

Message from the CEO



Seeking to become a constantly developing, truly excellent global corporation that is admired and respected around the world, Canon is accelerating its grand strategic transformation towards new growth while contributing to a sustainable society in this age of rapid change.

Contributing to Global Society with an Enterprising Spirit

Canon started as a small laboratory that was home to a group of researchers with a common desire to “make the world’s best camera.” Ours has been a history of challenge: the Enterprising Spirit that sought to create cameras by applying original knowledge and technology has been inherited as part of our corporate DNA. It has also found expression in Canon’s fundamental business strategy of diversification and globalization. In constant pursuit of innovation, we have been quick to diversify and embrace transformational trends in such industries as copy machines, printers and semiconductor lithography equipment, while also developing internationally in line with the growth of world markets. Today, Canon is a global enterprise employing some 200,000 people worldwide. In 1988, on the 51st anniversary of the company’s founding, we adopted

kyosei as our corporate philosophy—the idea that we should seek to build a society in which all people, regardless of culture, customs, language or race, harmoniously live and work together in happiness into the future.

In 1996, in line with our philosophy of *kyosei*, we initiated a five-year scheme called the Excellent Global Corporation Plan to make Canon a globally admired and respected company dedicated to contributing to society through continuous technological innovation. Based on the Excellent Global Corporation, we are applying the same Enterprising Spirit to various business reforms aimed at improving the management of consolidated operations, prioritizing cash flow, and achieving total business optimization. The plan has been a financial success: compared with 1995, our sales are 90% higher and net income attributable to Canon Inc. has increased by 360%.

Further Progress on Phase V of the Excellent Global Corporation Plan

In 2016, we embarked on the Excellent Global Corporation Plan Phase V, a five-year plan under the basic policy of “embracing the challenge of new growth through a grand strategic transformation.” This plan involves shifting Canon’s business portfolio from B-to-C businesses, which had been our earlier focus, to B-to-B businesses with growth potential stemming from high societal demand. The plan views changes in the industries Canon operates within as a source of growth. The seven key strategies that we formulated and have been implementing as part of the plan are outlined below.

1. Establish a New Production System to Achieve a Cost-of-Sales Ratio of 45%

We are approaching the challenge of achieving a cost-to-sales ratio of 45% from two angles: through developing unmatched stand-out products and by reducing manufacturing costs.

For product development, we maintain a keen understanding of the needs of our customers and society as a whole and adopt the latest technologies to deliver superlative products that contribute to society through unrivaled functions and performance. In pursuit of reduced manufacturing costs, we are enhancing productivity by pushing forward with our plan to reduce costs from the development stage as well as promoting automated assembly and the use of robots.

2. Reinforce and Expand New Businesses while Creating Future Businesses

We aim to create and expand new businesses through the diversification and lateral expansion of our existing operations. We are also prioritizing the allocation of resources to our four new businesses of commercial printing, network cameras, healthcare and industrial equipment, which we view as growth markets that will benefit from strong societal demand in the future as anticipated trends play out.

3. Restructure Our Global Sales Network in Accordance with Market Changes

Amid significant changes in customer purchasing behavior in step with advances in internet technology, we are looking to shift quickly to an omni-channel approach that takes advantage of the strengths of both online and offline operations. In addition, in line with the emerging IoT (internet of things) era, we are creating systems that seamlessly integrate products and services aimed at enhancing customer productivity and convenience. In B-to-B businesses, such as the four new areas we are targeting, we are cultivating the development of high-level sales engineers to give feedback to development divisions on solutions-related technical issues.

4. Enhance R&D Capabilities Through Open Innovation

Our R&D capabilities are the source of our competitiveness. With our emphasis on technology, a key element of Canon’s DNA, we look to differentiate using proprietary technologies so that we can continue to generate stable profits. However, with the increasingly rapid evolution of advanced technology across multiple fields, with growing complexity, it is unrealistic to expect one company to develop everything themselves. Combining technologies from different fields will also be necessary to respond to increasingly diverse needs. While we seek to develop our own proprietary core technologies, we are concurrently pursuing an open innovation approach for R&D based on partnerships with external organizations to source information about advanced technologies from around the world to accelerate development and generate better results.

5. Complete Our Three Regional Headquarters Management System Capturing World Dynamism

We have adopted a system based on three regional headquarters in Japan, the United States and Europe so we can benefit from the dynamism of the global economy while diversifying our operations in ways that exploit the characteristics of local markets. In the United States, one of the most medically advanced countries in the world, we are working to commercialize such advanced equipment as microfiber endoscopes in partnership with leading hospitals. In Europe, in collaboration with Canon Group company Océ, we are developing commercial printers for printing on wood, metal, glass and other materials to further technological innovation within the field of commercial printing, including printed packaging materials.

6. Cultivate Internationally Competent Human Resources with a Global Perspective

The globalization process at Canon involves the development of local workforces as well as personnel with regional perspectives from the Americas, Europe and Asia.

Going forward, we are looking to recruit talent on a global scale as we cultivate the next generation of managers to run Canon’s increasingly borderless operations.

7. Re-Instill the Canon Spirit as a Foundation for New Growth

The growth of Canon to date has been underpinned by the Enterprising Spirit that exists as part of our corporate DNA and a code of conduct summarized in the *San-ji* Spirit (the “three selves” of self-motivation, self-management and self-awareness). By re-invigorating this Canon Spirit, we will confront the reform challenges posed by changing global economic conditions.

Message from the CEO

Completing the Transformation of Our Business Portfolio in 2018

In 2018, the third year of Phase V of the Excellent Global Corporation Plan, we completed the transformation of our business portfolio, in the process marking the end of the first stage of Canon's strategic repositioning. With the markets for the consumer products that have driven Canon's development continuing to shrink, we have looked to shift our business portfolio from B-to-C towards B-to-B products and services. Leveraging the technology and resources of our existing businesses, pursuing a bold M&A strategy and establishing new

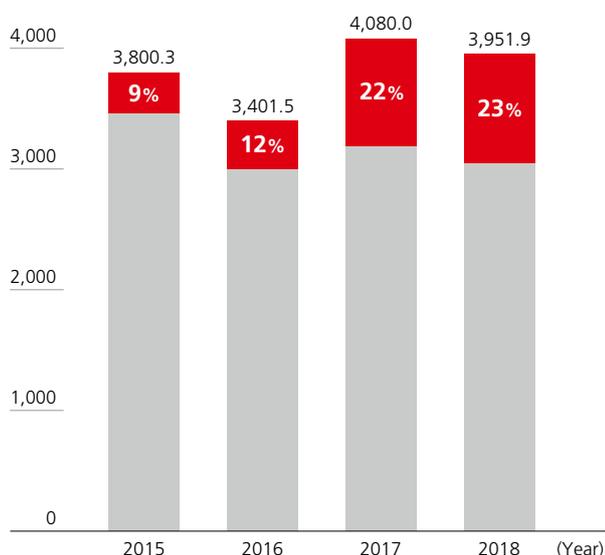
businesses where synergies can be expected, we managed to complete that shift in 2018. Our four new businesses of commercial printing, network cameras, medical and industrial equipment have all grown steadily. In aggregate terms, the new businesses generated 23% of consolidated sales in 2018. They have also made a substantial contribution to profits.

Higher Profits from Lower Sales in 2018

Looking back at the global economy in 2018, the U.S. economy generally performed well and Europe continued its modest recovery. However, with the trade friction between China and the United States in the latter half of the year and the political climates of various countries and regions, concerns of a global economic slowdown were mounting and growth slowed for the Chinese economy in the second half. At Canon, we tried to improve the financial performance of our revised business portfolio comprising such traditional core businesses as office equipment and digital cameras plus our four new businesses. The impact of the significant contraction of the digital camera market and a slowdown in capital investment in the OLED production equipment sector resulted in our consolidated net sales declining 3.1% to ¥3,951.9 billion compared with the previous year. However, this was offset by the strong performance of the medical equipment business, which benefited from the growth of such new products as high-margin diagnostic ultrasound systems, and our success in steadily reducing costs in the industrial equipment sector. These factors lead to a second consecutive year of higher profits, where operating profit rose 6.6% to ¥343.0 billion and net income attributable to Canon Inc. increased 4.5% to ¥252.8 billion.

Total Net Sales and New Business Composition

■ Existing businesses ■ New businesses
(Billions of yen)



Consolidated Statements of Income

	(Billions of yen)	
	2017	2018
Net sales	4,080.0	3,951.9
Gross profit	1,990.6	1,835.6
Gross Profit Ratio (%)	48.8	46.4
Operating Profit	321.6	343.0
Operating Profit Ratio (%)	7.9	8.7
Net Income Attributable to Canon Inc.	241.9	252.8
Net Income Attributable to Canon Inc. Ratio (%)	5.9	6.4

* Certain costs that were listed under operating expense have been reclassified under cost of sales following the adoption of new accounting standards.

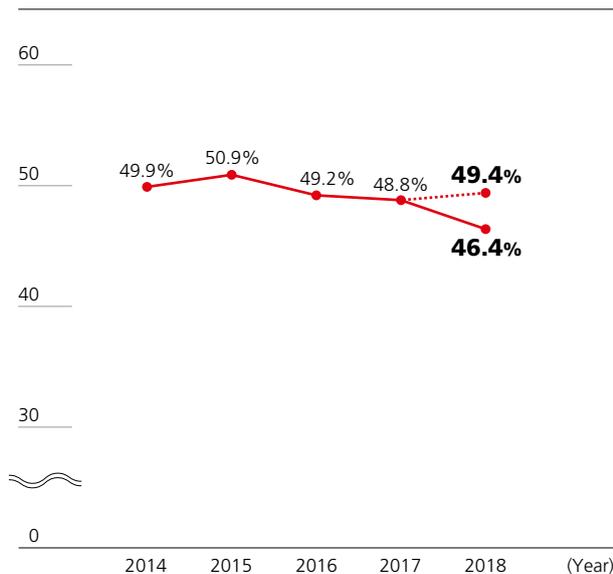
* In 2018, a reclassification of operating profit and other income (deductions) was conducted due to change in pension accounting standard. Figures dating to 2016 have been restated to conform with the current year's presentation.

Maintaining Our Strong Financial Position

We have established strong finances for Canon through the implementation of the Excellent Global Corporation Plan. And our financial position remained extremely healthy in 2018. One highlight was that we managed to maintain a high gross profit ratio of 46.4%. Additionally, certain costs that were listed under operating expense have been reclassified under cost of sales following the adoption of new accounting standards, and if the impact of this reclassification is excluded, the gross profit ratio increased by 0.6 points to 49.4% compared with the previous year (see graph below). In 2018, we also generated strong free cash flow of around ¥170 billion, while boosting the shareholders' equity ratio by 2.5 percentage points to 57.7%. This in part reflected further repayment of the debt assumed in 2016 to fund the addition of Canon Medical Systems to the Group.

Gross Profit Ratio

(%)



Targeting Productivity Gains in 2019

We entered the second stage of Canon's strategic transformation in 2019. The policy theme for the year is "to accelerate strategic transformation by targeting dramatic improvements in productivity" across all divisions from R&D to production, sales, customer services and central departments. We are prioritizing the following actions as we seek to achieve the high levels of productivity demanded of an Excellent Global Corporation:

Further Reinforcement of Existing Businesses

The contraction of consumer product markets has eroded the growth potential of the businesses that have supported Canon in the past. However, these existing businesses remain the core foundation that will continue to support Canon. In markets with reduced growth potential, it is critical that we bolster our market share. To this end we are employing such cutting-edge technologies as the cloud, the IoT and AI to develop and launch excellent products that will overwhelm the competition. At the same time, we continue to focus on reducing the cost of sales, not only through more automated product assembly, but also by developing production machinery and equipment in-house across the Group and bringing the manufacture of key components in-house.

Reinforce and Expand New Businesses

Océ is leading efforts to build up our commercial printing business base. We are also aiming to establish a line-up of products that support commercial printing characterized by high-resolution and wide-variety, small-lot print jobs. In the network camera business, we are looking to strengthen and expand our software capabilities to cater to the broadening requirements of the sector. We are also shifting our focus toward segments with medium-term growth potential, such as in-vehicle cameras and camera systems for industrial process management applications. In our healthcare business, we plan to strengthen our presence in diagnostic equipment, and at the same time we are starting to look at possible entry into such new segments as biomedical products and devices for medical treatment. In the industrial equipment business, we are working to accelerate the development of next-generation OLED production equipment while also developing new industrial equipment.

Review of R&D Set-Up

We are conducting a bottom-up review of our R&D structure to consider how best to develop products in an age of rapid global technological innovation where product life cycles are getting shorter and shorter. Our aim is to improve productivity by clearly defining R&D divisional roles and by focusing efforts on the medium-term and long-term R&D themes deemed necessary from a business perspective for developing the technologies required for future businesses as well as the advanced technologies needed in our existing operations. One focus is to investigate global tech start-ups as potential future M&A targets.

Message from the CEO

Canon's Concept of Social Responsibility

At Canon, we see dispelling concerns surrounding our business and satisfying stakeholder expectations as our social responsibility as a corporate citizen. Under our corporate philosophy of *kyosei*, we have identified the following as materiality themes that Canon must help address to contribute to the realization of a better society: "creating new value and solving social issues," "protecting and conserving the global environment" and "responding to people and society as a good corporate citizen." Our CSR activities are strongly focused on achieving these goals.

In promoting these activities, compliance, governance and risk management are the basis for gaining the trust of our customers and business partners. In 2017, we instituted the "Canon Group CSR Basic Statement," which we disseminated throughout the entire Group. Supply chain management is another area where expectations have risen in recent years. In 2018, we instituted the "Canon Supplier CSR Guidelines" alongside the annual checks that we undertake to gauge the CSR activities of our thousands of suppliers.

Kyosei is consistent with the Sustainable Development Goals (SDGs) adopted by the United Nations in 2015. We believe we can help achieve these goals through our various business activities.

Creating New Value and Addressing Societal Issues

One of the key strategies under Phase V of the Excellent Global Corporation Plan is to reinforce and expand new businesses while creating future businesses. We believe that we should seek to create new value for society through our business activities, while also supplying products and services that can help address societal issues. Many examples of Canon products that help to address these issues already exist, including medical diagnostic systems, network cameras and industrial equipment.

Protecting and Conserving the Global Environment

Global environmental protection and conservation constitute one of the most critical issues that companies must address to generate sustainable growth. We are striving to increase operational efficiency while reducing environmental impact at all Canon Group operating sites worldwide, based on the concept of maximizing resource efficiency.

We have consistently engaged in activities that aim to reduce the environmental impact of Canon products over their entire life cycle. We practice green procurement, the purchasing of eco-friendly parts and materials. Other activities include energy-efficient design, recycling of factory wastewater, and collection and



Canon network cameras are installed in the JAL hanger at Haneda Airport

recycling programs for toner cartridges. As an overall indicator of environmental performance, we have set a goal of improving product lifecycle CO₂ emissions by an average of 3% per year. Over the period from 2008 to 2018, we achieved average improvements of 5% per year. In 2018, we also began operating the Canon Eco Technology Park for more advanced and efficient “closed-loop recycling” through state-of-the-art recycling technology. In addition, based on our Biodiversity Policy, we are seeking to leverage our products and technologies to promote a society that fosters rich biodiversity. Going forward, as outlined in our Environmental Vision “Action for Green,” we will continue our efforts to realize a society that promotes both enriched lifestyles and the needs of the global environment.



Canon Bird Branch Project highlights the cycle of life focusing on wild birds

Responding to People and Society as a Good Corporate Citizen

Canon strives to gain the trust of customers and business partners, and implements thorough quality control to improve our corporate sustainability. For employees, alongside respect for human rights, we focus on creating workplaces that help to promote diversity while supporting better work-life balance. We continue to promote the Canon Spirit—comprising the *San-ji* Spirit and an Enterprising Spirit—while creating workplace conditions to help each employee fulfill their potential. We are also actively engaged in various social contribution activities around the world to assist with humanitarian and disaster-relief efforts, fund educational and academic support initiatives, and promote the arts, culture and sports.



Canon India carries out multifaceted support activities through the 4E's Project

Canon's Aspiration as a Good Corporate Citizen

With the Enterprising Spirit and the *San-ji* Spirit that make up our corporate DNA as a starting point, we will work to accelerate our strategic transformation based on the Excellent Global Corporation Plan with the aim of generating sustained growth.

Based on our corporate philosophy of *kyosei*, we will work together with our customers and business partners to help realize a better society by contributing to the achievement of the SDGs through Canon's business activities. In doing so, we hope that Canon will continue to prosper as an enterprise for the next 100—or even 200—years.

We humbly ask for your continued support.

Fujio Mitarai
Chairman & CEO
Canon Inc.