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**Q3 2016 RESULTS**

**Q3 2016 in Summary (Slide 3)**

The U.S. economy, despite showing signs of weakness in investment and other areas, remained on a path of gradual recovery, supported by continued improvement in employment and consumer spending. As for the European economy, although consumer spending and export activity was firm, we could not take an optimistic view as there are concerns over the U.K.’s withdrawal from the EU. In Japan, and in emerging countries like China, no material changes in economic activity were seen. Overall, the global economy was limited to gradual recovery.

Under these conditions, the yen, which at one point in August fell below the 100 yen-to-U.S. dollar mark and remained high throughout the quarter, had a large negative impact on net sales and profits. On top of this, within our businesses, sales of laser printer consumables declined significantly, as they did in the first half of the year, and for cameras, we recorded a 50% decline in compact camera sales. As a result, net sales and profits declined.


As for changes in exchange rates, the overall impact was negative on both net sales and operating profit, due to the continuing strong yen.

As for changes in sales volumes, we continued to post strong sales of Canon Tokki’s OLED display manufacturing equipment. Sales of laser printer consumable, however, continued to decline at a rate similar to the first half. From this, the net result was a decline in both sales and profits.

As for “Others,” the impact of price reduction was 8.3 billion yen, less than the level of last year’s 10.6 billion yen. As for cost savings, the Kumamoto earthquake had a negative impact on compact camera production efficiency. As a result, cost savings were limited to 8.0 billion yen, which was below the level of last year. As for expenses, we reduced this by approximately 22.0 billion yen, focusing on advertising and R&D activities.

**FY2016 PROJECTIONS**

**Exchange rate assumptions (Slide 6)**

As for exchange rates in the fourth quarter, although we have recently seen the yen weaken, considering the possibility of further yen’s appreciation within this year, we revised our assumptions from 105 yen to 100 yen against the U.S. dollar and from 115 yen to 113 yen against the euro.

**Overview of Latest Projections (Slide 7)**

As for the U.S. economy, we expect continued improvement, supported by a trend of recovery in the employment situation. In Japan, the employment situation is also improving, but at the same time, we also see prolong weakness in consumer spending. As for the European economy, a sense of deceleration is intensifying as the U.K.’s withdrawal from the EU starts to have an impact. And in emerging countries like China, we are not seeing any signs of meaningful recovery.
As for our full-year projections, sales of network cameras and Canon Tokki’s OLED display manufacturing equipment, which are included in Industry and Others, are projected to grow significantly. For laser printers, we project declines in the sales of hardware and consumables. In addition, as for compact cameras, where the market continues to shrink, we also project a large decrease in sales due to a parts supply shortage caused by the Kumamoto earthquake.

Furthermore, we expect the yen’s appreciation against both the U.S. dollar and the euro of about 12% each to have a negative impact on net sales and operating profit of around 330.3 billion yen and 129.1 billion yen, respectively, compared to last year.

**FY 2016 Current Projection v. FY 2016 Previous Projection (Slide 9)**

As for exchange rates, we revised our assumptions to reflect yen’s appreciation, which is projected to have a negative impact on net sales and operating profit.

As for changes in sales volumes, within Office, we lowered our sales projections for copiers and laser printers. We also lowered our projection for Industry & Others, mainly due to revised expectations that some IC lithography equipment sales will fall into next year.

As for “Others,” we revised our projection for price reduction, from 46.0 billion yen to 37.0 billion yen, and our projection for cost savings, from 33.6 billion yen to 33.0 billion yen. As for expenses, we revised our projection to reflect an additional 37.0 billion yen in mainly advertising expense reduction.

**DETAILS BY BUSINESS**

**Office – Q3 2016 Actual and 2016 Full-year Projection (Slide 10 & 11)**

Within the copier market, color copiers maintain stable growth thanks to an ongoing shift to color.

In this market environment, we are posting market-leading growth, introducing models that offer savings in service and maintenance costs as well as improved image quality. The driving force behind this is the A3 model for small- and medium-size offices that we launched last year. In addition, we started expanding sales of core medium- and high-speed models globally, which are also contributing to sales.

As for monochrome copiers, amid ongoing market contraction, we have been enhancing our lineup by actively introducing new models, from the high-end to those targeting emerging markets. However, we expect our full-year sales to decline compared to last year, due to further market contraction in emerging countries.

As for commercial printing equipment, in the third quarter, light production models were again the driving force behind unit sales growth. For the successor model that was launched in October, the improvement in speed and the ability to print on both sides of the long-sheet paper used to print calendars etc., is making it possible to further meet diversifying needs. As for the high-end model that can print at a fast output speed of 100 pages per minute, we have been steadily winning deals, which is also contributing to sales. Furthermore, we also expect to grow unit sales of high-speed cut-sheet inkjet printers over last year.
As for the laser printer market, although the rate of decline is slowing, the market continues to shrink. Due to prolonged economic weakness, product replacement cycles are elongating. For consumables, a shift to third-party solutions and efforts to restrict printing are a couple of factors that are putting pressure on the market. Additionally, amid continued advancement in office network environments, hardware unit sales are decreasing, as printers become increasingly shared by groups, driving the shift from SFPs to MFPs.

Especially in the markets of emerging countries, where SFPs make up a large portion of total units, there has been a trend of major decline since last year. This is partially due to China’s economic slowdown, and the low price of crude oil, which indirectly caused us to raise prices in some areas.

In this market environment, our performance has also worsened from the beginning of the year, as we could not quickly and accurately assess market changes and demand trends, which led to our subsequent delayed response.

Sales of hardware units have recovered to a point where they are basically in line with last year. Sales of consumables, however, are basically around the same level as the previous quarter. Taken together, we showed a decline in sales.

Although the market situation remains challenging, demand continues to expand, mainly for MFPs in the color market, and we posted third-quarter unit sales that exceeded those of last year. Based on the steadily materializing results of new products launched since last year, we decided to raise our fourth-quarter sales projection. Additionally, as for new products, in line with our original plan, we will launch low-end models to enhance our new platform lineup, which we will be leveraging to effect recovery starting next year.

As for consumables, in the fourth quarter, we project a sales increase of more than 20% over the previous quarter. However, we are lowering our projection for the full year due to the fact that our actual results in the third quarter were below target. Going forward, we will work even closer with HP, deepening our cooperation as we work to improve our performance, aggressively carrying out all measures aimed at recovering printer demand.

Regarding HP’s announcement that it will acquire Samsung’s printer business, we expect negligible impact on our business. Based on what HP announced, the main purpose for the acquisition is to enter the copier market. We both believe that this will not change our partnership in the laser printer space and that mutual growth can be achieved. As for the impact that this might have on our copier business, a lot remains unclear, such as how service and maintenance will be managed in the future. Although we need to continue monitoring the situation, this market has high barriers to entry. As such, the possibility of this M&A suddenly becoming a threat is unlikely.

Imaging System – Q3 2016 Actual (Slide 12)

As for interchangeable-lens cameras, in the third quarter, sales increased 8% to 1.37 million units thanks to mirrorless models and new DSLRs.

Canon, through the launch of new products, has been working to stimulate latent demand for interchangeable-lens cameras. For the new DSLRs that were launched in the first half of this year, like the EOS 80D, which offers improved capacity to track fast-moving subjects, and the EOS Kiss X80 (EOS Rebel T6 in the Americas, EOS 1300D in Europe) with its enhanced ability to connect to networks, have been enjoying strong sales. In addition, the EOS 5D Mark IV, the core model...
incorporating a full-size sensor that was launched in September has been contributing to sales since its launch thanks to the well-balanced basic performance it offers in terms of still and video shooting.

Furthermore, for mirrorless cameras, following the EOS M3, we launched an affordably priced model, the EOS M10 last year. We continued to post strong results through carrying out focused marketing activities by strengthening online advertising and our sales network. We were successful in generating new demand among groups that have had little familiarity with inter-changeable lens cameras in the past, such as women and young generations. Enhancing our lineup in this way, we are growing our mirrorless camera market share in Europe and Americas, but especially in Asia, and this is now beginning to serve as an underpinning factor that supports our presence within the entire interchangeable-lens camera market.

As for compact cameras, the market continues to shrink. On top of that, the Kumamoto earthquake caused difficulties in securing parts, and as a result, third-quarter sales decreased to 750 thousand units.

As for home-use inkjet printers, amid the trend of market contraction, we prioritized profits in areas where we saw shifts to high value-added products. This led to a decline in our unit sales, but also an improvement in profitability due to an improved product mix.

In the business market, demand is steadily expanding and we continue to exceed our sales of last year for SOHO models and large-format printers. Additionally, we are piling up sales in line with our plan for large-volume ink-tank models that we launched at the end of last year.

**Imaging System - FY 2016 Projection (Slide 13)**

As for interchangeable-lens cameras, although we posted unit sales in the third quarter that exceeded those of last year thanks to mirrorless and new products, this was within our expectations and as a result, we decided to maintain our full-year projection of 5.5 million units.

We have been consistently working to expand sales and develop products that meet the potential needs of customers. Speaking further about mirrorless cameras, as we identify market needs and work to expand our entry-level camera user base, we are also aiming to acquire a user base that have a desire to take higher-quality photos. In November, we incorporated the same AF function that is used in our DSLRs in our mirrorless cameras to greatly improve image quality, aiming to strengthen our lineup by launching our first high-end mirrorless model, the EOS M5.

As we head towards the year-end selling season, we expect competition to become increasingly fierce as we believe competitors will have adjusted their production systems and will work aggressively to recover lost ground.

As for compact cameras, we maintained our full-year projection of 4 million units, and going forward, we will continue efforts to expand market share and improve profitability with a continuing focus on high-end models.

As for inkjet printers, we renewed our platform, launching new products at the end of September that realizes a significant reduction in size, and we are actively working to stimulate demand as we head towards the year-end selling season.
As for large-volume ink-tank models, we are seeing penetration in the markets of emerging countries in Asia.

Furthermore, for B2B products such as SOHO-oriented business models and large-format printers, we are steadily building our installed base in the market, which will be linked to an increase in consumables sales.

In this way, we are carrying out sales strategies that take into account special market characteristics for each product and expect to post sales that are in line with last year.

**Industry and Others – Q3 2016 Actual (Slide 14)**

As for IC lithography equipment, although demand for DRAM and NAND flash memory for smartphones remained solid, due to the postponement of customer investment plans until next year, we posted third-quarter sales of 14 units, which was below the 20 unit of last year.

As for FPD lithography equipment, due to increasing demand for OLED panels, unit sales of lithography equipment used in production of high-definition small- and medium size panels increased. As for lithography equipment used in the production large-size panels, demand for panels used in large-size TVs remained solid and business negotiations are proceeding smoothly, however, third-quarter sales were 7 units, which were below the 12 units of last year, due to a temporary decline, reflecting a timing gap in the investment plans of customers.

As for network cameras, which are included in “Others,” we recently added to our lineup a new product that is able to capture color images even in darkness and sales have been steadily increasing.

As for Canon Tokki, which is also included in “Others,” on the back of strong demand, the Canon Group is working to expand its production system. Sales of the Industrial Equipment of Group Subsidiaries were about 3 times that of the same period last year.

For reference, “network cameras” and “Industrial Equipment of Group Subsidiaries” account for around 25% and 30%, respectively, of the “Others” segment of the Industry and Others Business Unit.

**Industry and Others - FY 2016 Projection (Slide 15)**

As for IC lithography equipment, amid solid demand for existing DRAM and NAND flash memory chips, there is a trend in the market of shifting investment towards next-generation 3D NAND, resulting in customers postponing some capital expenditure until next year, which is why we expect our sales to be 63 units for the year.

As for FPD lithography equipment, thanks to expanding demand for OLED panels, we project our sales to be 38 units, exceeding those of last year.

As for network cameras, which are included in “Others,” amid ongoing market expansion due to diversifying market needs, we are working to strengthen cooperation among Canon Group companies and recently launched an interchangeable-lens network camera co-developed by Canon and Axis. This and Axis’s full-year contribution are expected to support a 20% increase in sales.
We also expect a significant increase in sales for the Industrial Equipment of Canon Group Subsidiaries, which are projected to increase by 70% compared with last year thanks to Canon Tokki.

For reference, “network cameras” and “Industrial Equipment of Group Subsidiaries” are each projected to account for roughly 25% of “Others.”

**FINANCIAL SITUATION**

**Inventories (Slide 16)**

Inventory at the end of September was higher than it was at the end of June. From a value perspective, merchandise inventory increased, but was within an appropriate range as this was basically due to the building up of camera and inkjet printer inventories in preparation for the year-end selling season.

As for work-in-process where inventory turnover measured in days increased, the main factor for this was the postponement of some IC lithography equipment installations until next year. Work-in-process for Office and Imaging System both remained within our target of around 10 days.

**Capital Expenditure / Free Cash Flow (Slide 17)**

Free cash flow is projected to be a negative 432 billion yen for the full year, which is not a significant change from our previous forecast. This mainly reflects the purchase of rights to acquire the shares of Toshiba Medical Systems Corporation.

**Cash on Hand (Slide 18)**

Cash on hand at the end of the year is now projected to be 560 billion yen from a previously projected 590 billion yen. This reflects, among others, the lowering of our projection for the full year.

**Closing**

This year, the external environment has become increasingly challenging with each passing quarter. And this, coupled with the delay in responding to laser printer market changes has resulted in the repeated lowering of projections. That said, we continue to work all out, implementing measures to reform the profit structure of existing business and expand new businesses that will become drivers of growth from next year on.