

April 24, 2019
Canon Marketing Japan Inc.

Q&A at First Quarter 2019 Results Presentation Meeting for Analysts

Date and time: April 24, 2019, 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】

The early results were strong, but are there any temporary factors?

【A1】

We believe that this trend will continue throughout the year. It is partly because sales are increasing due to PC replacement before the extended support for Windows 7 expires. We think this will probably decline starting next year. The trend will not end in 1Q but does have a periodic element to some extent. As for other IT solutions, some SI projects were brought forward to 1Q from 2Q, and the profit margin looks a little high. Other than that, there is no transient factor.

【Q2】

Have network cameras been affected after the US government banned Dahua Technology and Hikvision products?

【A2】

They may have been affected depending on the way products are procured, but there has been a move to limit manufacturers in tenders put out by public offices in particular, and we do not think it has much to do with the US government's exclusion. This is not something that suddenly emerged recently, but rather a situation that has been going on for a long time, so in that sense projects themselves are going on with high order accuracy.

【Q3】

In the case of Japan, it had nothing to do with Chinese products in the first place?

【A3】

We hardly compete with them.

【Q4】

Regarding maintenance, are there breakdowns by print volume and unit price?

【A4】

Breakdowns have not been disclosed, so we can only talk about the recent trend. Overall, the print volume per unit has been decreasing. Recently this has been continuing, particularly among large companies. SMEs have not seen print volumes fall, but the paperless trend will have some impact here as well. We do maintenance properly in light of remote monitoring so that customers can use our products in good condition for a long time, and thus MIF has been growing steadily. The unit price has been falling, but it has not fallen as much as it used to, and this has raised maintenance sales overall.

【Q5】

What is the reason behind the smaller decline in the unit price of maintenance service?

【A5】

We believe that by providing various forms of added value to customers, our efforts to not get caught in a price war have gradually borne fruit.

【Q6】

As for industrial equipment, there are not many large semiconductor manufacturers in Japan, but I've heard about investment. Could you tell me about the business sentiment and the prospects for that?

【A6】

There are very few major manufacturers, and this year the economy has leveled off and few investments have been made. We expect that it will recover from around 4Q of this year and will show up in our sales from 2Q of next year.

【Q7】

Orders for Canon IT Solutions Inc. alone were up 53% year on year in 1Q, but I would like to know to what extent each of SI and data centers has contributed and how long it will last this year.

【A7】

The content of their orders has not been disclosed in detail, but the data centers have begun receiving orders for a new building that will be launched next summer. These are not all of the orders, and others will come in stages. In 1Q, SI and IT infrastructure services have had double-digit growth, even excluding orders for data centers. Going forward, orders will fluctuate with the timing of SI growth and IT infrastructure system development. Please note this trend.

【Q8】

With regard to production, you mentioned sales of color continuous feed models had been rising. They have not risen for a long time, but did the situation change? Also, please tell me how to consider the outlook from 2Q.

【A8】

Actually, the market situation has not improved significantly, but we have been expanding sales by extending the range of genres such as inspection equipment and related products. The color inkjet market has been expanding gradually, so we hope to grow business from 2Q.

【Q9】

I think it took time to match the needs of the Japanese market, including software, but what is the situation now?

【A9】

We are now working hard on that, and the number of projects is gradually increasing.

【Q10】

I think SG&A expenses remained restrained in 1Q in real terms, but what is your plan for the year?

【A10】

In 1Q, considerable savings were made, and labor costs were reduced due to a decline in the workforce, and that reduction is generating some effects. Since 2Q, direct costs that relate to sales have been cut in the past few years due mainly to the announcements of new products, so we will continue to make efforts in the future. IT and other expenses fell to their lowest level last year, so expenses are basically expected to remain as planned. However, we will continue to make efforts to reduce them.

【Q11】

Do the new products refer to both digital cameras and business equipment? Also, it seems that there were not many sales promotion expenses in 1Q after releasing MFP in January, but will that change from 2Q?

【A11】

They refer to both. We think that the expenses will remain according to our current plan. We will work to cut SG&A expenses, but cannot make any firm commitments. Rather, we believe that it is necessary to increase sales and the gross margin using the necessary expenses.

【Q12】

You provided an explanation about improvements in gross margins and higher unit prices this quarter. Were they better than your projections in 1Q? What was the largest contributing factor? Was it temporary?

【A12】

In terms of our overall product mix, hardware products were discouraging compared to the projections, although services and consumables remained solid. Highly profitable IT solution businesses, such as SI services grew, making greater contributions in relative terms. With respect to unit prices, inkjet printers, mirrorless cameras, MFPs and LBPs recorded slight price increases from last year. Major factors were relatively solid performances in non-hardware products such as IT solutions, maintenance services and cartridges. SI projects, which were moved up to 1Q, may be considered a special factor. However, given the business-as-usual status of maintenance services and consumables, we do not think there was any significantly special factor.

【Q13】

Looking at the overall printer market, Ricoh appears to be declaring the completion of structural reform internally, ready to make an aggressive turnaround from defense to offense in terms of sales initiatives. Ricoh has released new products. From this perspective, does Canon feel any impact from Ricoh's aggressive approach? Is there any concern about the risk of another price war?

【A13】

We do not know much about other companies' trends. From the perspective of a party competing in the market, we do not expect significant changes. The trend shows that companies are no longer eager to win business by resorting to unreasonable price wars, which applies to us as well. We feel that companies are striving to take more selective and discreet approaches to ensure that they are not trapped in price wars. You can assume that there is no significant change in the impact level.

【Q14】

You previously said that the network camera market would continue to grow by approximately 10%. However, the growth in 1Q, which was 4%, appears to be lower than in recent years. My observation is that you need slightly more time to develop the market. Is it attributable to hardware, software or market share issues? Describe your insights with the outlook of the business, which appears to be slightly weak compared to the projections.

【A14】

We initially said that the network camera market would grow at a double-digit rate. However, it has not been growing that quickly. Still, the actual growth of 4% is higher than the projection and solid. With prices for hardware units expected to fall, we seek to drive growth by facilitating a shift to SI businesses such as video platforms.

【Q15】

Am I correct in assuming that there is no dramatic change in the market share and you did not lose it to competitors?

【A15】

That is our observation.

【Q16】

What evaluations did you receive with respect to initial sales of the WG7350 inkjet printer for business use that you announced at the end of last year? Can you describe what evaluations were given by users and retailers in terms of comparison with competitors' products in a similar category?

【A16】

We adopted a business model including fixed fee-based maintenance services, which is similar to EPSON's smart charge scheme. However, we need more time to popularize the model because the product is being marketed through a sales channel where users are familiar with the traditional business model of MFPs. With many customers showing an interest in the wide range of supported media and speed, both notable advantages in inkjet printers, the product started to be sold in a market that had not been identified due to the unit's performance. We believe this market does not cause cannibalization to the traditional xerographic market. With performance not inferior to competitive products, we are confident that we are marketing the product advantageously. The good thing about a business model with fixed fee-based maintenance service is that it can be easily included in budgets if more products are marketed in certain channels, because the barrier to introduction is low. Looking ahead, we expect the product to be promoted gradually in markets that have not been tapped so far.

【Q17】

Is your competitor practically focused on smart charge services?

【A17】

There are not many competitive situations, because there are not many competitive factors in terms of functions.

【Q18】

With the January to March period over and an eye on April, can you describe any changes from your assumptions three month ago and any matters to which attention should be paid with respect to the full-year image and forecasts for the

digital lens interchangeable camera market?

【A18】

The sales volume was 1.06 million units last year in the domestic market for digital lens interchangeable cameras. It was comprised of 0.47 million units of digital SLR cameras and 0.59 million units of mirrorless cameras. We initially expected sales volume to be approximately 0.95 million units this year; however, we assume that it will be lower than 0.95 million units because sales volume fell short of expectations for SLR cameras in particular as of the end of 1Q.

【Q19】

If the total is less than 0.95 million units, am I correct in assuming the sales volume of mirrorless cameras will be flat and that of SLR cameras will decrease?

【A19】

Your assumption is correct.

【Q20】

From the perspective of product mix, am I correct in assuming that full-frame (full-size) cameras showed unexpectedly good results, while entry models recorded decreases? Do you perceive the composition ratio to be unchanged?

【A20】

During 1Q, unit prices for digital SLR cameras fell 15% on a sell-out basis in the market and those for entry models declined. Mid-range cameras recorded a decrease in sales volume as well as unit price. On the other hand, the mirrorless camera market grew by 12%, which was attributable to the increase of unit prices rather than the number of units. Last year, our full-size mirrorless cameras contributed to the increase because unit prices rose due to the launch of EOS R and RP, although we only had mirrorless cameras, which are almost compliant with the APS-C.
