1 increased ¥400 million YoY, which is about a 10 percent rise. Since advertising costs for last fiscal year came to ¥16 billion, and we expect them to increase another 10 percent during this fiscal year, it is reasonable to assume an increase of ¥1.5-2.0 billion.
The increase in labor costs is partly due to the impact of the weakening yen and also to a recovery in the Japanese domestic market.
Other SG&A expenses are expected to increase due to an increase in payments to department stores as a result of the strong retail business.
In the Watch business, rather simply relying on mass media to carry our message, we have been enhancing brand value through the strategic use of digital media, including active use of SNS and digital events. In overseas markets in particular, we are using online media to conduct everything from branding to promotion through an integrated digital approach, which is increasing the efficiency and productivity of our marketing efforts.
In terms of business strength, we believe that the marketing of luxury goods is becoming increasingly powerful.

Q6. How do you foresee labor costs and other general costs increasing from Q2 onward?

A6. We expect labor costs will rise little by little, much as in Q1, but the impact of yen movements will appear differently in each quarter. Other SG&A expenses should stabilize from Q2 onwards.

Q7. You mentioned that normal wage increases for domestic workers were a significant cost factor, but going forward, in order to expand GB sales in Europe won’t it be necessary to hire highly talented staff, and won’t that seriously impact overall labor costs?

A7. In our domestic operations, wage increases were not the result of a hike in base pay, but rather, derived from bonus payments tied to improved corporate earnings, and these payments fell within our originally anticipated range. While we naturally expect an additional cost burden associated with hiring high-quality personnel overseas, we do not expect this single expense item to be particularly conspicuous.

Q8. Q1 results were favorable and exceeded the company’s forecast, but how much profit was above the official projections? If you have a breakdown by business segment, that would be helpful.

A8. We originally aimed for a 1.3 billion yen improvement YoY in Q1, and we hoped to exceed that amount. As it turned out, we earned 1.5 billion yen in Q1. The System Solutions business remained firm, while the Device Solutions business was positively affected by the weakening yen. Setting aside the impact of foreign exchange rates, the impact of the Shanghai lockdown has been less than expected. In addition, earnings for the EVS Domain overseas grew well beyond our expectations.

Q9. It is widely believed that US business confidence is weakening and individual consumption patterns are changing due to inflation. How do you foresee demand in the US watch market changing in the near future?

A9. Indeed, we hear about the US economy slowing and consumer spending faltering, yet our business continues to show healthy growth. In particular, GS is doing quite well, and we believe that there is still plenty of room for GS to gain market share. We will continue to expand our share even if we are faced with sluggish consumer spending.

Looking at GS in terms of market power, the brand is still in the introduction stage in the US. Even if the economy were to worsen significantly, we will continue entering this market steadily, so if anything, we will be taking market share away from other companies. We do not expect that situation to change.

Q10. Could you talk a bit about the Watch business in the Chinese market? Specifically, how serious was the sales decline in Q1, and how soon do you foresee that market recovering?

A10. Our Watch sales in China were down over 50% year-on-year in Q1. This was not a surprise, as the downturn started in Q3 last year. We expect Q2 will also be very difficult, but we do not see Q3 being worse than a year ago. The Chinese market is fraught with risk for foreign companies, from geopolitical risks to problems stemming from the zero-Covid policy and co-prosperity policies. Fortunately, we have a smaller weighting in China than our main competitors do, and we are taking a defensive management approach to avoid adding China risk in the current fiscal year.

Q11. Could you explain in some detail why sales of watch movements to the US market improved in Q1, and what types of movements were sold?

A11.The two main products for the U.S. market are standard and value-added movements, and both types performed well in Q1. Since value-added movements have higher unit prices, they contributed more to our growth figures. Overall, there was also noticeable growth in standard movements compared with past years.

Q12. Your presentation shows a 3.9 percentage point improvement in the GP ratio of the Device Solutions domain. Could you please explain in some detail the changes for each category in that domain, such as Precision devices, Printing devices, Electronic devices, and so on?

A12. The operating margin in the Device Solutions business improved by more than 2 points. Sales of electronic devices increased noticeably, as did printing devices, due to the recovery of thermal printers and other products. These two categories were the major contributors to growth.

Q13. Please explain the impact of forex rates on the increase in inventories.

A13: Of the ¥7.5 billion increase in inventories, ¥2.7 billion was due to the effect of foreign exchange rates, so there was a net increase of ¥4.8 billion. Of this amount, slightly more than ¥2 billion was an increase in merchandise and finished goods, mainly overseas inventories of finished watches and high-grade products. The remainder was due to an increase in work in process for increased production in the Device Solutions business.

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