



Canon Inc.

FY 2017

Analyst Meeting

Tuesday, January 30, 2018

Speech Summary

(English Translation)

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FY 2017 RESULTS

Key Message – FY 2017 Results (Slide 2)

In 2016, we embarked on a new five-year initiative, Phase V of the Excellent Global Corporation Plan. In 2017 – the second year of Phase V – as part of our efforts to achieve the goals laid out in this plan, we made steady progress in structurally transforming our businesses.

For existing businesses, which support our business foundation, in addition to the recovery in our laser printer and camera businesses, we managed to achieve sales and profit growth in all of them through continued efforts to enhance profitability. Additionally, for new businesses, we were able to post significant sales growth thanks to measures we took to cultivate and strengthen them.

As a result, for the full-year, we managed to achieve sales and profit growth for the first time in four years.

Change in New Business Composition Ratio (Slide 3)

Now that Canon Medical is part of the Canon Group, we have four new business pillars of commercial printing, network cameras, industrial equipment, and medical coming to fruition. This resulted in new businesses sales rising to 24% of total sales in 2017.

The sales of new businesses more than doubled in 2017. Even if we exclude the impact of adding Canon Medical to the Canon Group, we managed to achieve growth of more than 20%, mainly thanks to the expansion of network camera and OLED vacuum deposition equipment sales.

FY 2017 Financial Results – Full Year (Slide 4)

Net sales were in line with our projection. Profit, however, were below. This reflects a 33.9 billion yen impairment loss on goodwill related to our commercial printing business.

Regarding Impairment Loss – Commercial Printing Business (Slide 5)

Seven years have elapsed since we made a full-scale entry into the commercial printing business through the acquisition of Océ. Over this period, the market environment surrounding this business has significantly changed, far exceeding our initial expectation. Over the next three years, in particular, aggressive investment into R&D is important, due to increasing severe competition caused by competitors entering this market, and due to the change in technology trends. As this will cause a temporary decline in the profitability of this business, we decided to review our plans to reassess the value of this business from a three-year perspective.

The new products we have introduced so far have steadily penetrated the market. From this expanding MIF, we can expect increasing service revenue as well. From the fourth year on, we expect significant sales and profit growth, returning to path of growth that we initially envisioned. There is no change in our view that the commercial printing market is a growth area.

FY 2017 Financial Results by Business Unit – Full Year (Slide 6)

If you look at our business performance by business unit, you will see that we managed to achieve sales and profit growth in all of them.

Within our Office and Imaging System business units, the recovery in our laser printer and camera businesses contributed significantly to this. Additionally, in our Industry & Others Business Unit, lithography equipment and OLED vacuum deposition equipment were the main drivers.

FY 2017 Operating Profit Analysis – Full Year Comparison against FY 2016 (Slide 7)

Compared to 2016, the yen was weaker against the U.S. dollar and euro. This had a positive effect.

Changes in sales volumes, which includes the impact of adding Canon Medical to the Canon Group, had a significant positive effect. Even if we exclude the impact of adding Canon Medical to the Canon Group, we see positive effects from increased sales of lithography equipment and OLED vacuum deposition equipment and from changes in product mix for such businesses as cameras.

Continued efforts to curtail price reduction allowed us to reduce the level of impact from 32.7 billion yen in 2016 to 16.9 billion yen in 2017. As for cost reduction, we generated nearly the same level as 2016, which was 31.1 billion yen.

For expenses, the large increase reflects the impact of adding Canon Medical to the Canon Group. Excluding this factor shows that we managed to reduce expenses through continued efforts to be selective and focused in our R&D spending.

FY 2018 PROJECTIONS

Key Message – 2018 Projection (Slide 8)

Regarding the external environment in which we operate, although there is concern that political uncertainty might further increase, we expect the global economy to remain on a path of modest growth. Considering the current situation, our exchange rate assumptions are 110 yen to the U.S. dollar and 130 yen to the euro.

2018 marks the halfway point in our five-year plan. This year, for existing businesses we will work to further raise our market share and comprehensively strengthen profitability. Additionally, for new businesses, we will work to continue expanding sales and plan to improve profitability through such efforts as reducing the cost of sales. Through these efforts, we will work towards our goal of achieving sales and profit growth for the second consecutive year.

FY 2018 Financial Projection – Full Year (Slide 9)

We project net sales to be at a high level, second only to our record set in 2007. For operating profit, this signifies recovery to a 400 billion yen level, for the first time since 2008.

FY 2018 Financial Projection – Change in Accounting Standard (Slide 10)

From the first quarter of 2018, several new accounting standards will be applied. We highlight two important ones below.

The first is “Revenue from Contracts with Customers,” which is a standard related to revenue recognition. As we are applying this standard, we conducted a review to determine what constitutes service revenue. As a result, from 2018, we will independently display service sales and cost of sales. At the same, some items that were classified as operating expenses in the past will be reclassified as cost of sales. The impact that this will have on our 2018 projection is roughly estimated to be around 110 billion yen.

The second is linked to revisions made to an accounting standard that deals with pensions. Due to revisions that were made, within benefit costs, those items not regarded as service costs need to be displayed as Other income (deductions). The impact this will have on our 2018 projection is estimated to be 2.0 billion yen in cost of sales and 14.0 billion yen in operating expenses, which will be reclassified as Other income (deductions).

We will apply the new accounting standards from the first quarter of 2018. The projection for 2018 that we announce today is based on existing standards for easy comparison with our 2017 results.

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

Our 2018 projection shows that we expect all business to grow in terms of sales and profit, as they did in 2017.

For the Office Business Unit, in addition to actions we have taken so far to reduce costs, we will work to enhance profitability by expanding our install base through the launch of strategic MFDs and laser printers and linking this to the expansion of consumable sales.

Additionally, for the Imaging System Business Unit, we will work to raise profitability by improving the product mix and promoting in-house production and automation of manufacturing.

As for the Industry & Others Business Unit, we aim for double-digit sales and profit growth, driven by semiconductor lithography equipment and such new businesses as OLED vacuum deposition equipment.

FY 2018 Operating Profit Analysis – Full Year Comparison against FY 2017 (Slide 12)

Changes in exchange rates will have little impact on operating profit as the negative impact of yen’s appreciation against the U.S. dollar will basically be offset by the yen’s depreciation against the euro.

As for changes in sales volumes, we expect significant sales growth for all businesses. In each business, we will continuously launch new products offering features that will be promoted to achieve volume effects and improve product mix.

As for price reduction, although we plan to expand sales, we will continue efforts to limit this activity. As a result, we project the impact of price reduction to be 20 billion yen, which is near the level of last year. In our projection, we also expect to offset the impact of price reduction through cost savings.

DETAILS BY BUSINESS

Office – MFDs (Slide 13)

As for 2017, although the overall market was flat, we saw single-digit growth in color MFDs, due to continuing demand for color printing.

In this market environment, we have been enhancing our lineup of next-generation color equipment, launching new medium- to low-speed models after launching a high-speed models in 2016, which facilitate efforts to further expand sales. These new next-generation color models realize improvement in total cost of ownership, having advantage in areas such as low cost of service and maintenance.

This has been widely recognized and in 2017, we were able to raise our market share, achieving double-digit growth in color unit sales.

As for 2018, we expect the overall market to remain flat. Although we expect the shift to color MFDs to continue, particularly in emerging markets, we also expect the market for monochrome MFDs to shrink.

Within this market environment, we will introduce to our next-generation color lineup for which sales remain strong, new models in February that incorporate user authentication and print management functions as standard. Furthermore, through print management software, these new devices will be compatible with industry-standard cloud-based services. With our hardware that already boast high durability, we will work to differentiate our offering through the enhancement of software solutions. We will also work to realize market-exceeding growth through new products that further raise our competitive advantage.

From a profit perspective, the steady increase in our MIF, mainly for color devices, has begun contributing to service revenue expansion. Going forward, we will continue to promote the shift to color and link it to improved profitability.

Office – Laser Printers (Slide 14)

In 2017, amid recovery of the laser printer market, supported by the economic recovery of emerging markets, we achieved unit sales that exceeded those of last year. The driver for this was the new product lineup that we prepared. Sales grew thanks to efforts to differentiate our products from the competition by offering advantages such as low power consumption and compact body size.

As for 2018, we expect the overall market to be flat as increasing demand in emerging markets and the shift to MFPs offsets market contraction in developed countries. Under these conditions, we will work to grow faster than the market, leveraging the features just described that differentiate us from the competition, to drive sales, particularly those of new MFPs, which are in high demand.

Additionally, for consumables, low-temperature fixing of toner enables reduced power consumption for printer bodies. We will work to grow cartridge sales by continuing to increase the sales proportion of new products.

Furthermore, from a sales and marketing perspective, we will support efforts to steadily grow sales of consumables, by employing a variety of sales techniques, such as linking printer sales with contract services that provide consumables on a continuous basis.

Office – Others (Slide 15)

Within the commercial printing market, digital equipment continues to steadily replace offset, thanks to the high image quality of digital equipment and increasing demand for small lot printing of many products.

In order to respond to a broad range of customer needs, we are developing and introducing solutions that offer high image-quality color printing and can handle a wide range of media. For the VarioPrint i300, our first high-speed cut-sheet inkjet printer, which launched full scale in 2016, we are increasing unit sales with each passing year as market awareness increases.

As for 2018, in addition to this, we will work to expand sales of two new devices launched in 2017. In the second half of last year, we launched a high-speed continuous feed printer that realizes the highest level of image quality in its class. Additionally, in the fast growing graphic arts market, we launched a new wide-format printer that offers high competitiveness in terms of cost. Both models will contribute a full year to sales in 2018. We expect significant sales growth thanks to the contributions of these kinds of new products.

Imaging System – Cameras (Slide 16)

In 2017, the market for interchangeable-lens cameras shrank by 1% to 11.4 million units. This rather small decrease reflects, among others, the market's recovery from the supply shortage caused by an earthquake in 2016. We, on the other hand, posted a sales decline of 3% to 5.51 million units, which was in line with our plan. Although our sales decreased at a faster rate than the market, this was expected as our sales were at a high level in 2016 because the earthquake did not affect us.

Canon took steps to stimulate demand through new products, launching 6 models in 2017, the most in the industry. All of these new products were well received by the market, receiving high markets for their enhanced network connectivity and AF capabilities for which there is strong user demand. Among these, we grew sales of the 6D Mark II – a model that features a full-size sensor in a body that is relatively compact and light and offers improvements in basic functions, which contributed to the shift to hi-amateurs. Launching such new products, enables us to limit the decline in selling prices and as a result, we improved sales and profitability compared with last year.

As for 2018, given that the market in 2017 was at a high level due to the earthquake, we expect the market to shrink by 4% to 11 million units. Within this market, however, we expect our unit sales to be 5.5 million units, which is in line with last year.

The new products launched in 2017 that were just highlighted will contribute to sales for a full-year. With this and continued efforts to enhance our lineup we will stimulate demand and work to further increase our market share. Within this, for mirrorless cameras where we are working to enhance our lineup, this year we continue our aim to grow at a double-digit rate, putting focus on expanding sales of mainly new products that captures SNS user demand.

From a profit perspective, we will work to improve our product mix by raising the proportion of new product sales. Additionally, to reduce costs, we will promote automation and in-house production as well as accelerate sales of mirrorless cameras thereby benefiting from lower cost of sales through volume effect.

Next, compact cameras.

In 2017, the market shrank by 10% to 13.5 million units, while our sales were flat at 4.04 million. In 2018, we expect the market to shrink by 19% to 11 million units. Within this, we expect our sales to decline 16% to 3.4 million. Despite the markets continued decline, we will continue to take steps to improve our profitability and market share, expanding sales of mainly G series premium models.

Imaging System – Inkjet (Slide 17)

The market in 2017 grew thanks to the recovery in Asia, and in 2018, we expect a slight increase.

In 2017, in addition to growing sales of large-volume ink models in emerging markets, we also posted solid sales of models that make use of a compact platform. As a result, we achieved unit sales growth.

In 2018, the new products that we launched in the second half of last year will contribute to sales for the full year. On top of this, we will continue efforts to significantly expand sales of large-volume ink models by totally renewing our lineup, and introducing new products that offer improvements in color reproduction and user-friendliness. This will work to accelerate sales and realize growth that exceeds the overall market.

Medical System (Slide 18)

In 2017, the market is estimated to have grown 3%, supported by an increase in worldwide population, particularly in emerging markets, and demand for advanced medical technology in developed countries.

In this market environment, this business unit performed in line with our expectations, mainly reflecting favorable sales of new diagnostic imaging systems, including CT and ultrasound.

In CT, we steadily grew sales, launching a new system that delivers the industry's highest level of image resolution. Additionally, in ultrasound diagnostic systems, a new model that enables the visualization of microvascular blood flow without the use of a contrast agent contributed to sales.

As for 2018, we expect the market to grow at a stable rate similar to 2017.

With a focus on competitive products that feature advanced image processing technology, like those referred to above, we will work to grow faster than the overall market, maintaining our already strong position in Japan and expanding sales overseas.

Additionally, we will work to internalize service revenue in regions where we are selling through agencies as a way to improve profitability. Furthermore, as part of the group's cooperative activities, we will accelerate efforts aimed at reducing costs of sales, making use of the production engineering

expertise, which we have cultivated over the years, to shorten lead-time and raise production efficiency.

Industry & Others (Slide 19)

Next, lithography equipment.

As for 2017, amid increasing investment into OLED panel production, our sales of FPD lithography equipment more than doubled to 84 units. This reflects the high marks our high-resolution technologies have received from customers. IC lithography equipment unit sales also grew thanks to strong demand for memory.

As for 2018, we expect unit sales of FPD lithography equipment to remain at a high level, supported by continued strong demand.

For IC lithography equipment, amid even stronger demand for memory used in data centers and mobile devices, we are receiving more and more inquiries regarding our equipment. Within this market environment, we expect our sales to grow significantly to 126 units, reflecting the high marks we have received for our attentive service to meet customer demand, and for continuously updating our product roadmap.

As for OLED vacuum deposition equipment, we doubled our sales in 2017. This reflects the technological advantage that our equipment has, and our production system that we enhanced to meet robust investment by panel manufacturers. In 2018, amid continued strong demand, we expect sales for the industrial equipment businesses of Group subsidiaries to continue growing at a double-digit rate.

Additionally, from a profit perspective, we will work to improve the profitability of our OLED vacuum deposition equipment business, through measures aimed at raising the skill level of our workforce, which will foster a shortening of production lead-time.

For network cameras, market expansion coupled with the continuous launch of new product played important roles in the double-digit growth we achieved in 2017.

In 2018, amid signs of increasing demand for video analytics solutions, we will work to grow faster than the market from both a hardware and software perspective, leveraging our strength in high image quality cameras and enhancing our solutions business utilizing software.

For reference, the sales composition of “Others,” was approximately 25% for network cameras and 35% for the industrial equipment businesses of Group subsidiaries in 2017. In 2018, we expect both of these figures to remain the same.

FINANCIAL SITUATION

Inventory Situation (Slide 20)

As for inventory turnover in days, at the end of 2016, this was temporarily inflated due to the inclusion of a newly consolidated subsidiary. At the end of 2017, inventory turnover was 49 days, which was at an appropriate level.

Excluding the effects of new consolidation shows that inventory turnover in days improved for all business units. Among these, our Industry & Others Business Unit showed significant improvement thanks to, among others, strong shipments of lithography equipment.

We will work to maintain inventory at an appropriate level, as we monitor continuing market trends.

Cash Flow – Full Year (Slide 21)

In 2017, we generated approximately 400 billion yen in free cash flow. This reflects a rise in net cash provided by operating activities, thanks to the increase in consolidated net sales. Additionally, though we worked to pay down debt, we were still able to secure cash-on-hand equivalent to two months of net sales. This reflects the steady progress we are making to raise the effectiveness of cash flow management.

In 2018, although we plan to invest to further the growth of new businesses, we will also continue efforts to realize comprehensive cash flow management, keeping capital expenditures below depreciation and through other measures.

Closing

The year 2017 marks the 80 anniversary of our founding. It also represents a year in which we were able to achieve significant sales and profit growth.

Maintaining this momentum, in 2018, we will work to thoroughly strengthen our existing businesses and further expand our new ones, to make it a break-through year that will lead us towards the achievement of our stated goals of our five-year plan.