



# Canon Inc.

## Second Quarter 2016

### Analyst Meeting

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#### Speech Summary (English Translation)

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## **Q2 2016 RESULTS**

### **Q2 2016 in Summary (Slide 3)**

The U.S. economy remained on a path of recovery, supported by a pickup in consumer spending. In Europe, we also saw a continuing trend of gradual recovery, particularly in Germany. In Japan, however, amid an improvement in employment, the yen's appreciation and other factors had a negative impact on consumers' willingness to spend. And in emerging markets like China, the pace of economic growth continued to slow. Overall, the global economy remained on a path of gradual recovery.

Under these economic conditions, sales of laser printers declined, as they did in the previous quarter. As for cameras, despite posting interchangeable lens camera unit sales that were in line with last year, and due to the large contribution by entry-level interchangeable lens cameras and a decline in compact camera sales, overall camera revenue declined. Although sales of network cameras and OLED display manufacturing equipment grew, net sales for the entire company declined at a double-digit rate, due to the significant impact of the yen's rapid appreciation.

Profit was also down due to the unfavorable change in exchange rates and lower sales of laser printer consumables.

### **Transition in Sales and Op. Profit – Q2 2016 Actual v. Q2 2015 Actual (Slide 5)**

As for changes in exchange rates, the overall impact was negative on both net sales and operating profit due to significant yen's appreciation.

As for changes in sales volumes, the impact was positive on the Industry and Other Business Unit thanks to strong sales of OLED display manufacturing equipment. On laser printers, the impact was negative due to lower sales of both hardware and consumables, which also occurred in the previous quarter. The impact was also negative on cameras due to a 30% decline in unit sales of compact cameras.

As for "Others," the impact of price reduction was 8.4 billion yen, less than the level of last year, thanks to efforts to limit this activity, mainly for cameras. Cost savings, however, were limited to 5.6 billion yen, mainly due to a decrease in production volume. As for expenses, we reduced this by more than 10 billion yen, mainly in advertising and R&D areas.

## **FY2016 PROJECTIONS**

### **Exchange Rate Assumptions (Slide 6)**

Since the beginning of June, "Brexit" concerns caused the yen to rapidly appreciate against the U.S. dollar and euro. Taking the current situation into account, we revised our exchange rate assumptions for the second half of this year from 110 yen to 105 yen to the U.S. dollar and from 125 yen to 115 yen to the euro.

## **Overview of Latest Projections (Slide 7)**

We expect the global economy to remain on a path of gradual recovery and the U.S. to remain the driving force that facilitates this. As for Japan, continued economic recovery is expected amid a pickup in employment and subsequent improvement in consumer spending. For emerging countries, however, we feel more time will be needed before we see a real recovery, considering the many uncertainties. Additionally, regarding Europe, although we expect the gradual recovery to continue, the U.K.'s recent decision to withdraw from the EU has heightened concern about a global economic slowdown. Consequently, this has increased uncertainty over a recovery from the second half of this year.

As for our full-year projections, we have lowered our forecasts for both net sales and operating profit by 80 billion yen and 35 billion yen, respectively, to reflect mainly the negative impact of the yen's rapid appreciation.

By business, we lowered our sales projection for laser printer consumables. However, for interchangeable lens cameras, where we exceeded our sales plan for mainly new products, and for Canon Tokki's OLED display manufacturing equipment, we raised our projections, reflecting our first-half performance and the current trend in orders.

From a profit perspective, we incorporated an additional allowance for further expense reduction, which we aim to realize through comprehensive selection and concentration.

## **Transition in Sales and Op. Profit – FY 2016 Current Projection v. FY 2016 Previous Projection (Slide 9)**

As for exchange rates, compared to our previous projection, we expect further yen's appreciation. This change in our assumptions had a negative impact of 88.2 billion yen and 36.0 billion yen on net sales and operation profit, respectively.

As for changes in sales volumes, we raised our projections for interchangeable lens cameras and OLED display production equipment, and lowered our projection for laser printer consumables.

Within "Others," we lowered our projection for the impact of price reduction by 3 billion yen, reflecting aims to further restrict price cutting for mainly cameras. As for cost reduction, we basically kept our previous projection. For expenses, we incorporated into our plan a reduction of 7.0 billion yen, which consists mainly of advertising.

## **DETAILS BY BUSINESS**

### **Office – Q2 2016 Actual and FY 2016 projections (Slide 10 & 11)**

As for copiers, the overall market was flat in unit terms, supported by continued color growth.

Within this market, we are posting strong sales of an A3 model, designed for small- and medium-size offices, that was launched last year. The strengths of this product are the industry's highest level of image quality and the ability to save on service and maintenance costs. Sales of this model are accelerating as the advantages are recognized by the market.

As for monochrome copiers, although our sales continued to shrink, in continuation of last year, we launched a model for emerging countries that, for example, offers advantages in terms of maintenance, a feature contributing to its strong sales.

For commercial printing, we are expanding sales of our light-production equipment, capturing demand for in-house printing. The high productivity and reliability of our offerings have opened the door to large business deals and we have already started installing this equipment in major corporations. Additionally, sales of a high-speed output tool with the ability to print 100 pages-per-minute, which has been highly evaluated for its output quality and stability, have been expanding since its launch.

As for laser printers, followed by the previous quarter, we recorded a significant drop in sales. I will now discuss the factors that led to this result and our countermeasures.

In the laser printer market, while a shift toward color models was a major source of demand in developed countries, in emerging countries, accompanying economic development, we saw continued expansion driven by new demand for mainly low-end models. Predicting this, we entered emerging countries at an early stage, which allowed us to not only maintain our strong competitiveness but also achieve growth, even as the market matured in developed markets.

Since the third quarter of last year, however, hardware unit sales have been declining at a double-digit rate. A major reason for this has been the slowdown of emerging markets, where we generate roughly 60% of our total unit sales.

Among office equipment, laser printers tends to be more sensitive to economic conditions. Additionally, in resource-rich countries, such as those in South America, Eastern Europe, and the Middle East, we saw currencies depreciate further than we expected and could not avoid raising prices. As a result, unit sales in these regions have been cut in half compared with last year.

Thus, the largest factor behind our current performance is the deterioration of the macroeconomic environment. Another factor is linked to our heavy reliance on emerging market growth and our inability to accurately predict how prolonged economic downturns impact laser printer demand trends.

From the beginning, compared with other office equipment or consumer products like cameras, the structure of sales channels within the laser printer market has been complex, as it does not only include mass retailers, but also numerous dealers that specialize in system integration.

Furthermore, advancements made in areas like e-commerce and the diversification of distribution channels and marketing routes have made it difficult to accurately grasp demand trends in ways we have done until now. On top of this, from time to time we have engaged in price competition in order to expand sales, which made it even more difficult to appropriately grasp end-user demand.

In order to overcome this situation, we have taken measures from both sales and product perspectives.

From a sales perspective, we will avoid aimless expansion in order for us to accurately grasp demand trends for mainly low-end models, and focus on making improvements in profitability.

This has already become a factor behind the further temporary decline in our current performance. We believe, however, that this is an unavoidable process to achieve an optimal balance between supply and demand.

As for consumables, we took the same approach, making adjustments in order to bring inventory back to an appropriate level. However, as efforts to suppress print volume and the shift to third-party products seem to be progressing in the market, we will make further adjustments in the second half, thus we are further lowering our annual sales projection for consumables.

From a product perspective, on the other hand, we will continue to expand sales of the new products that we began launching last year.

In the developed countries where these new products are already being sold, such features as energy-efficient operation and ease-of-use have received high praise. The switchover to new products is going smoothly and, along with consumables, sales are steadily growing.

In the second half of this year, we will expand sales of new products to include emerging markets in line with our original plan. Moving forward, we aim to raise the ratio of new products within our entire installed base.

Although the challenging situation that we have faced this year will continue for a short while, by executing the measures I just mentioned, we expect to head towards recovery from next year.

Looking into the future, we can envision risks of a slowdown linked to structural issues like a shift towards a paperless society. However, at this point in time, it is very difficult to imagine something replacing printing in the office environment. We do not see a significant change in the need for printers, and the shift of demand to color and MFPs remains solid.

Under this market environment, we are working more closely with our OEM partner and aggressively taking measures in order to stimulate print demand.

Within copiers, we expect our sales of color models to continue growing at a double-digit rate in terms of units. Starting with Japan, we announced a new mid- to high-speed color model in June, which replaces the core model within our lineup. In addition to offering significantly improved basic features like image quality, this model also features the ability to lower the costs of service and maintenance, a similar capability found in other new products. Business negotiations are going smoothly for this product and from the second half of this year, we will gradually increase the number of regions where this product is sold.

As for monochrome copiers, we aim to return to positive growth on an annual basis, as the model for emerging countries that were launched in the second quarter of the year will contribute fully to sales in the second half.

As for commercial printing, at Drupa, the world's largest print and media industry tradeshow held once every four years, we were able to secure numerous orders for the range of products that we exhibited, one in particular, Océ's high-speed cut sheet inkjet printer.

Going forward, we will work to expand sales of these products and facilitate the expansion of consumable sales.

## **Imaging System – Q2 2016 Actual (Slide 12)**

The interchangeable lens camera market continues to gradually improve, particularly in developed countries.

Within this market, our new DSLRs, such as one for advanced amateurs that offers improvement in tracking fast moving subjects, and an entry-level model that is network-enabled, have contributed to our sales. For mirrorless cameras, we have expanded unit sales, particularly in Asia, running advertising campaigns targeting young people and females. As a result, we sold 1.5 million interchangeable lens cameras in the second quarter, representing sales that were in line with last year, which was also the case in the previous quarter.

As for compact cameras, the market and our sales, which were 1.16 million units in the quarter, continued to shrink at a rate of about 30%. Under these conditions, we have been working to broaden our lineup of premium models and with the positive effects of this year's new product, we were able to achieve 50% growth in this category. This result has contributed to not only overall market share gain, but an improvement in overall compact camera profitability.

As for impact from the Kumamoto earthquake, it is already having a negative effect on our procurement and is expected to have a negative impact on compact camera sales in the second half.

The overall inkjet printer market continues to contract, mainly due to the trend in consumer-oriented products. We, however, were able to maintain our unit sales at the same level of last year, thanks to efforts to strengthen our B2B business.

Mainly in emerging countries, there is an ongoing shift towards high-volume refillable ink tank models. Addressing this trend, we launched new products at the end of last year which are enjoying strong unit sales growth.

Additionally, we are steadily expanding unit sales of B2B products, including MAXIFY, our line of business-use inkjet printers, and A2 inkjet printers targeting professional photographers. Both products are contributing to an improvement in profitability.

## **Imaging System - FY 2016 Projection (Slide 13)**

As for interchangeable lens cameras, we exceeded our sales plan for new DSLRs and our enhanced lineup of mirrorless cameras, particularly in Europe and China. As such, we raised our full-year unit sales projection to 5.5 million units, which is in line with last year.

This year as well, we will work to improve profitability and at the same time stimulate the market, launching new products, from professional to entry-level models, which address the needs of each user. Within mirrorless cameras, we have launched a dedicated macro lens, the world's first AF lens with a built-in LED light. We are aggressively enhancing our lens lineup for mirrorless cameras, which will support efforts to further expand our market share in all regions.

As for compact cameras, we expect impact from the Kumamoto earthquake, thus we lowered our full-year unit sales projection to 4 million units.

As for inkjet printers, we expect to grow unit sales of high-volume refillable ink tank models in emerging countries.

And as for large-format printers, in order to meet the extensive needs of the graphic arts market, in June of this year, we launched 4 models targeting professionals that realize both high-image-quality and high productivity. With these new products, we will work to expand sale and improve profitability in the second half of this year.

#### **Industry and Others – Q2 2016 Actual (Slide 14)**

As for IC lithography equipment, although unit sales declined due to a shift in the timing of some sales, the trend in orders remained solid and customer investment remained around the same level of last year.

As for FPD lithography equipment, the market remained favorable as we sold 10 units, exceeding that of the same period last year.

Amid continued network camera market expansion, Axis's performance has been strong. As for the Industrial Equipment of Groups Subsidiaries, we doubled our sales, reflecting continued strong growth in sales of Canon Tokki's OLED display manufacturing equipment.

For reference, "network cameras" and the "Industrial Equipment of Group Subsidiaries" both accounted for approximately 25% of the "Others" segment of the Industry and Others Business Unit.

#### **Industry and Others – FY 2016 Projection (Slide 15)**

For both IC lithography equipment and FPD lithography equipment, we expect investment to remain solid, driven by increasing demand for communication related devices thanks to IoT and for OLED panels.

Despite moves within the industry to adjust production of smartphones, our sales outlook is that we will maintain our previous plan.

As for Canon Tokki, we raised our plan, reflecting progress the Group is making in strengthening production systems. As a result, total sales of the Industrial Equipment of Group Subsidiaries are expected to grow by 70%.

As for network cameras, we expect our sales to grow around 40% thanks to strong market growth and Axis's full-year contribution to Group results.

For reference, "network cameras" and "Industrial Equipment of Group Subsidiaries" both account for approximately 25% of the "Others" segment of the Industry and Others Business Unit.

## **FINANCIAL SITUATION**

#### **Inventories (Slide 16)**

Inventory turnover at the end of June was basically in line with the end of March.

As for work-in-process, preparation for the production of lithography equipment to be shipped in the second half of the year accounts for the one day increase in turnover to 16 days compared with the end of March. We will continue efforts to achieve our target of 10 days.

### **Capital Expenditure / Free Cash Flow (Slide 17)**

Linked to the Toshiba Medical Systems Corporation acquisition, we expect free-cash-flow to be negative 415 billion yen for the full year.

As for the 660 billion yen we had in loans at the end of March, taking into account our mid- to long-term outlook and funding plan, we repaid 50 billion yen by the end of the first half. Going forward, we will continue our pursuit of comprehensive cash flow management.

### **Cash on Hand (Slide 19)**

Cash on hand at the end of this year is projected to be 590 billion yen, reflecting the repayment of loans.

### **Closing**

Due to further appreciation of the yen, we have again lowered our projections.

Although our performance is becoming increasingly constrained as core businesses of Office and cameras have entered maturity phases, our vision and goals are very clear. We believe we are currently in transition phase after which we will emerge a new Canon.

We will steadily execute our strategies, drastically reviewing our profit structure for existing business, while focusing on strengthening and expanding new businesses. Through this, I am perfectly convinced that we can make great strides forward in the near future, as a new Canon.