



Canon Inc.

First Quarter 2018

Analyst Meeting

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Speech Summary (English Translation)

Toshizo Tanaka
Executive Vice President & CFO

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Q1 2018 RESULTS

Key Message – Q1 2018 Results (Slide 2)

In the first quarter of this year – which we started with the aim of achieving a second consecutive year of sales and profit growth – although sales declined slightly, from a profit perspective we are maintaining the momentum from last year, and achieving increases in every profit line item thanks to an improvement in profitability of our Industry and Others segment and comprehensive cost reduction activities.

For existing businesses, revenue in the first quarter was basically flat overall. Camera revenue was temporarily below that of last year, reflecting the high level of sales in the first quarter of 2017 that resulted from the resolutions of shortages that arose following the Kumamoto earthquake in 2016. For other existing businesses, such as semiconductor lithography equipment, MFDs, and laser printers, however, we posted unit sales growth.

As for new businesses, medical revenue was temporarily down. This was due to a high level of sales in the first quarter of last year resulting from easing buyer restraint following the acquisition of Toshiba Medical (now Canon Medical). For other new businesses, such as OLED vacuum deposition equipment and network cameras, however, we posted continued growth. Excluding the one-off factor that impacted medical shows that new businesses are steadily expanding.

Q1 2018 Results (Slide 3)

I will highlight the accounting standards that we consider particularly important from those we are required to newly apply from this year on.

First, the standard regarding the recognition of revenue. Due to the application of this standard, we conducted a review to determine what constitutes service revenue. As a result, we are presenting service net sales and cost of sales independently. At the same time, we moved some expense items that were classified as SG&A to cost of sales.

Second, the change in the standard related to pensions. The purpose of the change is to present elements that are within benefit costs, but are not service costs, such as expected rate of return on assets and interest expense, as non-operating gains and losses. Figures related to pensions in our earnings reports for previous years have been reclassified.

Here, for easy comparison, I will discuss our figures on a pre-reclassification basis.

On a pre-reclassification basis, net sales decreased 1.2% to 960.7 billion yen, while operating profit and net income increased 7.4% to 81.2 billion yen and 3.7% to 57.1 billion yen, respectively.

FY 2018 Financial Results by Business Unit – Q1 (Slide 4)

Looking at the performance of each business unit separately, sales for Imaging System, which mainly handles cameras, and Medical System were below that of last year due to one-off factors.

Despite this, we posted an increase in overall profit thanks to a significant increase in both sales and profit within the Industry & Other Business Unit.

FY 2018 Operating Profit Analysis – Q1 2018 vs. Q1 2017 (Slide 5)

Next, the change in operating profit compared to last year by factor.

As for exchange rates, although the yen strengthened against the U.S. dollar, the total impact was slightly positive, reflecting the influence of a weaker yen against the euro.

As for sales volumes, although camera and medical sales were down reflecting one-off factors, we significantly increased the sales and improved the profitability of lithography equipment and OLED vacuum deposition equipment. As a result, the total impact was positive.

Regarding change in the standard linked to service revenue, 29.3 billion yen that was originally considered as SG&A was reclassified as cost of sales, resulting in no change in operating profit.

As for price reduction, we held this to 3.3 billion yen, which was basically around the same level as last year's 3.7 billion yen. Meanwhile, for cost reduction, despite soaring raw material costs, through detailed cost control we realized 2.1 billion yen.

As for operating expenses, we were able to lower this mainly through thorough efforts to improve R&D.

FY 2018 PROJECTION

Key Message – 2018 Projection (Slide 6)

Looking at the global economy, although the political situations in such regions as Japan, the United States, and Europe have become increasingly uncertain, corporate performance and consumer spending remains on the path of recovery. Based on this, we maintain our outlook of continued modest expansion overall.

As for foreign exchange rate assumptions used in our revised projection, taking into account the current situation, we changed them to 107 yen to the U.S. dollar and 132 yen to the euro.

Against this backdrop, we have been actively launching new MFDs, laser printers, and inkjet printers, from the first quarter. Additionally, from the second quarter, we will build on this momentum, starting sales of new interchangeable-lens cameras and medical products. Through this and group-wide measures to raise profitability, we will strive to realize our second consecutive year of sales and profits growth.

FY 2018 Projection – Current Full-year Projection vs. Last year (Slide 7)

In terms of sales, this will represent the highest level since 2007. And from a profit perspective, we will work to achieve our aim of two consecutive years of double-digit growth in operating profit.

FY 2018 Projection – Current Full-year Projection vs. Previous One. (Slide 8)

As for our foreign exchange assumptions from the second quarter on, we expect the yen to appreciate from 110 yen to 107 yen against the U.S. dollar, and depreciate from 130 yen to 132 yen against the euro. As the resulting impact on net sales and operating profit from these changes partially cancel each other out, we expect the full-year impact on net sales and operating profit to be limited to 20 billion yen and 7 billion yen, respectively.

To counter this, we will work to further improve product mix and augment sales of services and consumables.

FY 2018 Projection by Business Unit – Full Year (Slide 9)

As for our performance in 2018, we continue to seek sales and profit growth in all businesses.

In our Office Business Unit, we will work to further raise our market share, steadily launching new products with distinctive features. On top of this, we will focus on accelerating activities that we have promoted so far to reduce cost of sales, to enhance our current profitability.

In our Imaging System Business Unit, in addition to improving product mix, we will work to improve profitability by promoting both automated and in-house production.

In our Industry & Others Business Unit, we are aiming for continued double-digit sales and profit growth, driven by lithography equipment and new businesses.

FY 2018 Operating Profit Analysis – Current Full-year Projection vs. Last year (Slide 10)

As for exchange rates, although we expect the yen to appreciate against the U.S. dollar and depreciate against the euro, we expect the total impact to be a negative factor, reflecting a large impact from the strong dollar.

As for sales volumes, we aim to significantly increase sales in all businesses. In each of them, we are working to realize volume effects and improve product mix, by consistently launching new products with enhanced functions over conventional models.

As for price reduction, we will continue efforts to limit this activity, holding the impact to a level that is in line with last year. As for cost reduction, although the environment is challenging, characterized by persistently high prices for raw materials and a tight situation surrounding certain parts and components, we will work to thoroughly improve fixed costs to achieve our initial target of 21 billion yen.

DETAILS BY BUSINESS

Office – MFDs (Slide 11)

Ongoing demand for color models continues to be the driving force in the market, offsetting the shrinking demand for monochrome models. As a result, the market remained flat overall.

As for this first quarter as well, we were able to increase unit sales of next generation color models, including our main iR ADVANCE C5500 series. We have been replacing our color lineup to next generation series over the past few years, and these models have in common, competitive advantage in reduced total cost of ownership, which is highly evaluated by the customers even now, making it possible for us to continue to expand sales.

Additionally, iR C3000 series, our strategic model targeting emerging market has also performed well. This model has been performing well since the launch in second half of last year in such places as China. With these strong color products supporting our color device expansion that exceeds the market growth, we also managed to increase overall unit sales offsetting the decline in monochrome.

We have also launched a successor model of these next- generation models in February. While inheriting the basic features of their predecessors, we also standardized features that offer increased added value by incorporating user authentication and print management solutions, which is an industry first. In the first half, by taking steps to support industry- standard cloud services and further demonstrate the competitive advantage of our products, we are working to realize growth that exceeds the overall market for the full year.

On top of adding value to new devices, we will also work to improve the total amount of service revenue, by steadily expanding our MIF of color models.

Office – Laser Printers (Slide 12)

We expect the overall size of the market to be in line with last year, as increasing demand in emerging markets and the shift to MFPs successfully offset shrinking demand for SFPs.

Since autumn of last year, we have been launching new popularly-price models, and in the first quarter of this year, we posted unit sales that exceeded those of last year thanks to the contribution of initial demand for new products, particularly MFPs. Overall sales, however, declined, reflecting the high level of consumable sales in the same period last year, which was a phase of recovery triggered by an inventory adjustment.

These new products that drove sales in the first quarter, in addition to offering differentiated features such as small size and low energy consumption, also achieve reductions in the time it takes before printing starts compared with predecessor models. We will make the most of the advantages of these products to increase sales throughout the year with the aim of raising our market share.

As for consumables, through the expansion of new product sales, we are raising the proportion of our MIF made up of these products in line with our plan. In the future, we will further raise the proportion these products make up to steadily expand unit sales of consumables, and link this to improved profitability.

Office – Others (Slide 13)

We are working to strengthen our product lineup amid expansion and diversification of the digital commercial printing market, focusing on graphic arts as a growth area. In this segment, besides high image quality and high productivity, importance is attached to the ability to handle a wide variety of media. Our high-speed cut-sheet inkjet printer and new continuous-feed model, which address this need through their incorporation of ColorGrip technology, have enjoyed high praise since their introduction. Increased sales of these new products also contributed to the favorable growth we achieved in the first quarter.

In the second-half of last year, we also launched the Colorado 1640 wide-format printer. In addition to offering high image quality, this press achieves lower running costs—40% lower than conventional models—which is contributing to its strong sales.

We will work to facilitate our aim of healthy expansion, accelerating sales throughout the year, mainly of these new products.

Imaging System – Cameras (Slide 14)

As for interchangeable-lens cameras, we expect the market to continue to contract at a modest rate.

In the first quarter, although unit sales in the same period last year were at a high level, resulting from the resolution of shortages that arose following the Kumamoto earthquake in 2016, we posted 1.05 million in unit sales, limiting our decline to 3%.

Amid this business environment, we launched the EOS M100—a new mirrorless model that offers enhanced autofocus (AF) and network connectivity functions. The camera also realizes easy-to-use operability for beginners with such touch panel operations as tap-to-focus. With the proliferation of social media and the increasing number of smartphone users looking for higher image quality, we are capitalizing on ease-of-use to meet the needs of and successfully build up a base of new users.

As the market and our own sales were in line with our plan in the first quarter, we left our projection for the full year unchanged and still expect the market to decline 4% to 11 million units and our own sales to be 5.5 million units, which is in line with last year.

Following the launch of a high amateur model last year, we launched 3 new entry-class models all at once in the first quarter of this year.

This is part of our full-lineup strategy to further stimulate demand for interchangeable-lens cameras and our aim to capture demand from users looking to move up in class in the future. Under this strategy, we consider the EOS M50 to be a driver of sales. It is the first of our entry-class models to feature 4K video and it incorporate the same AF functionality found in higher end models. This camera also realizes operability that makes it easy to enjoy taking pictures even for beginners. Through these kinds of new products we will stimulate demand and effect improvement in our market share.

From a profit perspective, by raising the proportion of sales generated by new products and solidly expanding sales of high amateur models, we will improve product mix. We will also work to improve profitability by further expanding our use of automation for production and through efforts to thoroughly optimize expense management.

As for compact cameras, we left our projection for the market and our own unit sales in place and still expect the market to shrink by 19% to 11 million units and our unit sales to decline by 16% to 3.4 million units. We will continue to focus on increasing the proportion of our premium G-series, leading to improved profitability.

Imaging System – Inkjet (Slide 15)

We expect the market to grow slightly thanks to the recovery of emerging markets.

Against this backdrop, we renewed our lineup of refillable ink tank models in the first quarter, launching new models that offer improvement in such basic features as color reproduction and usability. Despite this and sales growth mainly in emerging markets, overall unit sales in the first quarter were slightly below those of last year due to a temporary negative impact from a revision of sales channels.

For the full year, we will work to expand sales, particularly in developed countries, maintaining aggressive investment in sales programs aimed at expanding sales of compact models that were added to our business lineup. For strongly performing refillable ink tank models as well, we will continue to expand sales, making further efforts to penetrate emerging markets where demand is growing. All in all, we will strive to realize growth that exceeds the overall market.

Medical System (Slide 16)

We expect the market to continue growing at a stable rate of around 3%. In the first quarter, however, we posted lower sales due to one-off factors, such as the high level of sales in the first quarter of last year, reflecting the easing of restrained buying before the acquisition of Canon Medical was completed. Outside Japan, we posted strong sales, exceeding the sales of last year in markets that continue to grow, such as China. This and efforts to limit the sales of low margin products supported a steady increase in profit.

For the full year, we will work to achieve our aim of sales growth by boosting sales of our expanded product lineup. One part of that lineup is ultrasound systems that incorporate proprietary technology. As we announced at the International Technical Exhibition of Medical Imaging 2018 (ITEM2018) this month, this year we will launch high-end models that inherit the technology of premium models and, by preparing a broad lineup of products with differentiated features, we will work to improve our market share.

From a profit perspective, we are leveraging Canon's production engineering expertise. One example of Group synergy, is that we have raised the cleanliness level within clean rooms to improve yield, resulting in a reduction in cost of sales. Additionally, in terms of service, we will work to strengthen profitability by increasing maintenance contracts for remote failure diagnostics that achieve a reduction in equipment downtime. Furthermore, we will work to reduce service cost by lowering the frequency of parts replacement through improvements in parts durability.

By continuing to accelerate these efforts, we will work towards our aim of improving profitability further.

Industry & Others (Slide 17)

Starting with lithography equipment. For the semiconductor lithography equipment market, we expect manufacturer's motivation to invest to remain strong. This reflects, among other things, the significant increase in demand for memory last year, which we expect to be even higher this year.

Amid this market environment, in the first quarter of this year, we sold 27 units, which was a 2.5-times increase over the same period last year. Leading this was our i-line equipment, which is known for very-high productivity, maintained through periodic upgrades, and high cost performance, realized through overwhelming stability. For FPD lithography equipment, we also exceeded the sales of last year, supported by continued strong demand for high-resolution panels.

As for our outlook for the full year, we aim to achieve our previous projection of 126 units, maintaining the momentum that was generated in the first quarter. Similarly, for FPD lithography equipment, we will work to realize our target of high level unit sales. In this way, by significantly growing unit sales of lithography equipment we will work to support overall company sales growth.

Next, OLED vacuum deposition equipment. In the OLED panel manufacturer market, we are seeing an expansion of the customer base. Against this backdrop, sales of our vacuum deposition equipment, which has overwhelming advantages over the competition in terms of both resolution and productivity, continued to grow at a double-digit rate.

Next, network cameras. Amid continued market expansion, sales of a 4K UHD model co-developed with Axis continued to grow, particularly in Europe and the United States. Additionally, capturing increasing demand for retail and office solutions, a model that contributes to lower installation costs due to its small size and light weight also supported the solid sales of camera hardware. From a software perspective as well, we worked to expand our lineup, including launching new products that can render humans as silhouettes to protect privacy. By focusing on our solutions business as well, in total, we will work to achieve double digit growth for the full year.

For reference, the sales composition of "Others," was approximately 25% for network cameras and 30% for the industrial equipment businesses of Group subsidiaries in the first quarter of 2018. For the full year, we expect network cameras to account for the 25% and the industrial equipment businesses of Group subsidiaries to be around 35%.

FINANCIAL SITUATION

Inventory Situation (Slide 18)

As for the inventory at the end of March, inventory turnover was 52 days, 3 days longer than it was at the end of December. This reflects preparation for expanding sales of new products such as cameras and inkjet printers. In total, our inventory level has been managed appropriately.

The inventory turnover of finished goods was one day longer. This reflects an increase in goods in transit, namely cameras, particularly in preparation of the selling season in the second quarter. As for work in process, inventory turnover was 2 days longer, basically reflecting an increase in production of semiconductor lithography equipment.

We will continue to work to maintain appropriate levels of inventory as we closely monitor market trends.

Cash Flow – Full Year (Slide 19)

As for annual cash flow, we left our projection unchanged. While we expect to continue making investments that support growth of new businesses, we will also work for comprehensive cash flow management, maintaining capital expenditure to below depreciation.

Closing

In the quarter, although our camera and medical businesses were impacted by one-off factors, we still posted increases in all profit line items. The first quarter was a good start, in line with our plan, towards achieving our initial full-year projection.

We will maintain the momentum we have generated, continuing to implement measures to improve our performance for the rest of the year, in order to firmly secure our second consecutive year of sales and profit growth.