



Canon Inc.

Second Quarter 2018

Analyst Meeting

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Speech Summary (English Translation)

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2Q 2018 RESULTS

Key Message

– 2Q 2018 Results (Slide 2)

This quarter, in addition to achieving sales and profit growth, driven by the launch of new products in each business, we also improved profitability. And for the first time since 2008, second-quarter net sales exceeded 1 trillion yen.

For existing businesses, net sales increased amid continued strong demand for lithography equipment and positive unit sales growth in our Office Business Unit (BU) for MFDs and laser printers.

As for new businesses, Medical—where net sales had declined in the first quarter due to a one-off factor—returned to growth thanks to the expansion of sales overseas. Additionally, we maintained growth of new businesses such as network cameras and OLED vacuum deposition equipment.

Despite posting lower sales in the first quarter, through the contribution of new products launched by each business, we returned to positive growth in the second quarter and also achieve sales and profit growth overall for the first half of the year.

FY 2018 Financial Results

– 2Q 2018 Actual versus 2Q 2017 Actual (Slide 3)

As I mentioned last quarter, this year, we are applying a new accounting standard for pensions and a standard where service revenue has been reclassified. For easy comparison with last year, we excluded the impact of these accounting standard changes from our results.

On this basis, net sales increased 1.4% to 1 trillion 6.4 billion yen, operating profit increased 6.1% to 102.2 billion yen, and net income increased 12.3% to 77.7 billion yen.

Furthermore, our operating profit ratio and net income ratio improved to 10.2% and 7.7%, respectively.

FY 2018 Financial Results by Business Unit

– 2Q 2018 Actual versus 2Q 2017 Actual (Slide 4)

Office sales and profit grew thanks to the steady increase in sales of new products.

Although Imaging System sales and profit declined, mainly due cameras, we posted significant sales growth in Industry & Others thanks to lithography equipment and new businesses, which contributed to overall sales and profit growth.

FY 2018 Operating Profit Analysis

– 2Q 2018 Actual versus 2Q 2017 Actual (Slide 5)

As for the impact of changes in exchange rates, although the yen strengthened against the U.S. dollar, the positive impact of yen depreciation against the euro was greater.

As for the impact of changes in sales volumes, the impact of lower volume on our Imaging System BU of which cameras are a major component was absorbed by Industry & Others, limiting the overall impact to minus 3.1 billion yen.

Regarding change in the standard linked to service revenue, 28.1 billion yen that was originally considered as SG&A was reclassified as cost of sales, resulting in no change in operating profit.

As for price reduction, efforts to limit this activity, particularly for office equipment, resulted in 4.6 billion yen, which was 1.2 billion yen lower than last year.

Meanwhile, for cost reduction, amid soaring raw material costs, strict cost control resulted in 3.5 billion yen.

FY 2018 PROJECTION

Key Message

– 2018 Projection (Slide 6)

Looking at the global economy, despite lingering concerns of political uncertainty and the prospect of escalating trade friction between the United States and China, we continue to see improvement in corporate earnings in major countries and improvements in employment leading to recovery in consumer spending. As a result, we expect the trend of modest economic expansion to continue.

Given the current economic situation, we adjusted the exchange rate assumptions used in our revised projection to 110 yen to the U.S. dollar and 130 yen to the euro.

Against this backdrop, we will continue efforts to realize our second consecutive year of sales and profit growth, implementing various sales strategies in the second half of the year to further accelerate sales of new products that are driving our performance. At the same time, the Group will work in a concerted effort to thoroughly reduce costs and expenses.

FY 2018 Financial Projection

– FY 2018 Current Projection versus FY 2017 Actual (Slide 7)

Our full-year projection compared with last year on a pre-reclassification basis.

We project a 1% increase in net sales to 4 trillion 120 billion yen, a 19.3% increase in operating profit to 395.5 billion yen, and a 15.7% increase in net income to 280 billion yen.

In terms of sales, this will represent the second highest level since 2007. And from a profit perspective, we will work to steadily raise profitability and expect our operating profit ratio and net income ratio to be 9.6% and 6.8%, respectively, exceeding those of last year.

FY 2018 Operating Profit Analysis

– FY 2018 Current Projection versus FY 2017 Actual (Slide 8)

As for the impact of changes in exchange rates, although we expect the yen to appreciate against the U.S. dollar, we calculate the total impact to be favorable due to the expected depreciation of the yen against the euro.

As for the impact of changes in sales volumes, we will work to absorb lower camera revenue through sales expansion of new products that have been launched so far in our Business Units of Office, Medical, and Industry & Others.

As for price reduction, we will continue efforts to limit this activity, holding the impact to a level that is in line with last year.

As for cost reduction, although the environment is challenging, characterized by persistently high prices for raw materials and a tight situation surrounding certain parts and components, we will work to lower fixed costs through improved productivity to achieve our full-year target of 18 billion yen.

FY 2018 Financial Projection

– FY 2018 Current Projection versus FY 2018 Previous Projection (Slide 9)

In our previous projection, we disclosed our full-year plan based on newly applied accounting standards. For comparison purposes we will follow the same approach today.

In the first half of this year, we posted sales and profit growth. Taking into account sales trends and market changes during this period, however, we decided to adjust our full-year projection.

This will be discussed in more detail from the next slide. Suffice it to say, average selling prices (ASPs) for MFDs and interchangeable-lens cameras (ILCs) have declined due to growth in sales of affordably priced MFDs and entry-class ILCs. Against this backdrop, although unit sales were in line with our plan, revenue was below our expectation. In addition, looking at our Industry & Others BU, rapidly overheated investment in OLED panels is now entering a temporary adjustment phase in which panel manufacturers are postponing their investment plans.

Reflecting these kinds of situations, we lowered net sales and operating profit by 180 billion yen and 25.5 billion yen, respectively.

FY 2018 Operating Profit Analysis

– FY 2018 Current Projection versus FY 2018 Previous Projection (Slide 10)

As for the impact of changes in exchange rates, although we expect the yen to be stronger against the euro, the total impact is expected to be positive due to a weaker-than-expected yen against the U.S. dollar.

As for the impact of changes in sales volumes, for Office, we revised our projection for both sales and profit to reflect a change in sales composition. We have been launching next-generation color devices and strategic models for emerging markets. Among them, affordably priced models have earned high praise for their industry leading competitive total cost of ownership and image quality. Due to this, we are seeing growing interest in these models, even from customers who would typically purchase higher-end devices. Additionally, we are seeing significant growth in emerging markets where there is strong demand for affordably priced models. This is linked to a decline in ASP and although we did not change our unit sales projection, it was the factor for us lowering our projection for net sales.

For Imaging System, we have been working to strengthen our lineup of entry-class models as a way to cultivate new customers. By launching new cameras that incorporate features found in higher-end models and also designing them to be easier to use, we have not only expanded our sales to first time

users of ILC, but have also stimulated interest from a broad range of users which is leading to a sharp increase in entry-class unit sales. Because of this situation, our ASP is trending lower than our original plan. Although we kept our unit sales projection, we revised our projection for both sales and profit.

For Medical, revision of the medical payment system that was conducted in Japan, is having a large impact of restraining customer buying. As such, we lowered our sales projection, however, we do not expect this to have a large impact on profit as we effect improvement in product mix through the acceleration of sales of new products.

For Industry & Others, we revised our projection mainly for OLED vacuum deposition equipment, taking into account the postponement of OLED investment.

On the other hand, through a comprehensive review of all expenses, we expect 52.7 billion yen in reduction. This includes not only a reduction in sales company expenses linked to the lowering of sales, but also savings through continued efforts to be selective and focused in our R&D investments.

As for price reduction, we expect to maintain the level of our previous projection by not pursuing excessive price competition.

Meanwhile, for cost reduction, taking into consideration soaring raw material costs that has had a larger than expected impact, we lowered our projection by 3 billion yen. Against this backdrop, however, we will continue to work to improve productivity through efforts to aggressively promote automation and in-house production.

FY 2018 Financial Projection by Business Unit – Full Year (Slide 11)

Although we did lower our projection, we still aim to increase sales with new businesses continuing to be the growth driver. We will also work to realize increase in profit through the promotion of cost and expense reduction of existing businesses.

DETAILS BY BUSINESS

Office – MFDs (Slide 12)

First, our Office BU. The office equipment market remains solid thanks to emerging markets that continue to grow, and the United States, which is driving recovery of the global economy.

Against this backdrop, although the market for monochrome devices continued to shrink, demand for color devices continued to expand, particularly in overseas markets. As a result the overall market was basically flat compared to last year.

In the second quarter, we maintained strong sales of next-generation color models as well as strategic models for emerging markets, which contributed significantly to the growth of color models overall. These products have earned high praise from both customers and dealers. From a customer perspective, designing replaceable parts to be more durable has considerably decreased the amount of down-time. From a dealer perspective, this has had the effect of reducing the load of machine maintenance.

Furthermore, new next-generation color models that were launched since February come equipped with such strong features as industry-first user authentication and print management as standard, and right now replacement of older models with these new ones is progressing smoothly.

In the second half of this year, we will work to expand sales of new models that were launched in the first half by continuing to further improve productivity from a user-side perspective and by expanding compatibility with industry-standard external cloud services. Additionally, we will work to raise the awareness of these new functions equipped as standard, and their ease-of-use and convenience, in order to enhance the appeal of these products.

Furthermore, from a sales perspective, we will work to maintain market exceeding growth for the full year by implementing in-depth follow-up systems with cooperating dealers more than we have in the past.

As unit sales were in line with our plan in the first half, we decided to maintain our previous projection for the full year, however, due to changes in the product mix towards more affordably priced models, which are popular in emerging markets, we revised our projection for revenue. In terms of profitability, we expect to improve through the steady increase in our MIF of color models to stabilize service revenue, and through efforts to reduce operating expenses.

Office – Laser Printers (Slide 13)

As for the laser printer market, we expect positive growth supported by the shift to MFPs and growing demand in emerging markets, which is expected to offset market contraction in developed countries.

In the second quarter, as with the first quarter, we posted positive unit sales growth. This was driven by new affordably priced monochrome and color models that we started selling from the fall of last year.

These new products are suitable for compact office spaces, which is stimulating demand not only in emerging markets, but in developed countries as well—contributing to a rise in the percentage of new products that make up our MIF. As a result, in the second quarter, sales of consumables also returned to growth.

As for our full-year outlook, as we are steadily increasing the market share of our hardware which boast competitive advantages due to their small form factor and low energy consumption, and as sales of consumables were in line with our plan in the first half, we kept our previous projection as is.

Office – Others (Slide 14)

The digital commercial printing market is steadily growing, particularly in North America, thanks to the tailwind of shifting demand from analog to digital.

Against this backdrop, quarterly unit sales of 3 new products, targeting the growing graphic arts area, which were released prior to the end of last year, increased sequentially.

In the second half of this year, we will establish a dedicated sales force in Europe for our commercial printers in order to accelerate sales. Similar to a structure that has worked well for us in North America, allowing us to precisely respond to customer needs.

Additionally, we will actively participate in large-scale commercial printing trade shows worldwide to promote the advantages of our offering with the aim of linking this to sales expansion.

Through this, we will work for future growth and increased profit, further raising our presence in the growing graphic arts market.

Imaging System – Cameras (Slide 15)

For ILCs, the rate of market contraction slowed as we entered the second quarter. This reflects the stimulation of demand through the launch of new products, both by competitors and ourselves. Against this backdrop, we managed 1.38 million in unit sales, a decline of 3% compared to last year.

In the second quarter, sales were driven by the EOS M50, a strategically positioned mirrorless camera. Despite being an entry-class model, it incorporates features found in more advanced cameras while delivering easy operation for beginners. Through this, we are bringing new users into our ILC ecosystem.

Through the launch of these types of new products, for the first half, we have secured the top market share position for mirrorless cameras in Japan and are steadily increasing our market share position in other regions.

For the second half of this year, in order to reach a broader range of customers, we will implement our plan to aggressively use social media in our marketing as a way to cultivate new users.

Additionally, we will strengthen our promotional activities targeting advanced amateurs, a growing segment of the market. At the same time, we will work to further strengthen our lineup, launching new products in the second half of this year.

From a profit perspective, we will work to further reduce costs through the acceleration of automation at domestic plants and the promotion of in-house production, including production equipment itself. At the same time, we will thoroughly reduce operating expenses. Through these measures, we will work to effect improvement in profitability from the second half on.

As unit sales in the first half of the year were in line with our plan, we decided to keep our full-year projection. From a revenue perspective, however, we lowered our projection, taking into account the increased proportion of sales coming from entry-class models that were used to cultivate new demand. This, however, also resulted in ASP decline.

As for sales of compact cameras, our unit sales decreased 22% to 840 thousand units amid continued market contraction. As the market and our unit sales were below expectations in the first half, we lowered our full-year projection for the market and our own sales from 11 to 10 million unit and from 3.4 to 3 million units, respectively.

Imaging System – Inkjet (Slide 16)

Although we are seeing market contraction in developed countries, we expect the overall market to be slightly up this year thanks to recovery of emerging markets.

In the second quarter, we increased sales of new refillable ink tank models that offer improvements in such basic features as color reproducibility and user friendliness. However, overall hardware sales were below those of last year due to a review of sales channels that was conducted throughout the first half of this year.

In the second half of the year, we will work to expand sales, focusing on models that fit the characteristics of each region, such as compact models for Japan and Europe and business models for North America.

Additionally, in emerging markets, we will work to expand sales by further penetrating the market for refillable ink tank models, which are performing well. For the full year, our efforts will be focused on posting unit sales that exceed those of last year.

We will work to link sales of these compact and business models with sales of consumables in the future. At this point in time, however, we are seeing signs that our MIF is shrinking in developed countries. This led to lower than expected consumable sales in the first half of the year. As such, we lowered our full-year projection.

Medical System (Slide 17)

In the second quarter, we achieved sales and profit growth, driven by expanded sales in overseas markets.

The market in the United States, the world's largest, has started to recover, thanks to renewed demand for equipment. Additionally, in emerging markets, we continue to see new demand, as they remain in a phase of developing their medical infrastructure.

We also posted double-digit sales growth overseas, including Europe and the United States, expanding sales of mainly new products. Within this, uses for the Aplio series of diagnostic ultrasound systems—which incorporate technology that enables high-resolution visualization of deep tissue inside the body—have expanded beyond their traditional application as an abdominal system in internal medicine to applications in cardiology, obstetrics and gynecology, resulting in significantly increased sales.

As for our full-year projection, we will work to realize positive growth, accelerating sales by further increasing the awareness of our new products in overseas markets.

In April of this year, we commenced sales of a high-resolution angiography system and an MRI system that achieves both high image quality and high operation rate. Over the past few years, we have been working to renew our lineup, including CT and diagnostic ultrasound systems, and that process is now almost complete. In overseas markets, where the second half is the selling season, we will also utilize industry trade shows in Europe and the United States to raise the awareness of our new products and facilitate our aim of growing overseas sales.

As for profitability, utilizing our production engineering prowess, we will work to reduce costs and promote further improvements in manufacturing processes, such as raising the level of cleanliness in clean rooms and sensing abnormal sounds in production equipment. At the same time, we will newly

undertake such initiatives as the in-house production of parts. Additionally, we plan to improve the operating profit ratio through efforts to reduce the cost of service by introducing such practices as remote diagnostics.

For the full year, although we lowered our net sales projection by 20 billion yen to reflect impact of the longer-than-expected customer buying restraint— linked to the revision of the medical payment system that took effect in April—we still expect to maintain our previous profit projection by steadily implementing the measures aimed at improving profit that were discussed earlier.

Industry & Others (Slide 18)

In the semiconductor lithography equipment industry, demand for memory continues to drive the market. Additionally, we see strong demand for power and sensor devices arising from increasing demand for communication and automotive applications.

Against this backdrop, we posted significant unit sales growth in the second quarter as well. This reflects the productivity and cost-performance of our i-line and KrF equipment, which have earned high praise from customers. As for the full year, we aim to sell 126 units, twice that of last year, in line with our previous projection.

In the FPD lithography market, while there is still demand for OLED displays, panel manufacturers are postponing their investment plans, entering a temporary phase of adjustment, after a period of rapid and overheated capital expenditure. For that reason, we are lowering our projection by 5 units to 70 units.

Amid this, however, we are also seeing an increase in demand for high-resolution large-size panels. And in line with this trend, we aim to launch a new tool in the second half that leverages our strength in high-resolution technology.

Next, OLED vacuum deposition equipment.

In the second quarter, we shipped equipment in line with our plan and posted sales that exceeded last year. For the full-year, however, we lowered our sales projection, reflecting the postponement of investment plans by panel manufacturers, which was discussed earlier.

Up to now, we have actively promoted the diversification of our customer base in preparation for the change in demand. However, the impact of reviews of investment plans made by panel manufacturers has significantly exceeded our expectations. From a mid-term perspective, however, we see a definite migration from LCD panels to OLED ones. From this, we will continue to expand upon our technological advantage in the areas of vacuum deposition equipment as we work to capture demand.

Next, network cameras.

Heightened global awareness of crime prevention and the shift to digital in emerging markets thanks to economic expansion, continues to grow the network camera market. Against this backdrop, we achieved strong double-digit growth, particularly in North America. This month, we welcomed BriefCam, a company known for having high-level video analytical technology, to the Canon Group. Through these kinds of acquisitions, we will work to expand sales solutions in conjunction with our broad hardware lineup.

For reference, the sales composition of “Others,” was approximately 25% for network cameras and 35% for the industrial equipment businesses of Group subsidiaries in the second quarter of 2018. For the full year, we expect network cameras to account for 25% and the industrial equipment businesses of Group subsidiaries to be around 30%.

FINANCIAL SITUATION

Inventory (Slide 19)

For inventory, turnover was 56 days at the end of June, which is similar to what it was at the end of June 2017, in both days and in monetary terms.

Compared with inventory at the end of March, turnover was 4 days longer. This mainly reflects an increase in consumer-oriented products in Imaging System for the selling period in the second half of the year.

We will continue to work to maintain appropriate levels of inventory as we closely monitor market trends.

Cash Flow – Full Year (Slide 20)

As for annual cash flow, we left our projection unchanged. While we expect to continue making investments that support growth of new businesses, we will also work for comprehensive cash flow management, maintaining capital expenditure to below depreciation.

Closing

For cash on hand, we did not make any significant change to our previous projection. We will be flexible in our response and expect we can maintain a certain level.

Although we built into our plan investment aimed at continuing the enhancement and expansion of new businesses, we will work for comprehensive cash flow management, maintaining capital expenditure to below depreciation.

Closing

In the second quarter, we achieved sales and profit growth through the effects of new products and other factors. At the same time, we were able to reach the 1 trillion yen in sales level.

Going forward, we will accelerate the momentum we have generated so far, pushing forward sales initiatives that were mentioned and measures to improve profit.

Through this, we will achieve our initial plan of second consecutive year of sales and profit growth.