



Canon Inc.

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Speech Summary (English Translation)

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2016 RESULTS

2016 (Slide 3)

In 2016, signs of an economic recovery in the U.S. became more evident from the second half of the year. The economies of Europe and Japan, however, remained weak, reflecting sluggish consumer spending. As for emerging markets which were limited to modest growth, in countries like China, we saw a trend of slowing expansion. At the beginning of the year, we assumed global economic growth in 2016 would exceed that of 2015. It was, however, at its lowest rate since the Great Recession triggered by the collapse of Lehman Brothers.

Even for exchange rates, although the yen depreciated towards the end of the year, the weighted average annual exchange rate shows that the yen appreciated more than 10% against the U.S. dollar (121.13 yen in 2015 to 108.58 yen in 2016) and the euro (134.20 yen in 2015 to 120.25 yen in 2016), which had a negative impact on both net sales and operating profit of 280.4 billion yen and 101.8 billion yen, respectively.

Amid this more challenging business environment, we posted a drop in laser printer sales. Sales of cameras also declined due to continued contraction of the compact camera market. These factors resulted in overall sales and profit decline.

In contrast, for new businesses such as network cameras and OLED display manufacturing equipment, we posted significant increases in sales. Last year was the first year of our new 5-year plan. Even amid the challenging business environment, we were able to cultivate and strengthen new businesses.

Transition in Sales and Op. Profit – FY2016 Actual v. FY2015 Actual (Slide 5)

Changes in exchange rates had a large negative impact on both net sales and operating profit due to significant appreciation of the yen.

As for changes in sales volume, in addition to lower sales of laser-printer hardware and consumables, we also posted a decline in compact camera sales due to market contraction. Sales attributable to the Industry and Others Business Unit, however, increased, thanks to the growth of new businesses.

As for “Others,” the impact of price reduction was 32.7 billion yen in 2016, less than the 43.2 billion yen in 2015, thanks to efforts to limit the lowering of sales prices. As for cost reduction, efforts to improve productivity contributed significantly to the 36.4 billion yen in total cost savings, which was basically in line with what was achieved in 2015. Expenses were down 45.6 billion yen, compared with the previous year, mainly due to reductions in advertising and development related expenses.

FY2017 PROJECTIONS

Exchange rate assumptions (Slide 6)

As for exchange rate assumptions, although we can foresee situations where the U.S. dollar would appreciate such as an interest rate hike, taking into consideration the trend we have seen since the end of last year up to now, we assumed 110 yen to the U.S dollar and 120 yen to the euro.

Overview of FY2017 Projections (Slide 7)

In 2017, we expect China's economic slowdown to continue, and the economies of Japan and Europe to be confined to modest growth. In the U.S., however, there is an underlying tone of economic improvement, centered on the employment situation. Coupled with positive expectations for economic policies put forward by the new administration, we expect further economic improvement going forward. On top of this, we expect to see positive economic growth in Russia, Brazil, and other emerging-market countries. Overall, we expect the rate of global economic growth to exceed that of 2016.

Under these circumstances, our laser printer business, which faced challenging conditions last year, has already started down a path towards recovery. And for cameras, where sales of new models have been strong, we expect to maintain the same level of sales as last year, mainly thanks to DSLRs and mirrorless models. In addition to the steady growth of existing businesses, we expect significant growth to come from such new businesses as OLED display manufacturing equipment and network cameras, leading to overall sales and profit growth.

Please note that in our 2017 net sales projection, we also included 420 billion yen related to TMSC, which was made a subsidiary at the end of last year.

Transition in Sales and Op. Profit – FY2017 Projection v. FY 2016 Results (Slide 9)

Changes in exchange rates are expected to have a positive impact on both net sales and operating profit as we assume the yen will weaken against the U.S. dollar.

As for changes in sales volume, for existing businesses within our Office and Imaging System Business Units, we expect sales to be basically flat compared with last year. For our Industry and Others Business Unit, in addition to expecting new businesses such as OLED display manufacturing equipment and network cameras to remain on a path of growth, we expect to significantly exceed last year's results as this segment also reflects the consolidation of TSMC.

As for "Others," we included in our projection, allowances for 30 billion yen in price reduction and 30 billion yen in cost savings. As for expenses, although our expenses will rise significantly due to the impact of new consolidations, we will keep tight control over expenses, especially those related to advertising and development.

DETAILS BY BUSINESS

Office –2016 Actual (Slide 10)

In the copier market, amid the shift to color, we have also been actively launching new products with a focus on color equipment. These new models, which strengthened our competitiveness, offered features such as higher image-quality and reduced service and maintenance cost. These contributed to their strong market acceptance and allowed us to realize color copier growth that exceeded the overall color market. In contrast, the monochrome copier market continued to shrink, mainly in the emerging markets, due to prolonged economic weakness, thus our unit sales also decline. Overall, we posted copier unit sales that were basically in line with last year, driven by color models. Net sales, however, slightly declined reflecting a change in product mix.

As for commercial printers, although we grew unit sales of a 100 page-per-minute and other color models that offer high image-quality and deliver high productivity, sales were basically flat due to a delayed introduction of a new continuous feed model.

The market for laser printer hardware remained challenging. Amid this, however, color models continued to grow. This reflects progress made in reducing costs, which subsequently led to a better balance between price and functionality. Additionally, even in the market for monochrome models, which continues to shrink, we started to see movement towards improvement as the emerging markets of Asia, including China, returned to positive growth.

As for Canon, although hardware and consumable sales both declined on an annual basis, we are seeing recovery, starting with hardware from the first quarter and consumables from the third quarter. As for hardware, unit sales increased in the second half compared to the same period last year, as the changeover to new products went as planned. Consumables also showed improvement as sales exceeded our plan in the fourth quarter, finally indicating signs of a recovery.

Office –FY2017 Projection (Slide 11)

Although we expect the overall copier market to be basically flat, we also expect the shift to color to continue and the subsequent growth in color to offset the projected decline in monochrome.

Against this backdrop, we will work to further strengthen our sales of color equipment. The A3 color model for small- and medium-size offices that offers high image-quality, enhancing the power of expression through vivid colors is an example. This model also achieves a high level of stability, resulting in a reduction in service and maintenance costs for both dealers and users. Since its launch two years ago, it has been highly evaluated by the market for these features, which in turn has driven growth in color models. The higher-end mid- to high-speed model as well as the flagship model which we released in the second half of last year, also inherit these advantages and we will focus on increasing sales of these models as well. On top of this, as for the model for small- and medium-size offices we are launching a new model from February starting with Europe.

As for commercial printers, we expect demand for short-run and in-house printing jobs to continue. Capturing this kind of market need, we aim to expand sales of light production and high speed printing equipment this year as well. Additionally, for Océ's high-speed inkjet cut-sheet printer, we are working to expand the range of various papers that can be handled and we expect significant sales growth to continue.

This year's laser printer market is expected to be basically in line with last year in terms of units. Within this market, however, we expect unit sales of color machines and MFPs to continue growing as more users are sharing printers on networks along with advancement being made in office network environments.

Capturing this market trend, we released new products based on a platform that was renewed in the spring of 2015. These products offer not only the advantages of basic performance such as reduced energy consumption and space savings, but also respond to user's demand for easy installation. New products are now becoming drivers for our sales recovery, in accordance with the positive reputations penetrating into the market. As for low-end models, we will continue our strategies to avoid aimless expansion and stay focus on profitability.

As for consumables, we project revenue to be basically in line with last year mainly due to expectations that the gradual improvement we saw from the second half of last year will continue. With the introduction of new hardware, we also changed to a new type of toner. We will work to expand sales of the new hardware to increase its proportion of our overall install base which will in turn lead to an increase in genuine consumable sales. In this way, we feel we can recover to moderate and stable growth path in the future.

Imaging System - FY2016 Actual (Slide 12)

The interchangeable-lens camera market for the full year was only down 9% to 11.5 million units, despite the temporary shortage of parts caused by the Kumamoto earthquake. This represents the first time in three years that the market contracted at a single digit rate.

As for our full-year unit sales, in addition to growing sales of new DSLRs and mirrorless cameras, we benefitted from the shortage of parts that impacted our competitors. As a result, our unit sales increased 2% to 5.67 million units.

Within this, last year, we strengthened our mirrorless lineup introducing a new high-end model. This, coupled with our tailored marketing activity allowed us to increase our market share in all regions. Mirrorless cameras are already supporting our existing interchangeable-lens cameras and we feel we can increase our share in each region.

As for compact cameras, last year the market declined by 44% to 15 million units due to impact from the shortage of supplies on all manufacturers, including Canon. Against this backdrop, Canon focused energy on expanding sales of G series premium cameras which exceeded those of last year. Overall, however, our unit sales declined 38% to 40.4 million yen, due to a significant drop in entry model

Amid the shrinking market for home-use inkjet printers, we focused on profitability. Although our unit sales declined, profitability improved as we focused on shifting towards value-added products and restricted price reduction.

Efforts to actively launch new products that fit market needs, such as those targeting the home that adopt stylish designs, realize a significant reduction in size as well as models that offer high-volume refillable ink tank models that were initially launched in the emerging market of Asia, and A2 size models for professionals are growing, but due to market contraction overall sales declined slightly.

Imaging System - FY2017 Projection (Slide 13)

The interchangeable-lens camera market, from what we saw during last year's year-end selling season, is projected to shrink by 4% to 11 million units, mainly reflecting decelerating contraction in developed countries.

We expect out unit sales to decrease about 7% to 5.3 million units, representing a steeper decline than the overall market. This reflects a one-off factor resulting from the Kumamoto earthquake. Excluding this factor show that the year-on-year decline is slowing down and that we are heading towards bottoming out.

Against this backdrop, we will, through the launch of new products, expand our base of entry-class users and cultivate demand of existing users to step up in class, which will stimulate the market. Using mirrorless cameras as a driver, we will work to acquire a new user base. At the same time, for advanced amateurs, we will extend our technological advantage to address users' desires in terms of AF, video features etc. to promote replacement demand and link this to profitability improved.

As for compact cameras, we expect the market to shrink by 13% to 13 million units and our unit sales to also shrink by 13% to 3.5 million units. As a future outlook, we still feel more time is necessary before the market bottoms out, as such we will continue efforts to reduce costs and at the same time, focus on high value-added products, in order to improve product mix as we strive to improve profitability.

Although we expect the inkjet printer market to continue contracting this year, we plan to increase our sales for high-volume refillable ink tank models intended for emerging markets, for which our lineup was expanded at the end of last year.

Additionally, in B2B, identified as a growth area, we have revamped our lineup of large-format printers designed for graphic-arts printing and business models targeting the SOHO market, launching new models one after another.

In this way, by making use of product strategies to meet the demands of each market, Canon aims to post unit sales that are in line with last year.

Industry and Others – 2016 Actual (Slide 14)

The capital investment plans of semiconductor device and panel manufacturers remains at a high level thanks to growing demand for various devices, reflecting sales of such mobile devices as smartphones and the proliferation of the Internet of Things (IoT).

Reflecting this hearty increase in demand, sales of FPD lithography equipment and vacuum deposition equipment for OLED panels are growing at a high level.

As for network cameras, amid continued market growth, to respond to diversifying user's needs, we are working to enhance our lineup by developing products that utilize the collective technologies of the Canon Group.

Last year, we launched a new product that makes telephoto image capture possible even in dark environments, generating new demand. In addition, due to the full-year contribution of Axis to our results, sales of our network camera business overall grew by more than 20%.

As for “Others,” for reference, network cameras and Industry Equipment of Group Subsidiaries both accounted for about 25% of sales.

Industry and Others - FY2017 Projection (Slide 15)

Unit sales of IC lithography equipment are projected to be in line with last year, supported by continued strong IoT demand. As for FPD lithography equipment, due to the launch two year ago of a high-definition tool for small to medium size panels, which is recognized by the market for its stable quality, we expect unit sales to more than double this year.

Canon Tokki, who handles vacuum deposition equipment used in the manufacturing of OLED panels, are tooling up to expand production as we expect to post significant sales growth again this year in response to strong demand from panel manufacturers.

For network cameras, the model co-developed with Axis which provide interchangeable lens options, will become available from the first quarter of this year. Going forward, we will strengthen software as well as hardware to further enhance our offerings.

For reference, network cameras are projected to account for around 25% and Industry Equipment of Group Subsidiaries are projected to account for about 35% of “Others,” when TSMC is excluded.

FINANCIAL SITUATION

Inventories (Slide 16)

At the end of 2016, inventory turnover was 59 days, 12 days longer than it was at the end of previous year. This mainly reflects the acquisition of TSMC. Excluding this factor, the increase was 3 days, largely due to growing demand for lithography equipment. As for laser printers and cameras, amid declining sales due to market change, we have maintained inventories of these products at appropriate levels.

Capital Expenditure / Free Cash Flow (Slide 17)

In 2016, free cash flow was negative, reflecting the acquisition of TSMC.

We continue our efforts to keep capital expenditures below depreciation and, going forward, we will continue our pursuit of comprehensive cash flow management.

Cash on Hand (Slide 18)

At the end of 2016, cash on hand was 630 billion yen, which roughly equates to two months of net sales. At the end of 2017, we expect cash on hand to be at a similar level.

As for our 2016 dividend, we plan to maintain the same level as 2015, which was 150 yen per share for the full year.

Going forward, we will continue to take steps to provide a stable return and actively return profits to shareholders, sufficiently considering our investment plan, cash flow, and our funds outlook—including our projected performance over the mid-term.

Closing

In our first year under the Global Excellent Corporation Plan – Phase V, amid the yen's appreciation, we could not avoid posting a decline in net sale and profits. We did, however, make steady progress implementing measures aimed at improving profitability and strengthening new businesses, which we identified as key challenges.

2017 marks the 80th anniversary of our founding. Although there is a great deal of uncertainty in the external environment, we aim to work as one and post sales and profit growth befitting the occasion.