



Canon Inc.

Second Quarter 2017

Analyst Meeting

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Speech Summary (English Translation)

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Q2 2017 RESULTS

Key Message (Slide 3)

Last year, due to such factors as the rapid appreciation of the yen, posting lower sales and profits was unavoidable. Even during this period, however, we continued to conduct a review of the profit structure of existing businesses and also focused efforts on expanding the scale of new ones.

The effects of these measures began to materialize from the first quarter of this year, evidencing steady progress in business-structure transformation.

Through the revitalization of our existing businesses and the expansion of new ones, we were once again able to post quarterly sales and profit growth.

Based on this situation, we raised our full-year projection for net sales by 30 billion yen and operating profit by 60 billion yen. As a result, operating profit and net income are now expected to recover to levels surpassing 300 billion yen and 200 billion yen, respectively.

Q2 2017 (Slide 4)

The global economy remained on a path of gradual recovery, led by the United States, where employment and corporate performance continue to recover.

Within this business environment, among our existing businesses, laser printers showed strong growth as it did in the first quarter. We also saw a continuing trend of recovery in our camera business. On top of this, we grew sales of lithography equipment thanks to robust demand for both semiconductors and flat-panel displays.

Among new businesses, we posted growth in the sales of industrial equipment of Group subsidiaries. This was mainly driven by vacuum deposition equipment used in the production of OLED screens. We also posted solid growth in the sales of network cameras. The addition of Toshiba Medical Systems to the Canon Group at the end of last year also contributed.

Transition in Sales and Op. Profit – Q2 2017 Actual v. Q2 2016 Actual (Slide 6)

Changes in exchange rates had a positive impact on net sales and operating profit as the yen was slightly weaker against the U.S. dollar and the euro.

As for changes in sales volume, the impact was positive on net sales thanks to increased sales of laser printers, lithography equipment, network cameras, and vacuum deposition equipment used in the production of OLED screens. On top of this, was the addition of Toshiba Medical Systems Corporation to the Canon Group. From a profit perspective, the impact was positive as well. This reflects not only the increase in sales, but also an improvement in the product mix of cameras.

As for “Others,” the overall impact on operating profit was a negative 31.0 billion yen. For price reduction, which was 5.8 billion yen, we held the level to below the same period last year. For cost reduction, which was 7.4 billion yen, we exceeded the amount in the same period last year through increased volume and improved productivity. As for expenses, although it increased 32.6 billion yen primarily due to the addition of Toshiba Medical Systems Corporation to the Canon Group, it does show a decrease when this factor is excluded, mainly thanks to lower advertising expense.

FY2017 PROJECTIONS

Exchange rate assumptions (Slide 7)

Taking into account the current situation, we revised our assumptions to 112 yen to the U.S. dollar and 125 yen to the euro for exchange rates in the second half of this year.

Overview of Current Projection (Slide 8)

As for the global economy, although we expect it to remain on a path of gradual recovery, we need to continue to watch the situation closely. This reflects, among others, an increased sense of uncertainty surrounding the policies of the U.S. administration as well as heightened geopolitical risk.

Under these circumstances, our plan is to expand sales, focusing our energy on revitalizing existing businesses and expanding the scale of new businesses, thereby furthering the transform of our business structure.

Among existing businesses, we expect to maintain sales growth for both laser printer hardware and consumables, as we have seen a favorable trend in their performance since the beginning of this year. For cameras, we will work to achieve sales growth – for the first time in five years – by expanding sales of new models and promoting a shift to high value-added cameras.

As for new businesses, for network cameras, which continued to grow at a double-digit rate in the first half, we expect to maintain this momentum over the full year. We also expect growth in the sales of the industrial equipment of Group subsidiaries, mainly thanks to vacuum deposition equipment used in the production of OLED screens. On top of this, with the addition of Toshiba Medical Systems to the Canon Group, we will continue working to achieve sales growth for the entire company.

Taking into account our improved performance and our revised exchange rate assumptions, we raised our projection for net sales by 30.0 billion yen. We also raised our projection for operating profit by 60.0 billion yen, mainly reflecting improvement in product mix and strict expense control.

FY 2017 Current Projection v. FY 2017 Previous Projection (Slide 10)

As for changes in exchange rates, we expect the yen to weaken against the U.S. dollar and the euro in the second half of this year. This has a positive effect on projected net sales and operating profit.

As for changes in sales volumes, although the expected recoveries in laser printers and cameras were positive factors on net sales, the overall impact was negative. This reflects some delay in shipments, mainly for the industrial equipment of Group subsidiaries. From a profit perspective, however, the overall impact was positive due to an improvement in product mix, mainly reflecting the increase in projected sales of laser printer consumables and cameras.

As for “Others,” the overall impact on projected operating profit was a positive 32.0 billion yen. For projected price reduction, based on progress that was made in the first half, we reduced the amount by 2.0 billion yen. For projected cost reduction, against the backdrop of raising costs for procured parts, we left our projection in place. As for expenses, we incorporated into our plan an additional reduction of 30.0 billion yen, mainly reflecting reductions in R&D expense and depreciation.

DETAILS BY BUSINESS

Office – Q2 2017 Actual (Slide 11)

The copier market overall continues to basically be around the same level as last year, supported by continued growth in color machine adoption.

Within this business environment, we have been working to actively strengthen our color copier lineup with next-generation models. We completed this lineup with the release of a new model in the first quarter of this year. The most distinctive feature of these next-generation models is their industry-leading productivity, which is linked to a dramatic reduction in maintenance frequency. This makes it possible to reduce costs that are incurred when service and maintenance is performed, a feature that has been highly rated by customers.

Additionally, these next-generation models offer advantages in features such as high image-quality and faster startup time which has led to overall growth, primarily driven by our IR ADVANCE C5000 Series and C3500 Series.

For laser printers, the hardware market continues to recover, showing two consecutive quarters of unit sales growth. This reflects progress in emerging market economic recovery, particularly in China.

Against this backdrop, we completed our lineup in the first half of this year of new products that we have been working to reinforce since 2015. These new products have gained competitive advantages by meeting users’ needs, such as, for example, faster print speeds, including the time needed for the printer to start up, and energy saving. These distinct features have been recognized by the market, leading to continued strong sales and double-digit unit sales growth in the first half.

For consumables as well, with the steady increase in our install base of new products, we are also seeing strong growth in the sales of the new toner used in these machines. Overall, sales of consumables exceed those of last year.

Office –2017 Full-year Projection (Slide 12)

As for copiers, we will work to expand our market share as well as focus our energy on actively expanding sales of next-generation models that performed well in the first half. On top of this, in May of this year, we launched copiers of our strategic C3000 Series. These models offer cost-performance advantages and leverage features found in next-generation models. We will work to expand sales of these models in China and other emerging markets, contributing to sales in the second half of the year.

Within commercial printing, we continue to see solid demand for our light production and our 100 page-per-minute models. We will work to expand sales of these models and also expect contribution to sales growth to come from new continuous-feed and wide-format printers that Océ plans to launch in the second half. Additionally, we also expect a continued strong performance from high-speed cut-sheet inkjet printers.

The laser printer market environment has been improving thanks to the recovering economy, with the shift towards MFPs picking up speed. Capitalizing on this trend, we will focus on further improving our market share, pushing our strategy to expand our presence in high value-added product segments.

By accelerating efforts to raise the portion of high value-added products, we will increase consumable usage, capturing additional printing volume. At the same time, we will work to raise the proportion of new printer hardware, which will lead to an increase in new toner sales.

Taking into account the recovery of the market environment and our better than expected first-half results, we have raised our full-year projection for both hardware and consumables.

Imaging System – Q2 2017 Actual (Slide 13)

The interchangeable-lens camera market continues to recover from the impact of last year's earthquake, particularly in developed countries. As such, the pace of market contraction has been gradually slowing on a global basis. Within this business environment, we sold 1.43 million units in the second quarter, as we limited the decline to 5%. And for the half, we secured the same level of unit sales as in the first half of 2016.

In this quarter as well, sales remained strong, particularly for mirrorless cameras. Within this trend, we grew sales of the EOS M6, a new mirrorless camera that has been highly rated not only for its high image quality, but also for its compact and lightweight form factor. This camera was designed to capture demand from people who, for example, are considering a step up to a camera with more features and better performance. Including this factor, first half unit sales of mirrorless camera grew more than 70% compared to the same period last year, leading to overall sales growth for interchangeable-lens cameras.

As for compact cameras, we continue to alleviate the pent-up demand following the earthquake last year. Under these circumstances, although our second quarter sales declined 8% to 1.07 million units, we significantly expanded unit sales of our G-Series brand of premium models that have been well received by the market for their design and portability, which subsequently contributed to revenue growth.

For inkjet printers, we secured the same level of unit sales as in the second quarter of last year.

In the domestic home-use market, we have maintained the top position since last year's year-end selling season, thanks to continued strong sales of our strategically positioned TS-Series. In addition to their design and compact size, the TS-Series has been highly rated for their rear paper feed function, which is suitable for various printing paper types. As a result, we posted a consecutive increase in quarterly unit sales in Japan.

For consumables, however, we saw a temporary trend of contraction, mainly in emerging markets.

Imaging System - FY 2017 Projection (Slide 14)

For interchangeable-lens cameras, as our first-half results were in line with our plan, we left our projection unchanged and still expect the market to shrink by 4% to 11.0 million units and our sales to decline by 7% to 5.3 million units. As for revenue, however, we raised our projection to reflect further efforts to improve the product mix and limit price decline.

We have enhanced the appeal of our EOS lineup, incorporating proprietary high-speed AF technology into all new products since the second half of last year. This year alone, we have already announced 5 new models. Going forward, we will continue to actively launch new cameras incorporating new technologies in order to stimulate the market.

As for compact cameras, although we left our market projection unchanged and still expect it to shrink by 13% to 13.0 million units, we raised our projection for our own sales by 200 thousand units due to the fact that our results in the first half were better than we expected. As a result, we now expect our full-year sales to decline 8% to 3.7 million units. Going forward, we will continue efforts to raise our market share and improve our profitability, concentrating our energy on expanding sales of such high value-added products as G-Series models.

As for inkjet printers, we raised our unit sales projection and now expect 2% growth. This reflects continued strong sales of strategic models for home-use and large ink tank models.

We will work to raise the profitability of this business, stimulating demand for consumables by increasing the proportion of high value-added products with a focus on strategic models for home use.

Additionally, even in the B2B category, which is a growth area, we will work to expand sales of high-margin models, focusing on large-format printers, which are performing well in the graphic arts market.

Medical System (Slide 15)

From this year on, Medical System will be reported as a separate business unit.

In the second quarter, sales were in line with our plan, driven by such imaging diagnostic systems as CT and ultrasound diagnostic systems. Second quarter sales were lower than the first quarter, however, due to seasonality.

As for our full-year projection, we will work to achieve our aim to grow faster than the market, enhancing our lineup with such systems as the Aquilion ONE GENESIS Edition, a new CT system that transforms routine imaging with new levels of resolution and lower doses of radiation. Additionally, from a profitability perspective as well, we will work to realize profitability that exceeds our previous projection through efforts aimed at reducing cost of sales and raising expense efficiency.

Industry and Others – Q2 2017 Actual (Slide 16)

Within existing businesses, in lithography equipment - capitalizing on the increasing demand for 3D NAND memory for data centers and other semiconductor devices - we were able to grow our second-quarter sales of IC lithography equipment from 12 units last year to 19 units this year. This reflects the high level of overlay accuracy and productivity of our equipment as well as our capacity to promptly meet customers' customization requests.

Within new businesses, due to continued abundant demand of panel manufacturers, we posted a 50% increase in the sales of industrial equipment of Group subsidiaries, mainly thanks to vacuum deposition equipment used in the production of OLED screens.

For network cameras as well, we maintained double-digit growth by capturing robust demand for our competitive products.

For reference, the sales composition of "Others" was approximately 25% for network cameras and 35% for the industrial equipment of Group subsidiaries.

Industry and Others - FY 2017 Projection (Slide 17)

For OLED related production equipment, we expect sales growth, thanks to continued strong demand, fueled by the shift to using OLED screens in smartphones. For FPD lithography equipment, our equipment used in the production of small- and medium-size panels, which were the first to realize high definition, are exhibiting strong competitiveness, which in turn is expected to lead to market share gain. Additionally, for our industry-leading vacuum deposition equipment used in the production of OLED screens, we will work to successively grow quarterly sales, furthering the enhancement of our production system.

In the area of network cameras, while we continue efforts to strengthen our lineup of cameras, we are also focused on strengthening our offering of video analytic solutions. Last month, we launched software that can recognize age and gender. Network cameras are not confined to security alone, in commercial facilities they can be used to gain a better understanding of the customer base, among other things. We will work to link this with sales, and propose new ways for their use.

For reference, the sales composition of "Others" is approximately 25% for network cameras and 35% for the industrial equipment businesses of Group subsidiaries.

FINANCIAL SITUATION

Inventories (Slide 18)

The level of inventory remained within an appropriate range. At the end of June, inventory turnover was 55 days, largely unchanged from the end of March 2017.

Compared with the end of June last year, inventory turnover was two days longer, mainly reflecting the impact of adding Toshiba Medical Systems Corporation to the Canon Group. Excluding this factor shows an improvement in this ratio.

Capital Expenditure / Free Cash Flow (Slide 19)

In relation to our previous projection, we raise our outlook for net income which is linked to an expected increase of 345 billion yen in free cash flow. Going forward, we will preserve our financial health, maintaining effort to keep capital expenditures below depreciation and our aim to ensure comprehensive cash flow management.

Cash on Hand (Slide 20)

As for cash on hand, although we conducted a share buyback in the second quarter, we expect to hold 600 billion yen at the end of the year, which is the same level as our previous projection.

Closing

Throughout the first half of this year, we showed a solid recovery in our performance. This is evidence that our efforts to promote structural transformation are steadily bearing fruit and that we have taken a solid step forward towards achieving the goals set out in Phase V of the Excellent Global Corporation Plan.

Looking at the external environment, it seems to be in a phase of general recovery, but a large number of unstable elements still remain. Nevertheless, we will continue to take steps towards enhancing the profitability of existing businesses and growing and expanding new ones. Through is, we will work to make 2017 a break-through year that befits our 80 anniversary.