

July 26, 2018  
Canon Marketing Japan Inc.

## Q&A at Second Quarter 2018 Results Presentation Meeting for Analysts

Date and time: July 26, 2018, 10:00-11:00

Venue: Hall S at the head office of Canon Marketing Japan Inc.

Answerers:

- Senior Vice President      Yoshiyuki Matsusaka
- Senior Vice President      Masachika Adachi
- Vice President              Shiro Hamada
- Vice President              Kunihiko Kubo

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[Q1]

In the Consumers segment, all the negative factors appear to have come to the surface. Are there any future risk factors?

[A1]

With regard to inkjet printers, the market for home-use models is mature and the printing volume, including that for New Year's cards, is unlikely to grow significantly in the future. We are revising our plan based on this assumption. What we must do in the market of home-use inkjet printers is to shift to high value-added models as much as possible. In addition, we must focus on business-use inkjet printers, on CISS, continuous ink supply system, models that are compatible with high-capacity ink cartridges and the like to increase the unit price on the whole. We must also work to increase the printing volume per unit to secure profits. Instead of mindlessly increasing our market share in terms of quantity, we will place priority on profitability.

With regard to cameras, we anticipate that the market of SLR cameras, among others, will continue to shrink in the foreseeable future. However, this market has a very limited number of competitors. Here as well, we should not work mindlessly to increase our market share in terms of quantity, but we should mainly promote middle-range models. For interchangeable lenses, we have a huge backlog of orders for the high-end F2.8 model of the EF70-200 zoom lenses announced recently. There are numerous customers who have been using Canon cameras for a long time. This customer base is our asset. We have a bold plan for

mirrorless cameras. Sales are so far so good for entry models, and we are thinking of expanding the lineup in the future. We are by no means an early entrant to this market. We will take positive action as a challenger.

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[Q2]

Your plan sets a lower target for network cameras than the previous plan. Does it anticipate a short-term sales slide? And will they achieve a turnaround next year and thereafter?

[A2]

In the current domestic IP camera market, we see numerous relatively small business models, such as the camera units with a recording devices. The market has not expanded to businesses such as image analysis and the concentration of an enormous volume of data as expected. We have recently revised our target downwards, because the previous target was based on the assumption that mounting needs for security in view of the upcoming the Olympic and Paralympic Games Tokyo 2020 would rapidly expand the markets of image analysis and data concentration. In reality, the majority of the orders are still for security and minor purposes. In the future, at least 6,000 peripherals will be connected on Milestone Systems' Xprotect image platform, and software applications will be developed successively. We anticipate that image sensing will advance beyond the security solutions.

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[Q3]

I think that investments in electronic parts and sensors, in which Japan has strength, will grow. In this context, I imagine that there will be an opportunity for the semiconductor manufacturing equipment that you deal in. I also think that you may increase your market share when your MFP competitors are in trouble. What do you think about that?

[A3 Industrial Equipment]

As you have noted, the semiconductor related market is very strong, including sensors and power devices. It will remain brisk for a while centered on authentication technologies.

[A3 MFP]

Irrespective of the situations of other companies, we sell MFPs as IT and other solutions to customers' issues, and the number of units in operation is on the increase. This is a result of the modest continuation of our day-to-day business operation.

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[Q4]

In recent years, there has been an exceptionally large dip in sales of maintenance services in the first quarter, because this quarter has smaller number of operation days. The figure for the second quarter is back at a level close to where it was a year earlier. Are there any extra factors behind this? I would also like to ask for explanations about the difference between the figures for the first and second quarters.

[A4]

Rather than focusing on the gap between quarters, I would like to emphasize the fact that the number of units in operation is rising steadily. Amid the downward trend of the printing volume in the Japanese market, due partly to the work style reform, our efforts to shift the focus to the market of middle-sized businesses are beginning to produce positive results. This is helpful for increasing the printing volume and achieving sales of maintenance services.

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[Q5]

When I look at your recent revision to the earnings forecast, the downward revision to the operating income forecast in the Area segment is outstanding, although you argue that your shift to the market of middle-sized businesses is producing its results. You kept the maintenance services sales forecast on hold. Is there any difference between the overall outlook for MFPs and the forecast of sales to small- and medium-sized customers in the Area segment? Is it that some expenses are incurred for shifting the target to middle-sized businesses, and that these expenses constitute part of the factors behind the downward revision to the operating income forecast in the Area segment?

[A5]

Let me start by explaining the large gap between the first and second quarters. At the time of changing to the new framework, the head of the business unit changed, and so did the president of Canon System & Support. We seemed to make a slow start. For these reasons, the figure for the first quarter took a major dive. For the second quarter, the business unit implemented management for intensive internal actions to place top priority on profits and to place an emphasis on the profit rate in individual negotiations in order to make up for the decline in the previous three-month period. As a result of prioritizing deals with high profit

ratios, it succeeded in increasing the sales of the LBP-Cartridge, the ESET and other products. Comprehensive efforts to cut expenses led to massive growth in the second quarter. However, sales of the mainstay office-use MFPs fell for the period of January to June from the same period a year earlier. Small-to-mid-sized customers were interested in work style reform, the improvement of operational efficiency and cost cuts. They are not particularly interested in hardware replacement. They do not give a good response to the conventional approach of proposing replacement with new models at a cost equivalent to that of leasing, and the sales volume struggled severely in the first and second quarters. However, MFPs have stable quality, and service efficiency is rising. With a low competitor replacement rate, the average sales of services per unit are falling, while the number of units in operation is not. No significant decline is seen in total revenue. For the second half, we cannot leave the massive drop concerning MFP unaddressed, and we are thinking of stepping up efforts for business talks. In the MFP business, it is difficult to increase profitability by promoting hardware alone. Recently, the array of cloud-based solutions has been expanding. We will approach small-to-mid-sized business customers to promote maintenance services in combination with uniFLOW and other solutions. Another reason for the poor profit rate is the high share of IT products, both at partners and at Canon System & Support. We estimated that the share of IT products achieving poor profits is so high in sales that the growth of income is lower than that of sales, and that the profit ratio is low. On a product-by-product basis, however, we set conservative targets for maintenance services and LBP- Cartridge.

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[Q6]

The network camera sales growth rate exceeded 20% last year and the year before. However, you have set the growth rate target for this year at 5%. Can you provide detailed reasons for this target, including whether or not there was any change in the market and in the environment of the competition?

[A6]

There has been no notable change in the situations since the start of this year. It takes longer to cultivate customers and sales channels than in the fiscal years with which the comparison was made. The relevant market grew slightly less than 10%, while our growth was significantly faster two years ago and last year than in the rest of the period since we embarked on this business. With respect to the cultivation of customers on the routes that we and the individual business units worked on last year, sales growth is now slowing

slightly. In other words, we understand that the growth for the current year is growth from a base level that had heightened.

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[Q7]

Is it not that there are successive entrants to the competitive environment?

[A7]

We are experiencing a partial price war with Chinese manufacturers, but we are maintaining our market share. The Canon brand and the AXIS brand have a market share of slightly less than 20%. This situation is the same as it was two years ago.

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[Q8]

Are you able to disclose percentage change in the printing volume concerned with maintenance services? Are we to understand that it fell for the first quarter due to the number of days in operation, and that it returned to the normal level in the second quarter? Which of the two segments, namely Area and Enterprise, saw the larger change?

[A8]

We do not disclose the printing volume data, but its total value is higher on a year-on-year basis. It can be explained by the increase in units in operation. A greater increase was seen in the Enterprise segment. Compared to that, the rise in the Area segment was smaller. Meanwhile, the Area segment achieved a greater year-on-year improvement in maintenance services for the second quarter than the Enterprise segment did.

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[Q9]

Why did you reduce the full-year target for industrial equipment slightly, although sales were brisk in the first half? It sounds as if sales are forecast not to grow in the second half.

[A9]

Results relating to semiconductors are dependent on the investment trends on the part of customers. It is difficult to forecast results for half-year periods. For the current fiscal year, customers' investments are weaker in the second half than in the first half. In addition, we discontinued some products in the non-semiconductor area, and we anticipate that this move will have some impact on the results for the second half.

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[Q10]

According to your projection, operating income in the Consumers segment for the second half will be slightly higher than in the same period a year earlier. It is unlikely that your intensive efforts regarding office-use inkjet printers, CISS models and interchangeable lenses will immediately produce a positive effect in the second half. Can you explain how you foresee that you can improve the income for the second half?

[A10]

For the first quarter, expenses alone were as planned, despite sales failing to reach the target. For the second half, we will undertake the stringent control of expenses. We plan a decrease in revenue and an increase in income for the second half. We have a challenging goal in the category of mirrorless cameras, in particular. It may be a risk depending on the situation, but we think that if we meet this goal, this category could be a factor for a higher income figure than last year.