WATTS (TSE Prime, 2735) FY8/23 Q3 Operating Results

Announced a revision to the full-year forecasts. Despite the continued challenging environment, the pace of opening shops has been robust.

<Brief summary>

Overview of FY8/23 Q3 results

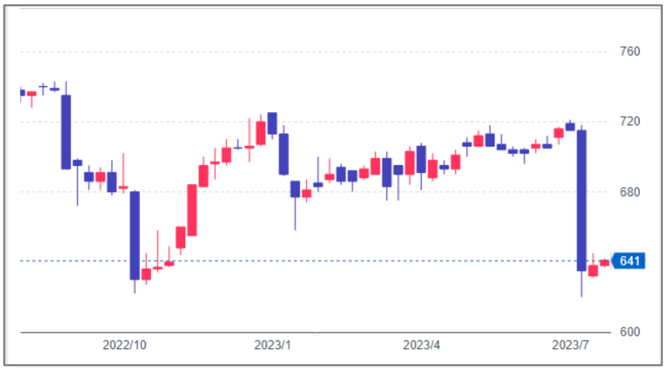
- Sales were 44,431 million yen (+2.2% YoY) and operating profit was 370 million yen (-59.1%), showing an increase in sales and a decline in profits. Although new shop openings are robust, profits continue to decline in response to cost increases, such as rising raw material prices. Based on the current situation, the Company announced revisions to its full-year business forecasts concurrently with the Q3 performance announcement. The revised forecast calls for sales of 59,000 million yen (-2.5% from the initial forecast) and operating profit of 400 million yen (-56.5%).
- The pace of opening shops has been robust; it has already opened 73% of its full-year target. In June, the number of new shop openings was 31, a record-high monthly count, driven by an increase in opening requests. On the other hand, the number of shop closures increased to 82. These closures were attributed to the necessary closure of unprofitable shops and the discontinuation of shops in tenants to be closed. Furthermore, the Company is progressively introducing higher price products, expanding from 2,169 items in 1H to a total of 2,808 items at the end of Q3.
- The gross margin stood at 37.7% for the nine months, maintaining the same level as in 1H at 37.8%. The rise in raw material prices and the prolonged yen's depreciation have continued longer than expected. In this situation, responding to price increase requests from suppliers is becoming unavoidable. However, through measures such as a review of the product mix, the Company has managed to maintain its gross margin at the level of 1H of the year. As is well known, some costs such as utility prices have also been on an increasing trend.
- In the overseas business, the Company is progressing with a shift towards more profitable models, such as closing unprofitable shops in Thailand while expanding wholesale operations.

Application for the Standard Market/Announcement of share buybacks

- Following the TSE's market restructuring, the Company is currently listed on the Prime Market. However, on July 10, it announced that it would apply for a transfer to the Standard Market. Although it has not met the criteria for maintaining a listing on the Prime Market from the outset, it finally decided to apply for the listing on the Standard Market. This choice arises from the challenge of fulfilling market capitalization and other criteria due to recent revisions to business forecasts. Given the current situation, it can be said that this is a realistic decision. At the same time, the Company decided to abolish the shareholder benefit program. The Company intends to focus on returning profits to shareholders through dividends to fairly return profits to shareholders. The dividend amount will remain unchanged.
- At the same time, the Company announced a large-scale share buyback of up to 300 million yen. It intends to take flexible measures to return profits to shareholders in the future, based on dividend payments.

Stock price data (July 26, 2023 closing price)

Stock price	641 yen
Shares issued	13,898,800 shares
Market cap	8,909 million yen
PER (est.)	58.01 times
PBR (actual)	0.72 times
Dividend yield forecast %	2.34%



Performance (Figures for FY8/23 are the Company's estimates)

(Million yen)	Sales	YoY (%)	Operating profit	YoY (%)	Recurring profit	YoY (%)	Net income	YoY (%)	EPS (Yen)	Dividend (Yen)	ROE (%)
FY8/22	58,347	15.1	998	-40.2	1,148	-27.6	781	-19.1	57.83	15.0	6.7
FY8/23(E)	59,000	1.1	400	-59.9	400	-65.2	150	-80.8	11.05	15.0	-
FY8/22(Q3)	43,476	13.4	905	-37.8	988	-31.7	518	-48.4	38.44	-	-
FY8/23(Q3)	**44,431**	**2.2**	**370**	**-59.1**	**372**	**-62.3**	**306**	**-40.9**	**22.55**	**-**	**-**

<Overview of FY8/23 Q3 results – The business environment still remains challenging>

- Sales were 44,431 million yen (+2.2% YoY) and operating profit was 370 million yen (-59.1%), showing an increase in sales and a decline in profits. As for sales, same-store sales are somewhat weak as a result of factors such as large-scale shop openings and revisions to the product mix of shops acquired through M&A, which have also affected the operations of existing shops, while the pace of opening shops has been robust. As for profits, external factors like a weaker yen and steep rises in utility expenses have squeezed its profits. However, the Company continues to focus on medium and long-term growth through initiatives like shop renovations and the opening of large-scale shops; the trend of overall cost increases has remained consistent since Q2, resulting in a significant YoY decline in profits. In line with these circumstances, it has announced a revision to its full-year forecasts concurrently with the Q3 performance announcement (details to follow).

<Overview of the 100-Yen shop Business- No significant change from 1H. The Company received many requests for opening a 100-yen shop.>

- In the 100-Yen shop business, the Company opened 172 shops, compared with the plan of 236 shops, and closed 82 shops, compared with the plan of 90 shops. The pace of opening shops has been robust, as the number of shops in June 2023 was 31, hitting a record high. Most shops are opened based on consignment, which is its forte, and they received many requests for opening a 100-yen shop handling miscellaneous goods in commercial facilities from enterprises that operate the facilities, so the number of shops opened increased. On the other hand, the number of shops closed is about 90% of the annual plan as of the end of Q3. In most cases, they closed unprofitable shops and shops in tenants to be closed, and this trend is projected to continue in Q4, so it seems that we need to keep in mind the possibility that the number of shops closed will exceed the planned number.
- Same-store sales decreased YoY in every month of Q3 (March to May). Considering the situation in which even Seria Co., whose market cap is the largest in the 100-yen shop industry, saw a YoY decrease in same-store sales this year, we cannot deny the fact that the entire industry was placed in a predicament due to the skyrocketing of costs. In addition, the demand for hygiene products, such as face masks, is declining, which is a negative factor, as the coronavirus crisis is subsiding partially because of the reclassification of COVID-19 into class-5 infectious diseases in May. The Company is reforming its shops while reviewing the strategy of opening many shops and the lineup of products, remodeling shops, and so on. Such reform has been producing some effects on the operation of existing shops since 1H of FY 8/23, but they are taking some measures while reconsidering the staffing at each shop.
- The number of higher-priced products increased significantly from 2,169 in 1H to 2,808 at the end of Q3, and the ratio of sales of higher-priced products reached 9.5%, indicating steady adoption.

Tips: What is the consignment-type model (for opening shops)?

The consignment-type model is one of the shop opening models at which Watts excels. In this model, the products of Watts are sold at a section for miscellaneous goods in tenants, such as a leading supermarket. The cashiers of the tenants collect payments for the products of Watts, so Watts does not need to station their staff in the tenants. Accordingly, they can reduce operational costs. Watts and tenants can develop win-win relationships, because a rich product lineup of Watts is expected to attract customers.

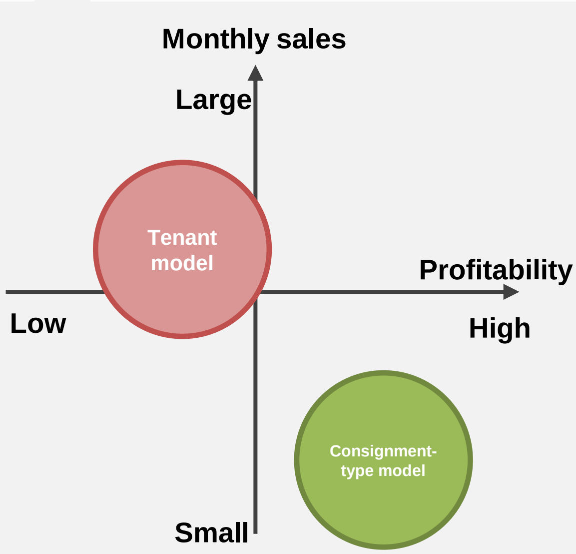
[Characteristics of the consignment-type model]

・It is unnecessary to station staff or install fixtures or fittings, so costs for opening and operating a shop are lower than those in the tenant model.

・Revenue per shop is low, but profitability is higher than that of the tenant model, because costs can be curtailed.

・Some know-how is required for periodically visiting shops, dealing in products, etc. This could become an entry barrier.

Positioning of shop-opening models



<Full-year Business Forecasts- Revised considering the current situation>

FY8/23 full-year forecasts

- Considering the situation in which the effects of external factors, such as soaring costs, are lingering while the performance of the core business of operating 100-yen shops has been slow, the Company announced the revision to the full-year business forecasts on July 10. The revised forecast calls for sales of 59,000 million yen (+1.1% YoY; -2.5% from the initial forecast), operating profit of 400 million yen (-59.9% YoY, -56.5% from the initial forecast), recurring profit of 400 million yen (-65.2%, -52.9%), and net income of 150 million yen (-80.8%, -71.7%), indicating the growth of sales and the decline in profit. Sales are expected to increase, but it seems that the environment surrounding profit remains harsher than expected. Under these circumstances, the Company is remodeling shops and revising the product lineup for improving profitability, and this term will become an investment period in which they will proceed with the reform of shops. As they expect the effects of shop remodeling and are starting to see the possibility of opening a multi-purpose shop combining a 100-yen shop and a different model, we would like to expect their medium/long-term growth.
- As of Q3, progress against full-year business forecasts was 75.3% for sales and 92.6% for operating profit. This forecast was revised in Q3, so it is unlikely that annual results will be significantly different from this forecast. Net income attributable to owners of parent in the cumulative third quarter is 306 million yen, exceeding the forecast amount of 150 million yen, but there is a possibility that they will post impairment loss on unprofitable shops. Accordingly, it is projected that annual results will be almost in line with the forecast.

<Shareholder Returns- Dividends remain unchanged despite the abolition of the shareholder benefit program, and announcement of share buybacks>

Abolition of the shareholder benefit program

- The Company offered a shareholder benefit program. Shareholders holding 200 or more shares received a coupon of 2,200 yen (including tax), which is available at the Company's online shop. This time, the Company announced the abolition of this plan on July 10 in order to promote the fair return of profits to all shareholders. It should be noted that since the plan would be abolished in the middle of the fiscal period, the shareholder benefit program will not be offered to shareholders in the current fiscal year ending August 2023 (shareholders with a record date at the end of August). On the other hand, through the abolition, the Company will be able to eliminate tens of millions of yen in benefit program costs, which have been recorded as entertainment expenses, from the next fiscal year.

Dividend policy

- The Company's basic policy is to pay a stable dividend. The Company says "We consider 20-30% of the payout ratio." Despite the revision to the business forecasts but through the abolition of the shareholder benefit program, the Company maintained the dividend at 15 yen per share, in line with its initial forecast. Accordingly, the payout ratio was 135.7%. As stated in the release announcing the abolition of the shareholder benefit program, the Company's policy of "concentrating on returning profits through dividends" can be seen. The dividend yield is 2.34% based on the closing price on July 26, 2023.

Announcement of share buybacks

- On July 10, the Company announced a share buyback. The repurchase is intended to improve capital efficiency and enrich shareholder return and will be the Company's largest-ever share buyback, with a maximum repurchase amount of 300 million yen. The repurchase period is from July 14, 2023 to March 29, 2024. The Company intends to retire the shares acquired through this buyback. They said, "We would like to take flexible measures based on dividends, to return profits to shareholders in the future."

<Topic- Application for listing on the Standard Market of TSE>

- On July 10, the Company announced its application for listing on the Standard Market of TSE. Although the Company is currently listed on the Prime Market of TSE, it has fallen far short of the criteria for maintaining its listing status on the market in terms of total market value (5.27 billion yen as of the end of August 2022, while to the criteria demand at least 10 billion yen). The Company has decided to apply for the listing on the Standard Market because of the risk of delisting in the future if it fails to meet the criteria for maintaining its listing status on the Prime Market, and because it has determined that it is best to ensure an environment in which shareholders can hold and trade Watts' shares with peace of mind.

<Latest Press Releases>

The Company's major press releases disclosed since the Q2 of FY8/23 are as follows.
(Click on the image below to check press releases on the IRSTREET.)

08/07/2023	Notice Regarding July 2023 Monthly YoY Change in Sales and Number of Shops
07/10/2023	Notice Concerning Revision to Business Forecasts
07/10/2023	Consolidated Financial Results for the Nine Months Ended May 31, 2023 (Under Japanese GAAP)
07/07/2023	Notice Regarding June 2023 Monthly YoY Change in Sales and Number of Shops
06/07/2023	Notice Regarding May 2023 Monthly YoY Change in Sales and Number of Shops
05/09/2023	[IR STREET REPORT]: Sales generally progressed as planned. Despite the relentless rise in costs, improving profitability through cost control measures.
05/09/2023	Notice Regarding April 2023 Monthly YoY Change in Sales and Number of Shops
04/14/2023	Operating Results for the Six Months of the Fiscal Year Ending August 2023 and Progress of the Full-Year Plan

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