

April 25, 2023
Canon Marketing Japan Inc.

FY2023/1Q Financial Results
Q&A at Presentation Meeting for Analysts

Date and Time: April 25, 2023, 16:30-17:30

Format: Zoom webinar

Presenters:

- Hatsumi Hirukawa, Director and Vice President (in charge of group planning and group communications)
- Tsuyoshi Osato, Director and Vice President (in charge of group accounting)

[Q1-1]

You described getting off to a steady start in 1Q. In terms of sales and income, around how much of an upswing did you perceive versus your expectations?

[A1-1]

As we explained on a per-segment basis on the page showing our results forecast, in the Enterprise segment we managed to secure BPO projects that carry high gross profits so there was a slight upswing in that area, but overall our performance was largely in line with expectations. We also said that 1Q of last year was too strong. A lot happened in 1Q, but we were able to beat back every challenge and achieve good financial results. In terms of our plans, we recognize that we managed to properly meet our numerical targets.

[Q1-2]

From looking at the published figures, I thought that you had been expecting figures for 1Q to be a little lower because the results at the same time last year were good to some extent, but is that not the case?

[A1-2]

President Adachi proactively put out the message that we should aim for around this result, and we managed to implement that in a steady fashion. And the fact that the supply of Canon products made it in time for March thanks to manufacturing efforts was also a major factor.

[Q1-3]

You mentioned special pay rises. Does this mean expenses will increase compared with your initial forecasts?

[A1-3]

The special pay rise was expected to apply from April onwards, and was already incorporated into our initial plans.

[Q1-4]

Personnel expenses were flat in 1Q. Do you have a sense that they will increase from 2Q onward?

[A1-4]

As we expect the special pay rise to increase personnel expenses considerably starting in April, we have incorporated it into our plans.

[Q1-5]

You mentioned that expenses needed to employ high-level talent and expenses for retirement benefits were on the increase, but it seems that there will also be natural attrition in your workforce. What is your overall outlook for personnel expenses this year?

[A1-5]

Last year personnel expenses declined significantly from the previous year due to two factors, a declining in expenses from retirement benefits, and the natural attrition of personnel.

This year we expect natural attrition to decline to some extent. However, as the special pay rise will be implemented for roughly 16,000 personnel across the Group, that amount of that increase and natural attrition will offset one another. We expect expenses from retirement benefits to trend upwards compared with the previous year, and project increased personnel expenses as a result.

[Q1-6]

Can you give a monetary figure for that? Any disclosures on that front?

[A1-6]

We have not disclosed exact figures, but we expect a considerable increase.

[Q2-1]

You explained that supply constraints on Canon products had been resolved. Was there a temporary

increase in sales in 1Q due to that?

[A2-1]

Back order had been accumulating due to supply constraints and we had kept some customers waiting as a result. In 1Q, supply recovered faster than expected and we managed to deliver products to customers in a satisfying way. For 1Q we had originally planned to cover the back orders, that could not be fulfilled, with ITS, but both approaches yielded steady results.

[Q2-2]

Does that mean that back orders themselves have been largely resolved?

[A2-2]

For some products the delivery deadline was decided from the outset, so there are still some remaining back orders.

[Q2-3]

You mentioned concerns about the future economic environment. Have you seen signs of a worsening trend among business equipment and ITS customers?

[A2-3]

Nothing has changed significantly. For BtoC, we expect camera sales to improve if opportunities of the photography expand. For printing demand due to people working from home, we believe a certain degree of demand will remain, but not as vigorous as the year before last or last year.

Meanwhile, the trend toward paperless will continue at a moderate pace among BtoB customers, but one good change is that color output, which carries a higher unit price, is on the rise. There are growing opportunities to provide customers and business partners with the materials they need. If those aspects increase, they will be a factor driving up business results. We also expect that personnel shortages will emerge. As the trends of replacing the work that people do with IT, or applying DX to the work itself will persist, if we can put together solid proposals we believe the business opportunities will continue in 2Q and beyond.

[Q2-4]

Both sales and income in the Professional segment have declined year on year, but they are extremely high compared with average levels in the past. What is behind this situation?

[A2-4]

There were large-scale production printing projects in 1Q of last year, and there were also industrial equipment projects that were unprecedented in size. The same goes for healthcare - we worked on major projects in 1Q, and since the projects in those three sub-segments wound down, we recorded a year-on-year decline. Looking at the figures from 2019 to 2022, however, the business is growing as planned. Looking ahead, the status of orders received in the three sub-segments is not bad, so if acceptance inspections take place, we can probably meet our targets in 2Q and beyond.

[Q3-1]

You noted that color output is performing well. Do you see this as indicating a return to the practice of users taking color-printed materials to customers in the post-COVID world? Alternatively, has CMJ just done well to reap those advantages, or has the structure changed in some way? How would we evaluate this in the medium to long term?

[A3-1]

In terms of customer environments, we are aware of a temporary increase the practice of customers going out and taking color materials to customers. As part of that, the number of LBPs in operation has increased because we are improving proposals that obtain printouts that are close to the operations of specific industries.

We think that increase of the LBP sales depends on our proposals in this way. Looking at the market overall, we recognize the trend of increasing opportunities to visit customers and a commensurate increase in opportunities to take materials for those visits.

[Q3-2]

ITS has performed relatively strongly in the Area segment. Previously demand was good in the area of security, but what is the current outlook? In the future, is there a lot of room to reap the benefits from the Makasete IT DX Series, or are there bottlenecks in terms of sales? As this area has grown to a certain size now, we would like to know the situation.

[A3-2]

There is still brisk demand for security, which is an area of focus. As SMEs tend to have a shortage of IT administrators, we provide support to meet those needs. We plan to expand the services we provide, going beyond selection, installation, maintenance and operation to also include employee instruction and training, and the development of IT adoption plans. That is why we expect this area to experience vigorous growth. As updating the skills of personnel is extremely important in accomplishing this, since last year we have been taking stock of personnel skills and expanding our training options. When you try to increase volume, whether you can enhance people's skills become a key point, and we are

also expanding and upgrading our training options to meet this need. We are also working to provide that training to customers. It depends on whether we can implement this well.

[Q3-3]

Does that include providing training to distributors?

[A3-3]

We plan to extend this initiative to our partners, but it is important to implement this as Canon System & Support first. We will propose the details to distributors and proceed while keeping them apprised of the specifics, such as whether such training would be paid or free.

[Q4-1]

ChatGPT has recently dominated the news. What changes do you think ChatGPT-based ITS or DX would bring to your business results in the immediate term?

[A4-1]

No specific changes have occurred yet, and we are at the stage of exploring the possibilities.

[Q4-2]

Does that mean for its part CMJ has not deciding anything, including how to promote it?

[A4-2]

We are at the stage of considering the possibilities.

[Q4-3]

Regarding industrial equipment, large-scale projects for semiconductor fabrication equipment continued from 1Q to 3Q last year, and while those projects had wrapped up by 1Q, you explained that you managed a recovery elsewhere. How do you see future trends in the semiconductor fabrication equipment industry? Have orders for projects turned around, or has difficult conditions persisted?

[A4-3]

We have heard from the people responsible for this business that the situation we are seeing in the newspapers and what we are seeing in the field is the same. The environment for memory-type semiconductors is tough, but products such as power semiconductors are performing strongly, and the same environment is being seen for investment. In the case of CMJ, the projects to be delivered to customers this fiscal year are proceeding largely as planned. We are now engaging in activities to

secure orders for investment activities for next year and beyond. Our read on the situation is that demand will recover from the middle of this year and into next year, so we do not have that pessimistic of an outlook.

[Q4-4]

Regarding healthcare, 1Q sales increased 11% year on year, but amid a sense that the COVID-19 pandemic is over, are you in an environment where demand will increase?

[A4-4]

CMJ is engaged in the medical IT business, and we are mainly involved with the development of systems for hospitals and clinics, such as electronic medical records. In the area handled by CMJ, various research has shown that system adoption particularly at clinics is only around half way there, so we recognize that there will be healthy system adoption in the future.

The Cabinet Office's policy on Medical DX came out because of a scattering of personal healthcare data related to medical treatment due to the pandemic. Subsidies to encourage a higher adoption rate for electronic medical records are also being prepared, and we expect to see brisk investments for a while. CMJ will proactively work to secure that business while devising a cross-selling strategy through comprehensive proposals that also include security and network cameras.

[Q5-1]

This is a question about inventory, supply and demand. Your inventories as of the end of March had increased by between 7 and 8 billion yen compared with three months ago or last year. Has something like an order backlog developed? Where are you in terms of appropriate inventory levels, and what is behind the up-and-down swings? As I think the situation at CMJ and the situation including inventory on hand on the customer side differs by product, could you please give an update on those aspects?

[A5-1]

As is stated on page 23 of today's materials, as of the end of March inventory turnover was 27 days. As it was 24 days at the end of last year, although there has been an increase of 3 days, this is within an acceptable range. This time, inventory has increased by around 7 billion yen compared with the end of 2022, but this represents new products and stock expected to be the subject of future orders, all of which is expected to be resolved by the end of the year due to the way supply and demand works. We therefore expect inventory turnover to decrease from its current 27 days.

[Q5-2]

In terms of the supplementary information, are there variations on a per-product basis? The

supplementary materials show that the number of inkjet printers is down 35%. You mentioned that this was a reactionary decline from the previous year and reflected weak demand, but even looking at annual targets, I get the impression this is a large drop. What is your thinking on this point? Perhaps this is part strategic to increase the number of models with large capacity tanks, or the inventory situation where distribution is taking place, or even that the situation with cartridge models is dire. Or is it something else? In addition, please indicate how we should look at the industry trends and how they look in a comparison of sell-through.

[A5-2]

The -35% appears to be large, but there are several factors behind the decrease. As sell-out has slightly declined in the market, that is around one-third of the cause. The remaining two-thirds are a comparison with the previous year. At the end of the 2021 there was a shorten of inkjet printers, but 1Q of 2022 we sold a lot. In absence of that large jump, this year looks like a significant decline. In terms of strategy, unit sales prices are being maintained or increasing. In the course of providing customers with high value-added products, our volume share has weakened. That impact is shown in the form of this 35% decline. As we do not have a sense of excessive store inventory regarding inkjet printers and cartridges, we believe we can meet our targets for 2Q and beyond. Similarly we do not have a sense of excess store inventory for digital interchangeable lens cameras, and since this falls within the range of what we consider normal, we are confident in meeting our targets.

[Q6-1]

For inkjet printers in the Consumers segment, are there differences in how demand has changed for cartridge types and ink tank types? The annual outlook has been downgraded and sell-through itself is weak, but has demand declined for cartridges but not for ink tanks?

[A6-1]

As we believe that our strategy and the needs of the market are slightly different, we do not recognize any major changes. Demand for printing at home did not spread as much as we thought. For color output there have not been any significant changes because most of that printing is done through electrographic means at offices.

[Q6-2]

For cameras, you have raised your volume outlook, but are there any cameras that are doing higher volume when divided by price range? You commented about the EOS R50. Is the higher than expected volume in 1Q due to the low price of products such as the R50? Or, is this coming from higher price ranges due to an increase in opportunities of the photography?

[A6-2]

Since the year before last we had been focusing new releases on high-end models such as the EOS R5 and R6 mirrorless cameras, and after that we began to release the mass adoption-type R7, and low-priced models such as the R10, R8 and R50. The EOS R6 Mark II has received extremely good reviews, but since sales of the mass adoption model are far greater from the perspective of overall volume, in 1Q there was an increase of 29% year on year. Since the year before last, high amateur-level users who have purchased high grade models such as the EOS R5 or R6 have had an entry-level model as their second camera. Our view is that if these users purchase additional RF lenses, they can also contribute to revenue. Volume of entry-level models are higher in terms of absolute numbers, but we recognize that both high-end models and mass-adoption models are performing strongly.

[Q6-3]

Regarding the consumer business, at one time there was tight supply and demand which made it easy to raise prices, resulting in an environment where you could get by without incurring costs, but has there been any change recently to price and promotional competition? Or do you think some changes will come within this year?

[A6-3]

We are also concerned about that. This differs from the situation when there was a shortage of products due to the semiconductor squeeze. As each manufacturer has now started to arrange its product lineup, from 2Q onward we think the business will change in various ways. That is why we are actively investing in sales promotion activities and will be building up SG&A expenses to a certain extent from 2Q onward to put high-end products in the hands of customers. We have formed our plans with those expenses taken into account. Unlike the situation during the pandemic, we recognize that a situation that will tend to incur costs is developing.

[Q7-1]

In the Professional segment, we've heard for some time that there were major projects for industrial equipment in the previous year. As those projects will wrap up, we believed that it would be difficult to generate profit this fiscal year. When we open the lid and look inside, we can see that profits have indeed declined, but only by 0.3 billion yen. Sales of industrial equipment itself was 5.8 billion yen in 1Q, but this is still a high level compared with past quarters. What kind of cycle is at work here, and what explains these sales and profit figures?

[A7-1]

Industrial equipment has performed according to plan. In healthcare, there were projects with higher profits than normal, and we recognize that healthcare profits were better than expected.

[Q7-2]

For healthcare, was revenue from the parts transferred from Canon Medical Systems good, or was the revenue from parts already maintained by CMJ group good? Please shed light on that aspect.

[A7-2]

It was both. Last year we worked on large-scale hospital projects in healthcare and they were not that profitable, but in the course of them wrapping up, this year we accumulated highly profitable projects, so while sales have declined, those remaining projects have generated high levels of profit.

We are looking carefully at the business transferred from Canon Medical Systems because this is the first quarter immediately following integration, but there were some very good projects leading to strong results. Those are the two aspects behind the results.

*The content reflects some additions and modifications to enable it to be better understood.

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Owing to various factors, actual results may differ materially from these projections.