Q&A at Enterprise Segment Business Briefing

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Presenters:

- Hiroyuki Matsumoto, Senior Vice President, Director of Enterprise Business Unit

- Akira Kanazawa, President of Canon IT Solutions Inc.

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

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[Q1-1]

I have a question about Edge solutions. As you told us in the results presentation for FY2023, while Edge solutions had been expanding steadily since 2020, growth slowed in 2023 if I remember correctly. You said that the business is forecast to grow by around 60% in the coming two years. Please tell me about the factors for the slowdown in 2023, your projections for 2024 and 2025, and the current situation.

[A1-1]

Imaging solutions and document solutions that the Enterprise segment is in charge of and solutions for manufacturers, including FOREMAST from Canon ITS, are growing steadily. We do not see that it slowed down. Security and BPO (which consist of other KPIs other than Edge solutions) were slightly below forecasts before. We believe that we can achieve further growth through the collective efforts of the team with high affinity, which has been joined by TCS Inc. and Primagest, Inc. as new members of the Group. These points are reflected in this figure.

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[Q1-2]

I have a question about Edge solutions. Are they growing steadily in 2024 at a rate that will result in achievement of around 60% growth in the coming two years?

[A1-2]

Specific figures will be explained by President Adachi along with the update to the Medium-Term Management Plan at the beginning of next year. They have been steady this year.

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[Q1-3]

You said that you are currently serving 60 *shinkin* banks with Shinkin Deposited Asset Navi. What is the scale of its sales? And what is the business model like? Is it a recurring business? What is the revenue mechanism like?

[A1-3]

We do not disclose sales. It is already used by about 60 *shinkin* banks and is well received. We are planning to expand it. The revenue mechanism is good.
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[Q1-4]

Is the amount of revenue determined by transactions? Will revenue increase further even from a single *shinkin* bank? What is the business model like?

[A1-4]

We sign a contract with each *shinkin* bank and receive an annual usage fee.
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[Q1-5]

I found that there are about 250 *shinkin* banks in Japan. Will you continue to expand it?

[A1-5]

Your understanding is correct.
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[Q1-6]

Do you have any competitors? Are there any other solution vendors who provide similar solutions?

[A1-6]

We have competitive manufacturers. However, because we have created the system in cooperation from Shinkin Central Bank under a relationship of co-creation, it is appropriate for operations of *shinkin* banks across Japan. Accordingly, they put priority on this mechanism.
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[Q1-7]

Are there any applications other than Shinkin Deposited Asset Navi that you are considering as new services?

[A1-7]

There is a project for which we are preparing. We will announce it at a later date. Please look out for

the announcement. When you see it, you'll know that is what I am talking about.

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[Q2-1]

You said that you expect to achieve net sales of ITS at 300 billion yen one year in advance this fiscal year. Do you have the next target in mind, such as net sales of ITS at 500 billion yen?

[A2-1]

We are considering the next Long-Term Management Objectives and Medium-Term Management Plan, with the leading role played by President Adachi. The ratio of ITS business to net sales of all companies for the first half was 48.5%.   If ITS business grows, we will be able to increase the number of customers of the Canon business as well. We would like to explain the numerical targets when we announce the progress of the Medium-Term Management Plan (2022-2025) in January next year. We hope to announce a figure which meets investors' expectations.

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[Q3-1]

How much scope for the expansion of Canon ITS sales is there in the MA HQs' customer base?

[A3-1]

I explained about two projects with the latest material. Because MA HQs have many customers, we still continue activities for expanding the area of specialty of Canon ITS. It takes time to introduce a project of a scale of 2 billion yen to 3 billion yen due to customers' circumstances and the term of the project. It therefore takes time to produce a result. However, we have done only a part of it. Please understand that we will continue to pursue this activity constantly.

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[Q3-2]

How will you increase the operating profit margin of Canon ITS hereafter?

[A3-2]

Canon ITS is implementing three business models. They are the system integration model, the service provision model, and the business co-creation model. With the system integration model, it is difficult to increase profit margin significantly in the short term, partly because of our relationships with customers. Regarding the service provision model, it is difficult to create a service which will sell explosively well. However, we will provide services which are suitable for social issues and common issues faced by customers. Because it is based on services, we are considering measures to increase the profit margin without investing a lot of SE resources.

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[Q3-3]

How large are the sales shares of businesses which are not on a person-month basis at Canon ITS? What about the profit margin compared to that of all companies?

[A3-3]

We are trying to minimize person-month businesses, and the industry is going in that direction. As I mentioned earlier today, we are going in the direction of service provision. I will refrain from giving the current sales shares because we do not disclose them. I will also refrain from giving the profit margin this time because we did not calculate it on a model-by-model basis.

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[Q4-1]

How high is the operating rate of SEs at present? To what extent can you increase it in the future and what measures do you take for this purpose?

[A4-1]

We do not disclose the operating rate of SEs. Sales have been increasing since 2020, as has the operating rate of SEs. However, if the operating rate is too high, we cannot spend time on employee training. The acquisition of various skills is necessary for responding to trends in technologies around the world and taking on new projects, and an operating rate that is too high will hamper such efforts. While we have been increasing the number of new hires in recent years, we would like to control the operating rate of employees by enhancing the cooperative relationships we have with development partners.

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[Q5-1]

Regarding office equipment, I believe that the overall market is shrinking. You said that you will achieve 101% growth by 2025. How are you planning to achieve that?

[A5-1]

We believe that we are still a challenger in the market of quasi-major and upper-medium-sized enterprises. We established the GB Solutions HQs in 2021. Before that, we could not make proposals sufficiently to customers in the market. Because we are a latecomer, we believe that we can increase sales by proposing solutions which are useful for customers and serving them cordially while selecting industries and business categories where output is demanded. Partly reflecting this, we believe that we can still have Canon products business grow in the overall Enterprise segment.

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[Q6-1]

Regarding data centers, we've heard for sometime that they are being occupied steadily and there will be a shortage in the near future. What are your thoughts on your future strategic investments?

[A6-1]

Regarding the data center business, there were a number of environmental changes in Japan. There is a lot of debate over whether we may go with the existing business model or whether we should pursue new initiatives. We are considering what form our data center business should take in the future. Building 2 of the West-Tokyo Data Center is doing relatively steady business, and we are thinking about what to do in the future. We are considering Building 3 but have yet to construct it.
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[Q6-2]

You said that there is a lot of debate. Could you explain what possibilities exist?

[A6-2]

Regarding the data center business, there is the colocation business, which mainly targets mega cloud vendors, and housing for individual customers. Regarding colocation, overseas companies are building their own data centers in Japan. We expect that these moves will significantly affect the data center business in Japan. Further, data centers designed with consciousness of AI are to be built in a different way. So we are thinking in which direction business opportunities exist.
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[Q6-3]

Suppose you are likely to be involved in AI data centers. What strengths will you exert?

[A6-3]

We have to date built data centers on our own, so we believe that we can apply our expertise to AI data centers as well. However, special technologies are needed to keep servers cool. How to acquire such technologies is therefore an issue.
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[Q6-4]

Regarding AI, have any new business opportunities emerged from the viewpoint of your Enterprise segment as a whole?

[A6-4]

As for specific business in the Enterprise segment, we have researchers working on AI related to video and image recognition, which has been embedded in actual services. Hopes are rising for

services deemed unique to Canon MJ, and we would like to invest more going forward. In the Enterprise segment, we have many customers in highly specialized domains. Therefore, a key point is how we can enhance our expertise. As we explained with the example of *shinkin* banks, we need to identify customer needs in a way that will allow us to give them all they could ask for. We would like to focus our efforts on fully understanding customers' feelings and developing specific initiatives with relevant technologies. Because business domains will expand further, we would like to develop specific initiatives in growth domains, including the Enterprise segment and Edge solutions, as soon as possible.

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[Q7-1]
With regard to the combination of GB Solutions HQs and Canon ITS, am I correct in thinking that a large amount of sales have yet to be achieved?

[A7-1]
We have yet to achieve a large amount of sales (compared to MA HQs) because we are continuing to expand the customer base of GB Solutions HQs with a focus on Canon products. The customer base is being developed gradually. Accordingly, we believe that when we have completed the development, we will be able to provide lifecycle support for customers, which is an area of specialty of Canon ITS.

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[Q8-1]
What are your thoughts on your future human resource strategy? Please give answers about Canon MJ and Canon ITS, respectively.

[A8-1] Canon Marketing Japan
Canon MJ has had many salespersons working successfully with a focus on Canon products. In the last few years, we have also been providing training for ITS to make the ITS business one of our mainstays. We also provide young employees, including new employees, with ITS training from the beginning. While we are still short of the human resources, we need to drive the business. Labor-saving and streamlining, including the introduction of IT in house, is what we have continued to do and what we need to continue to do. In addition, there will be an increasing number of things that Canon MJ Group cannot do on its own in making forays into markets. We therefore believe that we need to build alliances with other companies to take on challenges in the market of quasi-major and upper-medium-sized enterprises, which we have yet to develop, and that of large companies that will change in the future, by expanding the frameworks further.

[A8-1] Canon IT Solutions

Since around 2020, we have continued to increase the number of new graduate hires by 150 to 200 every year. We have also been increasing the number of mid-career hires. Regarding training of those employees, we are considering programs for having the three business models grow respectively. For the business co-creation model, we are working to increase the number of business co-creation human resources by around four times from the 2023 level (five times from the number in 2021). We are training human resources in charge of the service provision model under a partnership with an educational institution. For the system integration model, we have also been working on training human resources in the systems integration upstream who can consider customers' issues together with the customers. We would like to continue the training. Highly difficult projects emerge when a business is growing, which is not limited to the system integration model. We are therefore continuing activities to enhance the skills of systems engineers as a whole.
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*The content reflects some additions and modifications to enable it to be better understood.

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