



Canon Inc.

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Speech Summary (English Translation)

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Q3 2018 RESULTS

Key Message

– 3Q 2018 Results (Slide 2)

In the third quarter, continued strong sales of new office multifunction devices (MFDs) and laser printers contributed to sales and profit growth for the Office Business Unit (BU). However, in Industry & Others, due to a slowdown in customer OLED-related investment, which last year was overheating, and a temporary decline in camera sales, overall sales and profit declined.

From a profitability perspective, however, thanks to improved production efficiency and product mix in Industry & Others as well as progress made in Office cost reduction through fixed cost improvement of MFDs, we were able to raise our overall gross profit ratio by 0.8%.

FY 2018 Financial Results

– 3Q 2018 Actual versus 3Q 2017 Actual (Slide 3)

From this year, we applied new accounting standards for pensions and service revenue. For easy comparison with last year, we excluded the reclassification impact of these changes from our results.

On this basis, net sales decreased 6.8% to 926.5 billion yen, operating profit decreased 9.8% to 72.6 billion yen, and net income decreased 26.6% to 46.3 billion yen.

FY 2018 Financial Results by Business Unit

– 3Q 2018 Actual versus 3Q 2017 Actual (Slide 4)

For Office, in addition to sales growth and an improvement in the cost of sales ratio, the significant increase in profit reflects progress in reducing expenses, mainly within our MFD business.

As for Imaging System, profit was down due to temporary factors mainly impacting our interchangeable-lens camera business.

As for Industry & Others, sales and profit were down, reflecting impact from change in the external business environment surrounding OLED panels.

Note: regarding our outsourcing business, placing importance on its relationship with commercial printing, up until now we had included it in the Office BU. However, due to the fact that the business model has evolved to a point where the role of each sales company has become increasingly important, we reclassified this business to Industry & Others as of this quarter and have restated last year's figures to conform to the new presentation.

Interchangeable-lens Cameras (Slide 5 - 7)

Here, I will explain about Imaging System with a focus on cameras, which was the main cause for the decline in overall sales, together with our strategy for interchangeable-lens cameras.

Canon, under its full-lineup strategy, has been aggressively launching new products to cover a broad range of users, from professionals to entry-level users, with the aim of responding to various needs. The source of our competitiveness comes from having three key components, lenses, image-processors, and sensors in-house, and our direct involvement from the development stage through to manufacturing. This allows us to realize optimal designs and offer both competitive DSLRs and mirrorless cameras. Promptly capturing user needs that changes with the times, we consistently introduced many new products every year, which has allowed us to establish the No. 1 share position in the interchangeable-lens camera market.

Over the past few years, we have worked to aggressively introduce strategic entry-class models, including mirrorless, with the aim of cultivating potential new users. Through this product strategy, we have been able to capture such new users as young people and women. As a result, we raised our market share to 48% last year from 44% in 2013.

With the aim of continuing to expand our user base, we introduced one new entry-class mirrorless model and two DSLRs this year as well.

As for the mirrorless camera, despite being an entry-class model, the EOS M50 features shooting functions equivalent to those found in higher-end models. By introducing new products such as the EOS M50, which also realizes user-friendly operation, even for people that are just getting into photography, we continue to post solid results, successfully capturing first-time users of interchangeable-lens cameras.

We also introduced new products that focused on further cost competitiveness for entry-class DSLRs. With the aim of uplifting the market by capturing new demand, we focused on penetrating the market starting from the second quarter. However, this did not link to end-user purchasing as we originally anticipated, due to a short pause in the entry-class market trend. Thus, we temporarily narrowed down our shipment, prioritizing adjustment to optimize sales in the future.

Additionally, the successive announcements made by manufacturers, including Canon, of entering the full-frame mirrorless camera market has led to temporary restrained buying of advanced-amateur models. Compared to the same period last year, during which we launched two new models, our sales declined by 22.4% in the third quarter.

In light of such circumstances, we decided to reduce our full-year sales projection from 5.5 million units to 5.1 million units. We also lowered our outlook for the market from 11.0 million units to 10.5 million units, mainly factoring in our revised outlook for the entry-class DSLR market. Although we lowered both projections, we expect our market share to continue rising thanks to strong growth in each region for such new products as the EOS M50.

In order to further step up our competitiveness in the growing mirrorless market as well, we introduced a new model, the EOS R, into the full-frame category. This camera adopts a new system featuring a new mount that allows for greater flexibility when designing lenses, greatly improving optical performance through such features as greater light capturing ability and reduced distortion. In addition to releasing new RF lenses for this system, which achieve high image quality and compact designs, through the use of dedicated adapters, users can make use of the wealth of roughly 100 lenses already available.

Responding to the needs of all users by equally treating mirrorless and DSLR models is central to our full-lineup strategy. Pro models on top, advanced-amateur models for users seeking high image quality, and entry-level models to expand our base, all underpinned by our wealth of lenses that meet a wide range of image capturing needs, are the source for our EOS system strength. Leveraging our lineup that has been further strengthened by the introduction of the EOS R, we will work to accelerate sales toward the year-end selling season. We will also continue to launch new products going forward, as well as focus on realizing the overwhelming No. 1 position also in the mirrorless camera segment.

FY 2018 PROJECTION

Key Message

– 2018 Projection (Slide 8)

As for the global economy, while we continue to see a trend of recovery, particularly in the United States, efforts to raise interest rates in the U.S. has raised the risk of economic slowdown in emerging markets. Additionally, with the escalating trade friction between China and the U.S., levels of uncertainty are increasing, as evidenced by the IMF's recently announced global economic forecast, which was lowered by 0.2%.

As for exchange assumptions, though we are currently seeing a trend of yen depreciation, given the current macro-economic environment, we decided to maintain our previous projection of 110 yen to the dollar and 130 yen to the euro.

For our full-year projection, in addition to lowering our unit sales projection for interchangeable-lens cameras, we revised our full-year sales and profit projection to reflect a shift of some lithography equipment and OLED vacuum deposition equipment investments to the next period, due to customer circumstances.

Even under this situation, we aim to secure profit exceeding that of last year, through product mix improvement, comprehensive cost reduction, and the implementation of measures to curb expenses even further.

FY 2018 Financial Projection

– FY 2018 Current Projection versus FY 2017 Actual (Slide 9)

Compared with last year on a pre-reclassified basis, we now project net sales to decline 2% to 4 trillion yen, operating profit to increase 6.3% to 352.5 billion yen, and net income to increase 3.8% to 251.0 billion yen.

Although we expect a decline in revenue, we will work to realize our aim of second consecutive year of profit growth, exceeding all of the profit margins of last year.

FY 2018 Financial Projection

– FY 2018 Current Projection versus FY 2018 Previous Actual (Slide 10)

Compared with our previous projection, we lowered our expectations for net sales and operating profit by 120.0 billion yen and 43.0 billion yen, respectively.

FY 2018 Financial Projection by Business Unit

– Full Year (Slide 11)

We lowered our projection for Imaging System net sales and profit to reflect change in our plan for interchangeable-lens cameras.

As for Medical, though we are seeing signs of a recovery in sales in Japan, we reflected a larger than expected impact of restrained buying due to the revision of Japan's public health insurance program.

In Industry & Others, for semiconductor lithography equipment, though automotive- and communication-related market demand remains strong, memory-related supply and demand has faced a temporary adjustment phase. As a result, some memory manufacturers decided to postpone their investment plans until next year. In light of this, we revised our projection. For OLED vacuum deposition equipment, while we incorporated the impact of changes in the market environment into our previous projection, our latest projection takes into account the fact that equipment we had planned to ship at the end of this year is now expected to ship at the beginning of next year.

Due to temporary changes in the external environment, sales of Medical and Industry & Others in total are expected to be 30 billion yen lower. However, due to improvements in profitability, we maintained our previous projection for profit for these segments. This reflects lithography equipment volume effects, improved proficiency in OLED vacuum deposition manufacturing which leads to additional cost savings as well as efforts to carefully control expenses.

FY 2018 Operating Profit Analysis

– FY 2018 Current Projection versus FY 2018 Previous Projection (Slide 12)

As for the impact of changes in exchange rates, we expect this to be minimal as our assumptions for the yen-dollar and yen-euro do not significantly differ from our previous projection.

As for the impact of changes in sales volumes, as explained so far, we have taken into account the impact of revising our sales plan for each business segment.

As for price reduction, we have raised the amount compared to our previous projection in response to promoting sales and change in the competitive environment, particularly for cameras.

As for cost reduction, taking into account the continued rise in raw material prices and the impact of lower sales volume, we lowered our full-year projection. However, through the promotion of further automation and in-house production and through a comprehensive review of fixed costs, we will continue efforts to mitigate the impact of raw material price increases.

Additionally, with the aim of raising profitability, we will work to reduce sales promotion expenses in accordance with the revised sales projection. At the same time, we will make a concerted Group effort to thoroughly review other expenses.

DETAILS BY BUSINESS

Office – MFDs (Slide 13)

We expect the MFD market to remain solid, supported by demand in emerging markets and the shift to color models, mainly overseas.

As for next-generation color models, which have earned high praise for their increased durability, we started offering solutions in the third quarter that make access to external cloud-based services. On top of being unique in the industry in offering user authentication and print management as standard features, through the addition of new solutions we have raised the added value of our own cloud-based service and achieved unit sales growth that exceeded last year for MFDs overall. From convenience and risk management perspectives, we are seeing increasing demand for cloud-base solutions. By capitalizing on this changing environment, we will work to further expand sales.

Additionally, in October we will add a new high-speed A4 monochrome model to the lineup we have been strengthening. By filling in gaps in our product range, we will accelerate sales and work to realize overall MFD unit sales that exceed those of last year, even for the full year.

Although we maintain our unit sales plan for hardware, we revised our full-year projection for revenue to reflect a change in sales mix due to the improved performance of affordably priced medium- to low-speed models.

From a profitability perspective, we will work to stabilize service revenue by expanding sales with a continued focus on color models. From a cost perspective as well, increased hardware durability is leading to reduced service costs for sales companies. And with efforts to reduce manufacturing costs, we will work to steadily raise profitability compared to last year.

Office – Laser Printers (Slide 14)

We expect the overall market to exceed last year as emerging markets prop up demand for monochrome models and demand for color models remains solid, particularly for MFPS.

In the third quarter we worked to increase our unit market share, drawing as much attention as possible to the superiority of our products, highlighting such differentiating features as reduced size, reduced energy consumption, and shorter start-up times compared with existing models. As a result, we achieved unit sales that exceeded those of last year, continuing the trend we saw in the first half.

Supported by solid hardware sales and given the fact that consumable sales were in line with our plan, we maintained our full year projection for both hardware and consumables.

Additionally, through an increase in the proportion of MIF (Machines in Field) attributable to new products and an increase in contractual sales, we are seeing a stabilization of genuine consumable sales. Going forward, we will continue to implement these types of measures in an effort to raise profitability.

Office – Others (Slide 15)

As for commercial printing, third quarter sales remained solid, mainly due to a focus on new products.

Among them, we expanded sales of our new ProStream 1000, a continuous-feed press designed for graphic arts applications, capturing the diverse needs of customers by enhancing its ability to handle heavier weight papers.

As for our VarioPrint i300, a high-speed cut-sheet inkjet press, we have been continuously working to offer upgrades that improve image quality and expand the capability of handling various types of papers. Its durability is also gaining high praise, which is contributing to sales expansion.

As the market moves toward digital, we are seeing an increase in the diversification of customer needs. Going forward, we will continue efforts to penetrate the market with these new products, working to offer meticulous support and enhancing our dedicated sales force in the United States and Europe.

Imaging System – Cameras (Slide 16)

For interchangeable-lens cameras, we revised our full-year unit sales projection for ourselves and the overall market to 5.1 million and 10.5 million units, respectively.

For compact cameras, our sales in the third quarter were 720 thousand units, 15% below that of last year. For our full-year projection, we maintained our previous projection of 10.0 million units for the market and 3.0 million for our own unit sales. Under this situation, we will work to improve profitability with a continuing focus on selling premium models (G-series).

Imaging System – Inkjet (Slide 17)

Although we see continued market contraction in developed countries, we anticipate the overall market to be slightly up compared with last year thanks to growing demand in emerging markets.

In the third quarter, we posted unit sales that exceeded those of last year thanks to solid sales of models in preparation for the year-end selling season. Despite this, overall revenue was down due to the ongoing decline in our MIF in developed countries and its negative impact on consumable sales.

With the aim of stabilizing consumable sales in the future, we are working to strengthen our lineup and are launching several new small-size models, including A3 models for businesses in the second half of this year. We will put energy into expanding sales of these new models as well as focus on expanding sales of refillable ink tank models, which are performing well. In doing so, we expect to realize overall unit sales that exceed those of last year.

Medical System (Slide 18)

Overall, the market continued to gradually expand supported by overseas growth in such markets as the United States and emerging markets. In Japan, we saw a temporary slowdown in demand as investment decisions were being postponed, particularly for high-priced diagnostic imaging equipment. This reflects changes affecting the medical industry such as revisions to the nation's public health insurance program.

Our sales in Japan were also affected by this restrained purchasing, particularly for high-end products. That said, outside of Japan, where we are working hard to aggressively raise our presence, the new products that we have launched so far continued to experience strong sales in the third quarter as well. Within this, we launched the new Vantage Orian MRI system in April. This model has earned high praise for raising image quality, the most important feature, to a high industry standard level, which contributed to sales.

As for our full-year projection, in the fourth quarter, which is the selling season in Europe and the United States, we will work to realize revenue growth, accelerating sales with a continued focus on new products.

Amid ongoing market expansion in China, we received approval in September for a new ultra-sound diagnostic system, which continues to perform well in other areas. Going forward, we will work to further expand sales. For the X-ray diagnostic system launched in April, we are seeing sales funnel materializing in each region and expect this to start contributing to sales toward the year-end. On top of that, we expect to expand sales leveraging large-scale industry events to enter into sizable business negotiations, as well as raising our brand awareness through continued collaboration with reputable overseas universities.

In terms of profitability, with the aim of cost reduction, we have worked to improve yield by raising the purity of cleanrooms and by standardizing manufacturing processes. Even for key parts used in ultra-sound diagnostic systems, we are now in the middle of devising optimal design and production processes using Canon 3D simulation technology. In addition to advancing synergy with Canon's production technology, we will work to raise the operating profit margin and promote further improvements in lead-time and yield.

Industry & Others (Slide 19)

As for semiconductor lithography equipment, in addition to the high durability of our i-line and KrF equipment, our support structure that facilitates prompt response to customer requests is also earning high praise. As a result, we posted a significant increase in unit sales in the third quarter. However, we lowered our full-year sales projection due to memory manufacturers postponing their investment plans. Compared with last year, however, unit sales are still expected to remain at a high level, growing 50% and representing a steady raise in market share.

For FPD lithography equipment, third quarter revenue was below that of last year's high level. This, however, was in line with our plan, leading us to maintain our previous full-year unit sales projection. Although we are seeing a break in capital investment into medium- to small-size OLED panels, we are also seeing growing demand for large-size panels. We leveraged our strength in HD (high definition) technology, which features in the new model that we will launch in the fourth quarter. This will allow us to capture the demand for large-size panels, which will subsequently lead to expanded sales in the future.

For OLED vacuum deposition equipment, we revised our outlook for revenue to reflect changes in the shipment schedule. For profit, however, we will work to raise profitability through continued efforts to raise operating efficiency in manufacturing processes.

With network cameras increasingly being used for applications outside of just security, such as marketing, the market and our own sales continue to expand at a high rate. Additionally, in July, we launched a new cloud service that gives users the ability to manage integrated feeds from several location in a cost effective manner. We will continue our aim for double-digit growth through strong camera hardware sales as well as contribution from cloud services.

For reference, the sales composition of "Others," was approximately 30% for network cameras and 20% for the industrial equipment businesses of Group subsidiaries in the third quarter of 2018. For the full year, we expect both to account for 25% each.

FINANCIAL SITUATION

Inventory (Slide 20)

Inventory turnover at the end of September was 6 days longer than it was at the end of June.

The longer turnover period for Imaging System, reflects a major impact from temporarily restraining shipments of cameras. It also reflects an increase in work-in-process inventory for the year-end selling season.

For Medical System, as I mentioned earlier, work-in-process inventory increased due to preparation for the expansion of sales of mainly new products in the fourth quarter.

For Office and Industry & Others, we continue to maintain appropriate levels of inventory.

Cash Flow – Full Year (Slide 21)

As for cash on hand, though we lowered our outlook by 30 billion yen due to a change in projected net income, we expect that we can secure 570 billion yen, which is roughly two months of net sales.

Additionally, we will work for comprehensive cash flow management, maintaining capital expenditure to below depreciation.

Closing

In the third quarter, we were impacted by a short pause in camera sales, and OLED related investment by customers, which has run its course for the time being. Even in this severe environment, however, we made steady progress in strengthening our ability to generate profit, by raising our gross profit margin and curbing expenses.

As for the external environment, though escalating trade friction between the United States and China and other factors have raised uncertainty about the future, we will work to further expand sales of new products that we have introduced as we enter the year-end selling season. At the same time, we will work to achieve our aim of second consecutive year of profit growth, raising profitability even further through a concerted group effort.