Seiko Group Corporation

FY23 Q4 Consolidated Results Presentation - Q&A

- Date: : Wednesday, May 15, 2024, 10:30 - 11:40
- Location : JP TOWER Hall & Conference (hybrid style: virtual + real)
- Participants: : Shinji Hattori, Director, Chairman, Group CEO and CCO
  Shuji Takahashi, Director, President
  Akio Naito, Director, Senior Executive Vice President
  Jun Sekine, Director, Senior Executive Vice President
  Taku Yoneyama, Director, Executive Vice President
  Yoichi Endo, Executive Vice President

Summary of Q&A

Q1. For the final fiscal year of SMILE145, your gross profit margin target is an increase of five percentage points, and you said that it will increase one percentage point every year. However, as you pointed out, it increased 2.5 percentage points in the first two years. At this rate, consolidated operating profit for the final fiscal year is on track to exceed 20.0 billion yen. Did you set a conservative target because you plan to accelerate growth investment in the coming three years?

A1. Since SMILE145 is a five-year target, we naturally took fluctuations into account when we set our target range for consolidated operating profit at 18.0 to 20.0 billion yen. Due to the effects of the post-COVID economic recovery, both the EVS Business and SS Business are performing fairly well. With this in mind, we set a target operating profit of 17.0 billion yen for FY2024, and, of course, we are aiming for 20.0 billion yen or more in FY2026.
During the seven previous mid-term management plans, there have been many unforeseen events that have affected results, most notably the 2008 financial crisis and the recent pandemic. At the present time, performance is steady, and we are still aiming for 20.0 billion yen in OP for the final term of the current plan, but we are always cognizant of potential risks.
Since you asked about growth investment in the coming three years, I should note that we will indeed accelerate investment to boost growth. Our plan is to focus on the Watches Business and the Systems Solutions (SS) Business as the core of our growth strategy.

Q2. Could you share the details of business restructuring expenses posted in FY2023, as well as their effects in FY2024?

A2. Our business restructuring expenses were aimed at three important areas: the Watches Business in China, the Devices Solutions Business, and the domestic Clocks Business. The Watches Business in China has completed a major shift to a new business model. Although it is difficult to be patient, we know we must give it time and allow the restructuring to achieve positive results. The second area, the Devices Solutions Business, is problematic because some precision device sectors are slumping, and we also had to record an impairment loss related to precision processing. Among precision devices, automobile-related devices are improving, so we are now reorienting the business to focus on mobility. The third area is the domestic Clocks Business, which we are restructuring so as to shift to products with high unit prices.

Q3. I have questions about the cash allocation in SMILE145. Your plan calls for investing over 100 billion yen to spur growth. How is that going? What were results for the first two years, and what will the allocation be like in the remaining three years?

A3. During the term of SMILE145, we plan to invest over 100 billion yen in growth. In the first two years, we invested slightly less than two-fifths of that total to support growth, and we plan to increase these investments in the remaining three years.
The main focus of this investment will be the Watches Business and the SS Business. In the Watches Business, we will invest in three main pillars: manufacturing equipment, advertising, and the boutique market. The company that joined the SS Business through M&A has been doing well and has demonstrated positive synergies. We would like to create that kind of synergy throughout the Group as a whole, with Seiko Solutions playing a leading role in this. We will continue to pursue M&A activities in order to accelerate the growth of the SS Business.

Q4. The Watches Business was strong in Japan in FY2023, but weak in other countries. How do you see the growth of that business in each region in FY2024? Also, what is your view on increasing profit relative to net sales?

A4. About ten years ago, 90% of Grand Seiko's sales were domestic. Then overseas sales took off and grew rapidly, eventually exceeding domestic sales in FY2021. Last fiscal year, overseas sales slowed, while domestic sales were strong, partly reflecting the sudden increase in demand from inbound tourists.
We view GS as a global brand, and we attach more importance to overall sales growth and brand recognition than to sales by region. Now, with the yen down considerably against the US dollar, we aim to increase sales in Japan. Current trends in inbound tourism demand show that these products are selling especially well to visitors from the US, as well as to people from Europe. This is completely different from the demand generated by Chinese tourists for mass-market products, which they purchased as souvenirs. We are pleased to see many wealthy Americans and Europeans buying Grand Seiko products, which we believe is due to increased visibility of the GS brand overseas.
In the new fiscal year, GS will remain strong in Japan, partly reflecting this inbound tourism demand. While we struggled in the United States in the last fiscal year, we believe that the market has bottomed out. We also expect to see improvements in Europe. We have recently established a GS sales subsidiary in China and reset our business model to make a new start in that market and expand sales of GS. Despite all these positive steps, we feel the most prudent course is to maintain a somewhat cautious view in the current term.

Q5. I have questions about the Watches Business and about Grand Seiko in particular. We know the situation in China is still difficult. How much progress have you made in the business model transformation that you started last fiscal year? When will it bear fruit?

A5. Last fiscal year, we worked on business restructuring and reorganized the distribution of GS in China. This fiscal year, we will strengthen GS sales, supported by a newly established GS sales subsidiary in Shanghai. We are also working to secure talented human resources to support our shift from our old e-commerce-based business to a reenergized business based on sales at brick-and-mortar stores. And these are only some of the various initiatives that will propel our Chinese sales in the coming years.

Although our analysis of inbound tourism demand by nationality is only a rough estimate, we determined that Chinese buyers ranked 3rd or 4th overall. This signifies that GS is well known to Chinese people even though it was almost impossible to sell GS products in mainland China. This helped to convince us that we can grow GS in China by steadily developing a luxury distribution channel. This fiscal year, we are working to build a strong foundation for the expansion of GS sales, and we expect to see results as soon as the next fiscal year.

Q6. Strengthening direct sales in the Watches Business is not a new story. This time, what is your objective in strengthening the direct sales business? And what about your existing distribution network — will things change there?

A6. In the past, our main business was more or less a wholesale business. In recent years, we have been globally expanding our directly managed stores, called Seiko Boutiques, to enhance our brand value. We are also actively expanding GS Boutiques globally to build that brand. However, the tactics for the GS expansion are different from those used for Seiko Boutiques.

Our basic policy for GS Boutiques is to emphasize customer experience, which we do in part by communicating the brand story directly to customers, and also by strategically selecting the location and design of each new store. For example, last year we opened a flagship GS Boutique on Madison Avenue in New York. It is among the largest GS stores in the world. The location was very strategically chosen — it is ideal for a boutique that deals in luxury products. Because Manhattan attracts well-to-do buyers from all over the world, opening a major store in a prominent location helps to increase the brand's global appeal. Four years ago, we opened a directly managed European flagship store in the Place Vendôme in Paris, which has been very successful. The NY store delivers all the brand power of the Paris boutique and more. In Tokyo, we opened a GS Boutique in the fashionable Omotesando Hills development in Harajuku just two weeks ago. Of course, we already operate three GS boutiques in Ginza, but we specifically chose the Omotesando location to appeal to younger consumers. That strategy seems to be right on target, with over 1,000 affluent young customers visiting the store in just a couple of weeks.

Our current approach is to have a clearly focused strategy for each store that we open. We are not looking at specific sales figures or the total number of stores as KPIs. We will continue to actively invest whenever we find a location that serves our purposes.

Q7. It's clear that GS sales are steady, but the price range is quite broad. Is it possible that lower-priced quartz movements (which may not be seen as luxury products) are holding back Grand Seiko's growth? How will you position of quartz movements in the future growth of GS as a luxury brand?

A7. GS currently sells three types of movements: mechanical, quartz, and Spring Drive. It is true that the quartz models are in the lowest price range among GS products, but their unit prices are still quite high for quartz watches. The movements we use for GS are proprietary, extremely high-precision mechanisms, very different from those used in quartz watches in the mass-market price range. We are continuing to communicate to customers about the advantages of GS quartz movements. We absolutely do not think that having high-precision quartz movements in our lineup is harming our brand.

In both Europe and the United States, the overall luxury goods market struggled during the last fiscal year due to a tight economic environment, which included rising inflation and high interest rates. Retailers, who are not only our business partners, but also provide key market research insights, began to request that we expand the lineup of reasonably priced products. In overseas markets in particular, there is growing demand for products priced around 500,000 yen, and the GS quartz models fall nicely into this price range. In summary, rather than holding back GS growth, we see quartz movements as filling a market need, and so we will continue to focus our efforts on GS quartz.

Q8. I have a question about the DS Business. It appears that the recovery of operating profit relative to net sales in FY2024 is weaker than in FY2022. What is the reason for this?

A8. The environment surrounding the DS Business has changed greatly from what it was two years ago. However, we did not adequately expand either the customer base or user applications in response to these changes. That is the most direct explanation for the weak profit growth. As we go forward, we will focus on three product domains —medical, industrial, and mobility — in our efforts to expand applications and customers who operate in those domains.

Q9. More questions about the DS Business: You said you will institute changes to make it resistant to environmental change. Is differentiating investment destinations based on products enough to become more resilient? Are you considering measures such as shifting fixed costs to variable costs and downsizing low-profitability businesses?

A9. As I said before, we will concentrate on three main product domains, largely to mitigate the impact of a market cycle that is unique to the device business. Each domain has a different peak period. If we can launch innovative products in multiple domains with different peak periods, we can mitigate the effects of peaks and troughs in individual domains.

One of the strengths of our DS Business is that we can cater to customer needs. In the past, we offered fully customized products. While these products perfectly match customer needs, they are extremely time-consuming to produce. At present, we have established a two-step customization concept whereby we convert products into platforms and then later customize them to cater to specific customer needs. This enables us to deliver products with a shorter lead time. In addition, converting products into platforms has facilitated streamlining and improved yield, which in turn leads to a higher GP. We will combine this approach with good product strategy to make the business more resistant to market volatility.

Q10. I have a question about the SS Business. The FY2024 growth of SS operating profit looks great compared to sales growth. Could you comment on that?

A10. Computer Science Corporation, which the Seiko Group acquired in January of this year, does not have a higher internal profit rate, but its synergies with existing companies in our SS Business, such as IIM and Seiko Solutions, are already helping to increase our operating profit. We are pleased with the early results and hope to see this plan unfold smoothly in the coming years.

Q11. I have a question about the SS Business. As the use of generative AI accelerates, are there any AI-related strengths or business opportunities unique to Seiko Solutions?

A11. The strength of the SS Business is that we create both hardware and software. Because we manufacture hardware, we obtain certain kinds of data, which we analyze using AI to find optimal solutions. This is one special feature of our business.

We are also investing aggressively in an initiative that looks for optimal solutions by running multiple gen AIs. We hope to apply gen AI to solve some of our customers' social issues, and we have already received contracts from a number of customers.