



# **Canon Inc.**

  

## **FY 2018**

  

# **Analyst Meeting**

  

### **Wednesday, January 30, 2019**

## **Speech Summary**

  

### **(English Translation)**

**Toshizo Tanaka**  
**Executive Vice President & CFO**

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## **FY 2018 RESULTS**

### **Key Message**

#### **– FY 2018 Results (Slide 2)**

Sales were impacted by further contraction of the interchangeable-lens camera market and lower sales of OLED vacuum deposition equipment due to completion of one cycle of aggressive customer investment. As a result, total sales were down for the period. Conversely, our Office Business Unit achieved revenue growth thanks to continued strong sales of new MFDs and laser printers. Additionally, new businesses such as network cameras and medical continued to grow.

From a profit perspective, we posted an improvement in our gross profit ratio. This reflects growth in medical sales thanks to new products such as ultra-sound systems that have relatively good profitability and an improvement in industrial equipment product mix. This also reflects measures to steadily reduce costs amid the challenging environment where we saw tight supply for electronic components. Moreover, through group-wide efforts to reduce expenses, we achieved our second consecutive year of profit growth.

In the fourth quarter of 2017, we recorded an impairment loss on goodwill of our commercial printing business. Even when this one-off factor is excluded, we were able to keep our operating profit ratio at the same level as the previous year thanks to internal efforts to reduce costs and expenses.

### **FY 2018 Financial Results**

#### **– FY 2018 Actual versus FY 2017 Actual (Slide 3)**

From 2018, we applied new accounting standards for pensions and service revenue. For easy comparison with 2017, we have excluded the impact of these changes from our results.

On this basis, net sales decreased 3.1 % to 3 trillion 951.9 billion yen, operating profit increased 8.5% to 359.6 billion yen, and net income increased 4.5% to 252.8 billion yen.

Compared with our previous projection, sales were below our plan. This mainly reflects market contraction for cameras and other consumer related items in China, due to economic slowdown caused by US-China trade friction. Despite this, we were able to exceed our projection for operating profit and net income thanks to the reasons referenced above.

### **FY 2018 Financial Results by Business Unit**

#### **– FY 2018 Actual versus FY 2017 Actual (Slide 4)**

In Office, sales and profit increased thanks to growth in unit sales of new MFDs that make it possible to connect to external cloud services, capturing user needs for operational efficiency. This also reflects growth in unit sales of new competitively priced laser printers, particularly in emerging markets.

As for Imaging System, within cameras, sales of new mirrorless models remained strong. Overall camera sales, however, were impacted by market contraction, particular in the entry-class segment. Sales of inkjet printers were also negatively impacted by market contraction in developed countries. As a result, sales and profit were down for this Business Unit.

As for Medical, by expanding sales of such new products as ultra-sound and CT systems, particularly in non-Japanese markets, we were able to absorb the impact of restrained investment in Japan

stemming from revisions to the country's national healthcare system. From a profit perspective as well, by improving production yield, leveraging Group cooperation, and improving the product mix through the introduction of new products, we achieved sales and profit growth.

As for Industry & Others, sales grew thanks to an increase in sales of lithography equipment that captured expanding demand for semiconductors, mainly for memory used in data centers and in other areas. Additionally, we significantly raised profitability through improved product mix and cost reduction efforts such as those aimed at reducing the lead-time between production and installation.

### **Key Message – 2019 Projection (Slide 5)**

Looking at the global economy, we expect the United States to be the driver of growth worldwide, supported by solid personal consumption. There are, however, many risk factors and growing uncertainty surrounding US-China trade friction, economic slowdown in China and emerging markets, as well as political confusion in Europe surrounding Brexit and other issues.

As for 2019 exchange rate assumptions, taking into account the current situation and this kind of macroeconomic environment, we assumed 105 yen to the U.S. dollar and 125 yen to the euro. This represent a 5 yen appreciation against each currency compared to 2018.

Facing this kind of challenging business environment, re-strengthening profitability is an important issue for us this year. Although we expect revenue to decline due to the impact of yen's appreciation; for existing businesses, we will actively work to grow sales of promising products such as color MFDs and mirrorless cameras. Additionally, for such new businesses as network cameras and medical, we will continue efforts to expand sales, taking advantage of the favorable business environment. Through these efforts, we aim to maximize the revenue of the entire company.

On the expense side, we will work to thoroughly raise expense efficiency through selection and focus. At the same time, we will make efforts to further enhance profitability by accelerating activities aimed at reducing costs through the implementation of automation and in-house production.

### **FY 2019 Financial Projection – Full Year (Slide 6)**

We will explain our performance, taking into account the new accounting standards that were applied last year.

On this basis, we expect net sales to decline 1.3% to 3.9 trillion yen, operating profit to decline 5.2% to 325.0 billion yen and Net income to decline 5.0% to 240.0 billion yen.

Compared with 2018, we expected sales and profit decline. This reflects a negative impact of 123.7 billion yen on net sales and 51.1 billion yen on operating profit, due to expected appreciation of the yen. However, through measures aimed at reducing costs and comprehensively managing expenses, we will work to limit the exchange rate impact as much as possible.

### **FY 2019 Financial Projection by Business Unit – Full Year (Slide 7)**

As for Office, we expect sales and profit to decline due to the impact of changes in exchange rates. For MFDs, however, we will work to expand unit sales, launching new models that incorporate advanced security features based on last year's new products that addressed user needs to raise operational efficiency through connectivity with external cloud-based services.

In Imaging System, although we expect sales and profits to decline as a result of the contraction of the entire consumer market, in such growing markets as mirrorless cameras and refillable ink tank printers, we will expand our sales significantly. At the same time, we will work to support profit, accelerating cost reduction activities such as production automation.

In Medical, new products such as ultra-sound and CT systems that were launched up until last year will fully contribute to sales throughout the year. On top of this, we will work to facilitate our aim of significantly expanding sales and profit by enhancing our sales systems outside of Japan, particularly in North America.

As for Industry & Others, although we expect lithography equipment revenue to increase, supported by investment to address demand for image sensors, automobile related devices, we expect overall sales and profit to decline, given our expectation that investment in OLED panels will be restrained this year as well. During this period, however, we will work to improve profitability by further promoting activities to reduce costs in all processes from design and production to installation, ensuring we are prepared for the next period demand is expected to grow.

### **FY 2019 Operating Profit Analysis – Full Year Comparison against FY 2018 (Slide 8)**

The impact of changes in exchange rates is projected to be negative, given our outlook for yen appreciation against both the U.S. dollar and euro.

As for changes in sales volumes, for Medical, we expect the full-fledged contribution of new products and efforts to strengthen our network outside of Japan to lead to sales growth. Additionally, for Office, we will strive to expand sales of new MFDs with enhanced security features.

As for price reduction, which is mainly linked to cameras, for entry-class models, however, we will place more priority on profitability. Through this balanced approach, we will work to limit the overall impact to below last year.

As for cost reduction, taking into account the current placid pricing of raw materials and through the promotion of automation and in-house production, we expect to generate 15.0 billion yen, exceeding that of last year.

For expenses, we will work to raise effectiveness, accelerating selection and focus in areas from develop to production up to sales & marketing.

## **DETAILS BY BUSINESS**

### **Office – MFDs (Slide 9)**

The overall market realized modest growth thanks to the shift to color devices, particularly in emerging markets, and growing demand for office equipment that contributes to improved operational efficiency. Going forward, we expect the market to remain the same or similar to what we saw in 2018.

In 2018, we significantly expanded unit sales of next-generation color models. This reflects their advantage in terms of cost of ownership, their inclusion of user authentication and print management functions as standard features as well as their enhanced convenience through compatibility with

external cloud services. Additionally, from a regional perspective, in the Asian market, which still has plenty of room to grow, we posted double-digit growth evidencing continued strong performance.

From a profitability perspective, in addition to cost reduction during manufacturing, extending the longevity of replacement parts is one feature of our next-generation color devices that limits service costs incurred by sales companies, contributing to the improved profitability that we achieved.

In 2019, starting from January, we will successively introduce new products that incorporate industry-leading security features, based on the next-generation color models that have been steadily increasing in sales. Amid growing risks of information leaks from IT equipment connected to networks, users are demanding enhanced security even for MFDs. We will work to expand sales, leveraging the advantages of such newly incorporated security features as program tampering protection and unauthorized access detection.

Additionally, amid growing demand for office equipment that contributes to improved operational efficiency, the extent to which we are able to propose solutions that address customer problems through our MFDs—which feature various advanced cloud-based solutions—has become very important from a sales perspective to enter into business discussions. In order to further improve our ability to propose these solutions, we will promote training sessions for sales engineers within our direct sales arm that have a high level of specialized knowledge. Additionally, we will actively assist in the training of our dealers. Through this, we aim to grow sales of models with advanced features even further.

From a profit perspective, the steady increase in MIF of color models we have commercialized so far has led to the stabilization of service revenue. Going forward, we will work to enhance our profitability by expanding sales of mainly next generations color models.

### **Office – Laser Printers (Slide 10)**

Steady sales of color MFPs and emerging market demand are underpinning the market and, from a medium-term perspective, we expect the overall market to remain broadly around the same level.

In 2018, we significantly grew unit sales of competitively priced new models that we have successively launched since the second half of 2017, which have earned high praise from customers for their energy- and space-saving designs. Additionally, sales of consumables have remained steady.

In 2019, however, we expect unit sales to be lower than last year, as initial demand for new products fades. In this situation, we will work to improve product mix, raising the proportion of sales attributable to medium- and high-speed models, where higher print volumes are expected. Additionally, we will work to improve the overall profitability of this business by raising the proportion of sales attributable to genuine consumables, continuing promotional and other activities in cooperation with our OEM partner.

### **Office – Others (Slide 11)**

The digital commercial printing market continues to grow, driven by ongoing demand for high-mix, small-lot printing. Within this trend, we are seeing particularly strong growth in the graphic arts market, which includes the printing of posters and catalogs. We have launched several new products in this market that have earned high praise from customers not only for their high image quality but also for their ability to handle a broad range of media and for their high productivity. This has resulted in continued steady sales.

Additionally, at the end of 2018 we launched the LabelStream 4000 for the package printing market. This market continues to grow at a rate of about 20%, largely thanks to label printing demand. This new product offers such productivity advantages as high print speed. This year, we will commence full-fledged sales and work to ensure this product contributes to sales overall.

From a sales perspective, in Europe, we will also start a full-fledge roll-out of a sales structure that has been successful in growing sales in North America. In response to diversifying customer needs, we will promote further penetration of new products through this type of fine-tuned customer support.

### **Imaging System – Cameras (Slide 12)**

The 2018 interchangeable-lens camera market was impacted by restrained purchasing of advanced-amateur models, prior to the launch of new full-frame mirrorless cameras by each manufacturer, and the further contraction of the DSLR market, mainly due to lower sales of entry-class models. As a result, the overall interchangeable-lens camera market continued to shrink. Even under these conditions, sales of mirrorless cameras—with their lightweight, compact body designs—continued to grow. This reflects improvements in mirrorless camera performance in such areas as autofocus, which is now comparable to that of DSLRs.

Against this backdrop, we are framing this year as one in which we take measure that will stabilize this business in the future. Within this, accelerating the expansion of our mirrorless lineup is a priority.

The key to this is the EOS R, our first full-frame mirrorless model, launched in the second half of last year. Although its contribution to last year's performance was limited, sales have been strong due to its significantly improved optical performance, which has been highly rated by users. In order to further increase our presence in the mirrorless camera market, this year we will continue to expand our entire mirrorless camera lineup, consecutively launching new R-System products, including lenses. Additionally, we will also promote change in the distribution of internal resources, from development to production as well as sales & marketing.

Additionally, we will work to improve product mix, raising the proportion attributable to full-frame models that have high profitability by enhancing our mirrorless camera lineup and also expanding sales of full-frame models, particularly the EOS R.

We expect the market for camera equipped with full-frame sensors, which offer superlative descriptive performance, to continue growing at a stable rate. The customer base of this market are particular about image expression and pair their cameras with various lenses depending on the images they intend to capture. We will strive to improve total profitability by expanding sales of the full-frame model like the EOS R which will lead to expanded sales of lenses that have high profitability.

Additionally, as part of efforts to reduce costs, we are taking active steps to increase automation. Our camera business is leading all other businesses in this initiative. We are currently expanding this activity to include mirrorless camera and lens production. Going forward, we will expand our automation initiatives not only to other products, but also other processes, adding further momentum to our cost reduction efforts.

### **Imaging System – Cameras (Slide 13)**

Due to the proliferation of smartphones, the number of people capturing images is increasing and this is widening the range of users seeking image capture features as high zoom ratios and video functions. In response, we are broadening our horizon with regard to image capture and will launch models that don't fall under the typical notion of what a camera is.

We showed several new concept cameras that were well received by young people when exhibited in the United States last year. Going forward, we will work to propose new and interesting way to capture images even for people that are unfamiliar with conventional cameras, through the commercialization these concepts. It will take some time before we see these activities contribute to our performance. We will, however, continue efforts to actively cultivate new users.

### **Imaging System – Cameras (Slide 14)**

For interchangeable-lens cameras, the market in 2018 was down 10% to 10.3 million units. Our sales, were down 9% to 5.04 million units, which is a slower rate of decline than the market and reflects sales growth of our mirrorless cameras, including the EOS M50, a strategic entry class model that was launch in the first half. In 2019, we expect the market to continue to decline, shrinking 7% to 9.6 million units. Despite facing a shrinking DSLR market, we expect our interchangeable-lens camera sales overall to be 4.7 million units as we grow unit sales through new mirrorless cameras, including the ones that were launched last year.

Next, compact cameras. In 2018, the market was down 22% to 10.5 million units. And in 2019, we expect the market to decline at a continuing rate of around 20%, reaching 8.5 million units. We expect our own unit sales to decline in line with the market. From a profitability perspective, however, we expect steady improvement thanks to a higher proportion of sales coming from our G series of premium models. Going forward, we will continue to expand sales mainly for G series cameras.

### **Imaging System – Inkjet (Slide 15)**

In 2018, despite growth in emerging markets from the expansion of refillable ink tank models, the overall market was slightly down due to continued print volume decline in developed economies. In 2019, we expect the trend to be the same.

In 2018, although our unit sales declined overall, we posted significant growth for refillable ink tank models in emerging markets thanks to new products that were launched at the beginning of the year. As for 2019, we aim to grow faster than the market, stepping up already active investment into sales in emerging markets in such areas as further strengthening our sales support activity with mass merchandisers and authorized shops.

Additionally, at the end of 2018, we launched our first inkjet-based MFDs targeting the business market, where we expect even more demand for consumables. The new products not only operate at high speeds of 50 sheets per minute, but also require close to no maintenance, contributing to significant reduction in overall costs for users. We aim to tap new users, targeting medium- to small-size businesses that prioritize high-speed, low-cost high-volume printing.

## **Medical System (Slide 16)**

For the diagnostic imaging equipment market, we expect growth to continue at a stable rate of around 3%, thanks to an increasing need for advanced medical care in Western countries and the improvement of medical infrastructure development in emerging markets.

For core diagnostic imaging systems, we have been working to revamp our product lineup, introducing new products over a period of several years. Sales of new ultra-sound diagnostic systems were strong, particularly in 2018. The addition of new compact and light-weight products that inherit the ultra-high-definition technology of premium models also contributed significantly to sales. As for overall sales, although in the Japan market we were affected by the postponement of investment due to revisions to the nation's public health insurance program, overall sales grew thanks to expanded sales in other markets.

In 2019, we will strive for significant growth, driven by new products.

As of the end of 2018, we have received authorization to market our strong selling new products in all regions, and this year will be one in which we will realize a full-year contribution to sales. Furthermore, starting in January, we will work to secure new demand by launching competitively priced CT systems for emerging markets that also offer high image quality.

Additionally, we will work to realize market exceeding growth, further accelerating sales through the enhancement of our sales structure, expanding our sales force, particularly in North America and promoting the establishment of local agencies in South America.

From a profitability perspective, we will redouble our effort to realize group synergy. For example, vendor selection and price negotiation are being conducted in collaboration with Canon's procurement arm for parts needed for the in-house production of key units used in CT systems. Through this, we are working to reduce the total cost of key units. For MRI, in addition to efforts to realize reductions in MRI noise, we are utilizing our 3D simulation technology from the design phase in an effort to realize prototype-less development and improve development efficiency.

## **Industry & Others (Slide 17)**

In 2018, against the backdrop of growing demand for semiconductors used in data centers and other areas, capital spending, particular that of memory manufacturers, remained at a high level. Under this situation, we significantly grew unit sales of semiconductor lithography equipment. This was thanks to the stellar reputation we have earned from the market for our customer support capabilities and the high level of productivity of our equipment. Additionally, we raised our market share for FPD lithography equipment, particularly for small and medium-size panels, leveraging our high-resolution technology. As a result, we achieved revenue growth for lithography equipment overall.

In 2019, we expect the overall semiconductor market to shrink, reflecting an impact from slowdown in investment due to decline in memory prices. Within this projection, however, we expect continued growth in image sensors and devices for automobiles. For these types of semiconductors, customer requests for customization are wide and varied. In response, we are strengthening our customer support by offering equipment that can handle various substrate sizes. Through this, we aim to raise our market share further.



Additionally, for FPD lithography equipment, although investment into small- and medium-size panels is in a phase of adjustment due to sluggish smartphone sales, for large-size panels, we expect demand to grow for high-resolution panels used in such products as TVs. We will leverage the strength of our proprietary single-shot lithography system, which makes it possible to produce panels without seams, to capture this kind of demand for higher definition.

In 2019, we expect demand for OLED vacuum deposition equipment to remain in an adjustment phase due to smartphone market slowdown. From a medium- to long-term perspective, however, we expect the steady shift from LCD to OLED panels for smartphones and TVs to continue. Against this backdrop, we frame this year as the one we will work to strengthen our internal constitution, further advancing development of high-resolution technologies in preparation for future periods of market expansion. Additionally, we will work to improve profitability through continuing efforts aimed at reducing costs, such as switching from custom to general-purpose parts, which is a relatively easy way to reduce costs, and also by promoting the standardization of manufacturing processes.

Next, network cameras. In 2018, we once again achieved double-digit sales growth. Although the continued market growth is mainly driven by surveillance, we are seeing expansion into other areas, such as marketing. The fact that we have a broad lineup of camera hardware, video management software, and analytic applications, give us an advantage in responding to diversifying market needs. This year as well, we will work to expand our capabilities in these three areas. Additionally, we will strive to maintain high growth with a full-fledge contribution from cloud services that enables centralized management of images at a low cost.

## **FINANCIAL SITUATION**

### **Inventory Situation (Slide 18)**

Inventory turnover at the end of December was 56 days, 7 days longer than it was at the end of last year.

As for cameras within Imaging System, although we worked to optimize inventory by end of the year, we were impacted by market contraction, particularly in China, and as a result, we did not achieve our sales projection. Consequently, camera inventory at the end of the year was higher in both value and turnover in days. The inventory of Industry & Others also increased. This mainly reflects preparation for sales in 2019 of network cameras, a business in which we continue to post strong revenue growth.

We will continue efforts to optimize inventory, with a focus on our camera business. We will also work to promptly respond to changes, paying close attention to future market and customer movement.

### **Cash Flow – Full Year (Slide 19)**

At the end of 2018, cash-on-hand was 520.6 billion yen or 1.6 months of sales. This reflect the increase in inventory, in particular camera, and the repayment of debt. Having said that, we are still maintaining an adequate liquidity level.

In 2019, we will continue investment aimed at expanding new businesses as well as our focus to repay debt. At the same time, we will continue comprehensive cash flow management and will limit capital expenditures to within the range of depreciation.

## **Closing**

This year is the fourth in our five-year plan – Phase V of the Excellent Global Corporation Plan. In order to accelerate the “Grand Strategic Transformation,” envisioned in the plan, we will strive to thoroughly strengthen existing businesses and further expand new ones. At the same time, we will promote reinforcement of the Group’s profitability.