Seiko Group Corporation

FY22 Q3 Consolidated Results Presentation - Summary of Q&A

- Date : Wednesday, February 15, 15:00 - 16:00, Tokyo, Japan
- Respondents : Shuji Takahashi, President
  Shimesu Takizawa, Director, Executive Vice President

Summary of Q&A

Q1. What were the trends in the Watches Business in the Oct-Dec quarter? It seems that both the sales growth rate and improvement in the gross margin rate for Global Brands (GBs) weakened in this quarter compared to the first half. How do you explain this?

A1. In Japan, the rates have remained unchanged. Overseas, growth of the GB ratio seems to have weakened in the third quarter. This partly reflects the market reality that product lines other than GB are most likely to grow during the Christmas shopping season. In the US market in particular, results for the previous year, FY 2021 3Q, were very strong, and the FY 2022 3Q results were close to those numbers. We interpret this to mean that sales in the US market remained quite strong in this quarter, although new growth was minimal. The European market was just the opposite: growth in the 3Q of FY 2021 was low, so we achieved a roughly 10% gain in FY 2022. Although it is difficult to compare such different global markets, it is reasonable to say that we did well in Europe, the US, and Asia excluding China.

Q2. You have said that new orders declined in the Devices Solutions Business (DS) and your outlook for the fourth quarter is grim. How do you see future market conditions developing?

A2. The main factors for the decline in DS are the downturn in the Chinese market and the decline of personal consumption in Europe and the US. New orders for thermal printers began to fall sharply around last summer due to the decline in the Chinese market, but we believe they will recover together with China's ongoing economic recovery. In the Others section, hard disk drive components and other devices also declined in the Chinese market, while crystal oscillators for consumer products declined due to the slowdown in personal consumption, mainly in Europe and the US. We expect that the decline in hard disk drive components and crystal oscillators for consumer products attributed to the slowdown in personal consumption mainly in Europe and the US will continue a little longer.

Q3. Is the decline in printing devices only temporary?

A3. We do not see the market for thermal printers recovering rapidly in the 4Q. As with many other products, we believe sales are dependent on the economic recovery in China. Inkjet print heads are partially affected by the Chinese market, but this is due more to the real-estate recession than to effects from the COVID-19 lockdowns. We think this line may become a positive factor for us as the Chinese economy recovers in the near future.

Q4. In your fourth quarter forecast, the expected profit for the Watches Business is virtually zero. Does this reflect a reduction in the production of watch movements, a downturn in mass-market price range products, or aggressive advertising activities aimed toward the next fiscal year?

A4. We expect the Watches Business to almost break-even in the fourth quarter. We are assuming there will be declines in watch movements and products in the mass-market price range in overseas markets. The operating profit forecast was created in consideration of the overall decline in sales, the impact of soaring energy costs, and our reduction in the production of watch movements, which was slightly beyond a level commensurate with the reduction in sales. However, on the top line, we believe there is room for a better-than-expected result. As for advertising expenses, we expect only a slight year-on-year increase, which means it should not be a significant factor.

Q5. Regarding the changes in advertising expenses and the changes in the timing of their posting, was this because digital marketing has enabled more efficient advertising activities?

A5. It reflects the fact that monthly sales of high-end products have remained mostly steady throughout the year with no significant seasonal fluctuations, even during the Christmas season. Another key point is that full use of digital technologies has resulted in a shift away from quantity-oriented advertising activities to continuous, stable investments. Advertising expenses for the third quarter increased a little more than 10% year-on-year, the same as in the first and second quarters of this fiscal year, and we expect a similar rise in the fourth quarter.

Q6. How were the results for mass-market products excluding GBs in overseas markets during the nine months under review?

A6. They differ from region to region. In Europe, we have strategically suspended sales of brands in the price ranges below Seiko, which is why those results did not reach the previous fiscal year's level. On the other hand, in the US market, sales in the mass-market price range remained relatively stable during the first three quarters. In general, though, overall results were strong in the first half but have been somewhat stagnant so far in the second half. In Japan, the growth rate was higher in GBs.

The market with the sharpest drop in the mass-market price range is China. Domestic brands in that range include ALBA and some licensed brands. However, their unit prices are low and their sales numbers are weak. Our view is that the market itself has been shrinking. Products in the mass-market price range often used to be purchased in bulk by Chinese tourists, but we do not see that kind of activity now. Inbound demand has begun to recover, but at present most purchases tend to be of high-end products. We believe the mass-market price range is in a slump overall.

Q7. What was the ratio of spending by inbound tourists, particularly those from China, in the third quarter? Also, how big was the sales decline in China?

A7. Before COVID-19, spending by Japan-bound tourists accounted for approximately 15% of the domestic total, and around half of that figure came from Chinese tourists. China did not relax travel restrictions for its citizens until January (after the end of the 3Q), so we did not anticipate any impact from sales to Chinese tourists during that quarter. Although Japan relaxed inbound restrictions at the beginning of the 3Q, tourist numbers grew gradually. As a result, spending by non-Chinese tourists also remained below its pre-COVID-19 level (approx. 7.5% of the total). Total spending by inbound tourists did increase in the third quarter, but only in low single digits. We are hopeful for more significant growth in the 4Q. In the Chinese market, sales declined around 30% during the quarter under review. In FY 2021, the rate of decline in the third quarter was quite high, higher than in the first half, so the year-on-year rate of decline in FY 2022 decreased gradually compared to the first and the second quarter. However, at the beginning of the fiscal year, we assumed the 3Q decline would be a little smaller than it actually was, and we now expect the recovery will take a little longer. This has been factored in to our latest revised forecast.

Q8. What is your perspective on trends in the Watches Business by region from the fourth quarter onwards?

A8. First, let’s take a look at trends by region in the third quarter. Results in North America declined slightly on a local currency basis because of the strong growth in the previous year. Europe saw low single-digit growth on a local currency basis and double-digit growth in yen terms. Asia and other regions recorded double-digit growth on a local currency basis, which is a good overall showing considering the negative impact of China.

Now, looking at the fourth quarter and beyond, we believe that in Europe and the US our sales growth will be higher than the market average thanks to continuing promotion of GS and other GBs. In Asia as well, we are confident that we will be able to achieve ongoing growth of GS and other GBs, relying largely on our local subsidiaries. This positive outlook is partly due to the fact that we established a GS sales company in Singapore in October.

We want to continue offering new products in the GS line that will attract market attention. We believe we can increase sales in the Watches Business in Japan again in the next fiscal year thanks to price revisions and other factors.

Q9. Can we assume that the weakening of mass-market product in Europe and the US, which you attributed to the global economic slowdown, has not significantly affected higher-priced watches?

A9. In general, lower-end products are more susceptible to economic slowdowns, and higher-priced watches are less likely to be affected. Even when they are affected, we always aim for growth exceeding the market average. We also believe that GS and other GBs have considerable room for growth.

Q10. Did the GS price revisions announced in the 3Q cause a rush of demand in anticipation of the price hike? What impact will the price revisions have in the fourth quarter?

A10. Because we announced the GS price revisions on December 29, they had little impact on 3Q results. As for the fourth quarter, we saw good numbers in January, but on the whole we expect to see minimal effects, either positive or negative, from the price hike, as we reflected in our forecast. Of course, we are hoping that our forecast turns out to be too conservative and the price revisions prove to be a positive factor.

Q11. Is it reasonable to think that gross profit from domestic sales will begin to increase in the next fiscal year?

A11. A key reason why we revised GS prices in Japan at the time we did was to respond to increasing prices of raw materials, parts, and other items that we received from our suppliers toward the end of the previous fiscal year and the beginning of the current term. Accordingly, we increased prices together with rising manufacturing costs, including the sudden increase in energy costs. Obviously, the price increase needs to match our overall cost increase, but we believe this GS price hike will be a positive factor. On the other hand, because we did not increase prices across all product ranges, we do not expect the price revisions to have a major impact overall.

Q12. The ratio of MVP products in DS has been improving slowly compared to other businesses. What is your strategy going forward? Will you simply continue to increase MVP products or will you increase MVP products while also eliminating less profitable non-MVP products?

A12. The reason why the DS business showed sluggish growth in the third quarter is weakening sales of products for the digital economy and also for Chinese market. Of course we are working to expand the range of MVP products, both existing and new products. We are developing new MVP products to replace old ones, although they will not appear immediately. Our development cycle leads to product releases two or three years hence. However, we are confident that these activities will enable us to achieve the target ratio of MVP products in the final term of the current mid-term management plan. The ratio of non-MVP products is also likely to drop.

Q13. What was the response to the increase of GS prices in Japan? Are you considering revising the prices of other GBs as well? I think the GS price increase will be acceptable for customers in the watch market who have some appreciation of the added-value of GS.

A13. It has only been a short time since we revised the prices, so we cannot make definitive statements regarding market response at this time. However, considering the surge in demand up to January and the initial trends following the price revisions, we have reason to expect better-than-forecast results. We will consider price revisions for other GBs as necessary, but for the moment, our policy remains unchanged.

Q14. Seiko's PBR is slightly below 1.0 at present, partly reflecting the follow-up meeting on the TSE's market restructuring. Are you looking to raise the PBR above 1, and if so, will boosting ROE be a top priority? Will you try to increase the net profit ratio or the operating profit margin to increase ROE?

A14. We plan to raise our PBR above 1.0 by improving profitability. We aim to improve ROE to a level where our net profit reaches 10.0 billion yen. We believe that doing this will yield a structure that will keep the PBR above the 1.0 mark.