

CANON INC
Form 20-F
March 29, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

.. **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

OR

.. **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report _____

Commission file number 001-15122

CANON KABUSHIKI KAISHA

Edgar Filing: CANON INC - Form 20-F

(Exact name of Registrant in Japanese as specified in its charter)

CANON INC.

(Exact name of Registrant in English as specified in its charter)

JAPAN

(Jurisdiction of incorporation or organization)

30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan

(Address of principal executive offices)

Toshihide Aoki, +81-3-3758-2111, +81-3-5482-9680, 30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan

(Name, Telephone, Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
(1) Common Stock (the shares)	New York Stock Exchange*
(2) American Depositary Shares (ADSs), each of which represents one share	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of Class)

* Not for trading, but only for technical purposes in connection with the registration of ADSs.

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2011, 1,201,532,168 shares of common stock, including 37,765,092 ADSs, were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Edgar Filing: CANON INC - Form 20-F

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued Other

by the International Accounting Standards Board

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Table of Contents

TABLE OF CONTENTS

	Page number
<u>CERTAIN DEFINED TERMS, CONVENTIONS AND PRESENTATION OF FINANCIAL INFORMATION</u>	1
<u>FORWARD-LOOKING INFORMATION</u>	1
PART I	
Item 1. <u>Identity of Directors, Senior Management and Advisers</u>	2
Item 2. <u>Offer Statistics and Expected Timetable</u>	2
Item 3. <u>Key Information</u>	2
A. <u>Selected financial data</u>	2
B. <u>Capitalization and indebtedness</u>	3
C. <u>Reasons for the offer and use of proceeds</u>	3
D. <u>Risk factors</u>	3
Item 4. <u>Information on the Company</u>	13
A. <u>History and development of the Company</u>	13
B. <u>Business overview</u>	14
<u>Products</u>	14
<u>Marketing and distribution</u>	19
<u>Service</u>	19
<u>Seasonality</u>	20
<u>Sources of supply</u>	20
<u>Net sales by segment and geographic area</u>	20
<u>Competition</u>	20
<u>Patents and licenses</u>	22
<u>Environmental regulations</u>	23
C. <u>Organizational structure</u>	27
D. <u>Property, plants and equipment</u>	28
Item 4A. <u>Unresolved Staff Comments</u>	31
Item 5. <u>Operating and Financial Review and Prospects</u>	31
A. <u>Operating results</u>	31
<u>Overview</u>	31
<u>Critical accounting policies and estimates</u>	34
<u>Consolidated results of operations</u>	37
<u>Fiscal 2011 compared with fiscal 2010</u>	37
<u>Fiscal 2010 compared with fiscal 2009</u>	40
<u>Foreign operations and foreign currency transactions</u>	44
B. <u>Liquidity and capital resources</u>	44
C. <u>Research and development, patents and licenses</u>	46
D. <u>Trend information</u>	47
E. <u>Off-balance sheet arrangements</u>	51
F. <u>Contractual obligations</u>	52
Item 6. <u>Directors, Senior Management and Employees</u>	53
A. <u>Directors and senior management</u>	53
B. <u>Compensation</u>	60

Table of Contents

	Page number
C. <u>Board practices</u>	72
D. <u>Employees</u>	72
E. <u>Share ownership</u>	73
Item 7. <u>Major Shareholders and Related Party Transactions</u>	74
A. <u>Major shareholders</u>	74
B. <u>Related party transactions</u>	75
C. <u>Interests of experts and counsel</u>	75
Item 8. <u>Financial Information</u>	75
A. <u>Consolidated financial statements and other financial information</u>	75
<u>Consolidated financial statements</u>	75
<u>Legal proceedings</u>	76
<u>Dividend policy</u>	76
B. <u>Significant changes</u>	77
Item 9. <u>The Offer and Listing</u>	77
A. <u>Offer and listing details</u>	77
<u>Trading in domestic markets</u>	77
<u>Trading in foreign markets</u>	78
B. <u>Plan of distribution</u>	79
C. <u>Markets</u>	79
D. <u>Selling shareholders</u>	79
E. <u>Dilution</u>	79
F. <u>Expenses of the issue</u>	79
Item 10. <u>Additional Information</u>	79
A. <u>Share capital</u>	79
B. <u>Memorandum and articles of association</u>	79
C. <u>Material contracts</u>	86
D. <u>Exchange controls</u>	87
E. <u>Taxation</u>	88
F. <u>Dividends and paying agents</u>	91
G. <u>Statement by experts</u>	91
H. <u>Documents on display</u>	92
I. <u>Subsidiary information</u>	92
Item 11. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	92
<u>Market risk exposures</u>	92
<u>Equity price risk</u>	92
<u>Foreign currency exchange rate and interest rate risk</u>	92
Item 12. <u>Description of Securities Other than Equity Securities</u>	94
A. <u>Debt securities</u>	94
B. <u>Warrants and rights</u>	94
C. <u>Other securities</u>	94
D. <u>American Depositary Shares</u>	94
PART II	
Item 13. <u>Defaults, Dividend Arrearages and Delinquencies</u>	95
Item 14. <u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	95

Table of Contents

	Page number
Item 15. <u>Controls and Procedures</u>	95
Item 16A. <u>Audit Committee Financial Expert</u>	96
Item 16B. <u>Code of Ethics</u>	96
Item 16C. <u>Principal Accountant Fees and Services</u>	96
Item 16D. <u>Exemptions from the Listing Standards for Audit Committees</u>	97
Item 16E. <u>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	98
Item 16F. <u>Change in Registrant's Certifying Accountant</u>	99
Item 16G. <u>Corporate Governance</u>	99
PART III	
Item 17. <u>Financial Statements</u>	101
Item 18. <u>Financial Statements</u>	101
<u>Reports of Independent Registered Public Accounting Firm</u>	102
<u>Consolidated Balance Sheets</u>	104
<u>Consolidated Statements of Income</u>	105
<u>Consolidated Statements of Equity</u>	106
<u>Consolidated Statements of Cash Flows</u>	108
<u>Notes to Consolidated Financial Statements</u>	109
<u>Schedule II Valuation and Qualifying Accounts</u>	153
Item 19. <u>Exhibits</u>	154
<u>SIGNATURES</u>	155
<u>EXHIBIT INDEX</u>	156

Table of Contents

CERTAIN DEFINED TERMS, CONVENTIONS AND PRESENTATION OF FINANCIAL INFORMATION

All information contained in this Annual Report is as of December 31, 2011 unless otherwise specified.

References in this discussion to the Company are to Canon Inc. and, unless otherwise indicated, references to the financial condition or operating results of Canon refer to Canon Inc. and its consolidated subsidiaries.

On March 16, 2012, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥83.34 = U.S.\$1.

The Company's fiscal year end is December 31. In this Annual Report fiscal 2011 refers to the Company's fiscal year ended December 31, 2011, and other fiscal years of the Company are referred to in a corresponding manner.

FORWARD-LOOKING INFORMATION

This Annual Report contains forward-looking statements and information relating to Canon that are based on beliefs of its management as well as assumptions made by and information currently available to Canon Inc. When used in this Annual Report, the words anticipate, believe, estimate, expect, intend, may, plan, project and should and similar expressions, as they relate to Canon or its management, are intended to identify forward-looking statements. Such statements, which include, but are not limited to, statements contained in Item 3. Key Information-Risk Factors, Item 5. Operating and Financial Review and Prospects and Item 11. Quantitative and Qualitative Disclosures about Market Risk, reflect the current views and assumptions of the Company with respect to future events and are subject to risks and uncertainties. Many factors could cause the actual results, performance or achievements of Canon to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, changes in general economic and business conditions, changes in currency exchange rates and interest rates, introduction of competing products by other companies, lack of acceptance of new products or services by Canon's targeted customers, inability to meet efficiency and cost reduction objectives, changes in business strategy and various other factors, both referenced and not referenced in this Annual Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended, planned or projected. Canon Inc. does not intend or assume any obligation to update these forward-looking statements.

Table of Contents**PART I****Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information**A. Selected financial data**

The following information should be read in conjunction with and qualified in its entirety by reference to the Consolidated Financial Statements of Canon Inc. and subsidiaries, including the notes thereto, included in this Annual Report.

Selected financial data *1:	2011	2010	2009	2008	2007
	(Millions of yen, except average number of shares and per share data)				
Net sales	¥ 3,557,433	¥ 3,706,901	¥ 3,209,201	¥ 4,094,161	¥ 4,481,346
Operating profit	378,071	387,552	217,055	496,074	756,673
Net income attributable to Canon Inc.	248,630	246,603	131,647	309,148	488,332
Advertising expenses	81,232	94,794	78,009	112,810	132,429
Research and development expenses	307,800	315,817	304,600	374,025	368,261
Depreciation of property, plant and equipment	210,179	232,327	277,399	304,622	309,815
Increase in property, plant and equipment	226,869	158,976	216,128	361,988	428,549
Long-term debt, excluding current installments	3,368	4,131	4,912	8,423	8,680
Common stock	174,762	174,762	174,762	174,762	174,698
Canon Inc. stockholders' equity	2,551,132	2,645,782	2,688,109	2,659,792	2,922,336
Total assets	3,930,727	3,983,820	3,847,557	3,969,934	4,512,625
Average number of common shares in thousands	1,215,832	1,234,817	1,234,482	1,255,626	1,293,296
Per share data:					
Net income attributable to Canon Inc. stockholders per share:					
Basic	¥ 204.49	¥ 199.71	¥ 106.64	¥ 246.21	¥ 377.59
Diluted	204.48	199.70	106.64	246.20	377.53
Cash dividends declared	120.00	120.00	110.00	110.00	110.00
Cash dividends declared (U.S.\$) *2	\$ 1.503	\$ 1.447	\$ 1.196	\$ 1.073	\$ 1.034
Notes:					

1. The above financial data is prepared in accordance with U.S. generally accepted accounting principles.
2. Annual cash dividends declared (U.S.\$) are translated from yen based on a weighted average of the noon buying rates for yen in New York City as reported by the Federal Reserve Bank of New York in effect on the date of each semiannual dividend payment or on the latest practicable date.

Table of Contents

The following table provides the noon buying rates for Japanese yen in New York City as reported by the Federal Reserve Bank of New York expressed in Japanese yen per U.S.\$1 during the periods indicated and the high and low noon buying rates for Japanese yen per U.S.\$1 during the months indicated. On March 16, 2012, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥83.34 = U.S.\$1.

Yen exchange rates per U.S. dollar:	Average	Term end	High	Low
2007	117.45	111.71	124.09	108.17
2008	102.85	90.79	110.48	87.84
2009	93.67	93.08	100.71	86.12
2010	87.16	81.67	94.68	80.48
2011 - Year	79.43	76.98	85.26	75.72
- 1(st) half		80.64	85.26	78.74
- July		77.18	81.26	77.18
- August		76.50	79.01	76.41
- September		77.04	77.48	76.30
- October		77.97	77.97	75.72
- November		77.58	78.28	76.93
- December		76.98	78.13	76.98
2012 - January		76.34	78.13	76.28
- February		81.10	81.10	76.11

Note: The average exchange rates for the periods are the average of the exchange rates on the last day of each month during the period.

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

D. Risk factors

Canon is one of the world's leading manufacturers of plain paper copying machines, network digital multifunction devices, laser printers, cameras, inkjet printers, semiconductor lithography equipment and LCD lithography equipment.

Primarily because of the nature of the business and geographic areas in which Canon operates and the highly competitive nature of the industries to which it belongs, Canon is subject to a variety of risks and uncertainties, including, but not limited to, the following:

Risks Related to Canon's Industries

Canon has invested and will continue to invest actively in next-generation technologies. If the market for these technologies does not develop as Canon expects, or if its competitors produce these or competing technologies in a more timely or effective manner, there could be a material adverse effect on Canon's operating results.

Canon has made and will continue to make investments in next-generation technology research and development initiatives. Canon's competitors may achieve research and development breakthroughs in these technologies more quickly than Canon, or may achieve advances in competing technologies that render products

Table of Contents

under development by Canon uncompetitive. For several years, Canon has continued its investments in development and manufacturing in order to keep pace with technological evolution. If Canon's business strategies diverge from market demands, Canon may not recover some or all of its investments, or may lose business opportunities, or both, which may have a material adverse effect on Canon's operating results.

In addition, Canon has sought to develop production technology and equipment to accelerate the automation of its manufacturing processes and in-house production of key devices. If Canon cannot effectively implement these techniques, it may fail to realize cost advantages or product differentiation, and consequently lose business opportunities, which may adversely affect Canon's operating results. While differentiation in technology and product development is an important part of Canon's strategy, Canon must also accurately assess the demand for and commercial acceptance of new technologies and products that it develops. If Canon pursues technologies or develops products that are not well received by the market, its operating results could be adversely affected.

Entering new business areas through the development of next-generation technologies is a focal point of Canon's corporate strategy. To the extent that Canon enters into such new business areas, Canon may not be able to establish a successful business models or may face severe competition with new competitors. If such events occur, Canon's operating results may be adversely affected.

If Canon does not effectively manage transitions in its products and services, its operating results may decline.

Many of the businesses areas in which Canon competes are characterized by rapid technological advances in hardware performance, software functionality and product features; frequent introduction of new products; short product life cycles; and continued qualitative improvements to current products at stable price levels. If Canon does not make effective transitions from existing products and services to new offerings, its revenue and profits may decline. Among the risks associated with the introduction of new products and services are delays in development or manufacturing, low marketability due to an improper product quality during the introductory period, variations in manufacturing costs, delays of customer purchasing decisions in anticipation of further introductions, uncertainty in predicting customer demand for new offerings and difficulty in effectively managing inventory levels in line with anticipated demand. Moreover, if Canon is unable to respond quickly to unexpected technological innovations with respects to information systems and networks, Canon's revenue may be significantly affected as a result of delays associated with the incorporation of such new information technologies into existing products and services as well as new offerings.

Canon's revenue and gross margin also may suffer adverse effects because of the timing of product or service introductions by its competitors. This risk is exacerbated when a product has a short life cycle or when a competitor introduces a new product immediately prior to Canon's introduction of a similar product. Furthermore, sales of Canon's new products and services may replace sales of, or result in discounting of, some of its current products and services, potentially offsetting the benefits derived from the introduction of a successful new product or service. Canon must also ensure that its new products are not wholly or partially duplicative of existing products and operations. Given the competitive nature of Canon's businesses, if any of these risks materialize, future demand for its products and services could be reduced, and its operating results could decline.

Canon's digital camera business operates in a highly competitive environment.

In the interchangeable lens digital camera field, major new manufacturers released mirrorless camera in this year. Eliminating one of the key components enables these mirrorless cameras to be more compact and lightweight than digital single-lens-reflex (SLR) cameras. The growth of the mirrorless camera market has a potential to have a negative impact on the market for digital SLR cameras, in which Canon boasts top market share. If the mirrorless camera market continues to grow, it may adversely affect our leading position in the digital SLR camera market.

Table of Contents

Meanwhile, the smartphone market has been growing dramatically on a global scale. Smartphones allow users not only to take photos, but also to retouch them and to upload them to SNSs (Social networking services). If Canon's compact digital cameras become less appealing compared to smartphones, Canon could suffer from an erosion of the compact digital camera market, with a resulting adverse effect on operating results.

The markets for digital media and video recording technologies are subject to rapid technological change.

The markets in which Canon operates are subject to rapid technological change. The video camcorder industry has substantially transitioned to digital formats, and the increase in High Definition (HD) television broadcasts has accelerated the shift away from the Standard Definition (SD) format. Similarly, recording media are experiencing a rapid transition to flash memory and away from Mini DV tapes, DVDs, and hard disk drives. The pace of technological change has made predicting future market trends more difficult than was previously the case. If Canon is unable to forecast accurately the demand for particular new recording or media formats, this could reduce demand for its products, which would have a material adverse effect on Canon's business, financial condition and operating results.

Video camcorders are no longer the only products on the market that are capable of recording movies. Digital SLRs and mirrorless digital cameras, compact digital cameras, smartphones and tablets are now also capable of recording HD movies. An increase in market share of these new products and resultant contraction of the video camcorder market could have a material adverse effect on Canon's business, financial condition and operating results.

Because the semiconductor lithography equipment and liquid crystal display(LCD) industry is highly cyclical, Canon may be adversely affected by any downturn in the industry.

The semiconductor lithography equipment and LCD industry is characterized by fluctuating business cycles, the timing, length and volatility of which are difficult to predict. Recurring periods of oversupply of semiconductor devices and LCD panels have at times led to significantly reduced demand for capital equipment, including the semiconductor lithography equipment and LCD lithography equipment that Canon produces. Despite this cyclical nature, Canon must maintain significant levels of research and development expenditures to remain competitive. A future cyclical downturn in the lithography equipment industry and related fluctuations in the demand for capital equipment could cause cash flow from sales to fall below the level necessary to offset Canon's expenditures, including those arising from research and development, and could consequently have a material adverse effect on Canon's operating results and financial condition. In addition, LCD panel manufacturers are facing demands for severe price reductions of LCD panels as a result of intense competition among makers of televisions and personal computer monitors. As a result, panel manufacturers may reduce their investment or demand price reductions for such equipment, which may adversely affect Canon's operating results.

Downturns in the semiconductor and LCD markets have caused Canon's customers to change their operating strategies, which in turn may affect Canon's business.

The downturn in the semiconductor market has caused many device manufacturers to change their business models to focus on the design of semiconductors, while consigning the production of semiconductors to lower-cost foundries. At the same time, the downturn in the LCD market is leading to consolidation in the large-sized LCD panel production industry. If Canon is insufficiently responsive to market trends, including market changes led by device and large-sized LCD panel manufacturers, Canon may not be able to maintain its customer base among device and large-sized LCD panel manufacturers, which may result in a material adverse effect on Canon's business operations. In addition, it is difficult for Canon to predict the future effects of these trends on its business. Moreover, as research and development, manufacturing and sales activities become increasingly globalized, shifting particularly to emerging markets, unexpected global developments, such as adverse regulatory or legal changes, and unanticipated events, such as natural disasters, may adversely affect Canon's business.

Table of Contents

The semiconductor and LCD equipment industry is characterized by rapid technological change. If Canon does not consistently develop new products to keep pace with technological change and meet its customers' requirements, Canon may lose customers, and its business may suffer.

Canon's semiconductor and LCD lithography equipment is subject to rapid technological change and can quickly become obsolete. Future success in the semiconductor and LCD lithography equipment business depends on Canon's ability to enhance its existing products and develop new products using new and more advanced technologies. In particular, as semiconductor pattern sizes continue to shrink, the demand for more technologically advanced semiconductor lithography equipment is likely to increase. Canon's existing semiconductor and LCD lithography equipment could become obsolete sooner than expected because of faster than anticipated changes in one or more of the technologies related to Canon's products or in demand for products based on a particular technology. Any failure by Canon to develop the advanced technologies required by its customers at progressively lower costs or to supply sufficient quantities to its worldwide customer base could adversely affect Canon's net sales and profitability.

Risks Related to Canon's Business

Economic trends in Canon's major markets may adversely affect its operating results.

In Europe, the sovereign debt crisis adversely affected European economies and slowed economic recovery, whereas in the United States, a lack of improvement in employment rates and continuing problems in the housing market led to a lower rate of growth. Although progress has been made in recovering from the Great East Japan Earthquake, a persistently strong yen to the U.S. dollar and sluggish economic growth in Europe and in the United States are placing severe adverse pressure on the Japanese economy. Although emerging Asian countries, such as China and India, continue to achieve solid economic growth, prospects for global economic recovery remain uncertain. As a result of the economic downturn in recent periods, declines in consumption and restrained investment in Canon's major markets, including Japan, the United States, Europe and Asia, have affected both individual consumer and corporate sales, and if economic conditions do not improve, these trends may continue. Canon's operating results for products such as office and industrial equipment are affected by the financial results of its corporate customers, and deterioration of their financial results has caused and may continue to cause customers to limit capital investments. Demand for Canon's consumer products, such as cameras and inkjet printers, is discretionary. Fluctuating inventory levels, rapid price declines owing to intensifying competition and the recent decline in the level of consumer spending and corporate investment driven by the economic downturn could adversely affect Canon's operating results and financial position.

Canon derives a significant percentage of its revenues from Hewlett-Packard.

Canon depends on Hewlett-Packard for a significant part of its business. During fiscal 2011, 19.3% of Canon's net sales were to Hewlett-Packard. As a result, Canon's business and operating results may be affected by the policies, business and operating results of Hewlett-Packard. Any decision by Hewlett-Packard management to limit or reduce the scope of its relationship with Canon would adversely affect Canon's business and operating results.

Canon depends on specific outside suppliers for certain key components.

Canon relies on specific outside suppliers that meet Canon's strict criteria for quality, efficiency and environmental friendliness for critical components and special materials used in its products. In some cases, Canon may be forced to discontinue production of some or all of its products if the specific outside suppliers that supply key components and special materials across Canon's product lines experience unforeseen difficulties, or if such parts and special materials suffer from quality problems or are in short supply. Further, the prices of components and special materials purchased from specific outside suppliers may surge, triggered by the imbalance of supply and demand along with other factors. If such risks occur as an outcome of the dependency on such specific outside vendors, Canon's operating results may be adversely affected.

Table of Contents

Although competition is increasing in the market for supplies and services following initial product placement, Canon maintains a high market share in such sales. As a result, Canon may be subject to antitrust-related lawsuits, investigations or proceedings, which may adversely affect its operating results or reputation.

A portion of Canon's net sales consists of sales of supplies and the provision of services after the initial equipment placement. As these supplies and services have become more commoditized, the number of competitors in these markets has increased. Canon's success in maintaining these post-placement sales will depend on its ability to compete successfully with these competitors, some of which may offer lower-priced products or services. Despite the increase in competitors, Canon currently maintains a high market share in the market for supplies. Accordingly, Canon may be subject to lawsuits, investigations or proceedings under relevant antitrust laws and regulations. Any such lawsuits, investigations or proceedings may lead to substantial costs and have an adverse effect on Canon's operating results or reputation.

Increases in counterfeit Canon products may adversely affect Canon's brand image and its operating results.

In recent years, counterfeiting of Canon products has increased worldwide. Counterfeit products may diminish Canon's brand image, particularly if purchasers of such products mistakenly attribute the counterfeit products' poor quality to Canon. Canon has been taking measures to halt the spread of counterfeit products. However, there can be no assurance that such measures will be successful, and the continued manufacture and sale of such products could adversely affect Canon's brand image as well as its operating results.

Per unit production costs are highest when a new product is introduced, and if such new products are not successful or if Canon fails to achieve cost reductions over time, Canon's gross profits may be adversely affected.

The unit costs of Canon's products have historically been highest when products are newly introduced into production. The introduction of new products has at times had a negative impact on gross profit, operating results and cash flow. Cost reductions and enhancements are typically achieved over time through:

- engineering improvements;
- economies of scale;
- improvements in manufacturing processes;
- improved serviceability of products; and
- reduced inventories of parts and products.

Initial shipments of new products adversely affect Canon's profit and cash flow, and if new products do not achieve sufficient sales volumes, Canon's gross profit, operating results and cash flow may be adversely affected.

Cyclical patterns in sales of Canon's products make planning and inventory management difficult and future financial results less predictable.

Canon generally experiences seasonal trends in the sales of its consumer-oriented products. Canon has little control over the various factors that produce these seasonal trends. Accordingly, it is difficult to predict short-term demand, placing pressure on Canon's inventory management and logistics systems. If product supply from Canon exceeds actual demand, excess inventory will put downward pressure on selling prices and raise inefficiency in cash management, potentially reducing Canon's revenue. Alternatively, if actual demand exceeds the supply of products, Canon's ability to fulfill orders may be limited, which could adversely affect net sales and increase the risk of unanticipated variations in its operating results.

Canon's business is subject to changes in the sales environment.

A substantial portion of Canon's market share is concentrated in a relatively small number of large distributors, particularly in Europe and the United States. Canon's product sales to these distributors constitute a

Table of Contents

significant percentage of its overall sales. As a result, any disruptions in its relationships with these large distributors in specific sales territories could adversely affect Canon's ability to meet its sales targets. Any increase in the concentration of sales to these large distributors could result in a reduction of Canon's pricing power and adversely affect its profits. In addition, the rapid proliferation of Internet-based businesses may render conventional distribution channels obsolete. These and other changes in Canon's sales environment could adversely affect Canon's operating results.

Canon is subject to financial and reputational risks owing to product quality and liability issues.

Although Canon works to minimize risks that may arise from product quality and liability issues, such as those triggered by the individual functionality and also from the combination of hardware and software that make up Canon's products, there can be no assurance that Canon will be able to eliminate or limit these issues and the resulting damages. If such factors adversely affect Canon's operating activities, generate additional expenses such as those related to product recalls, service and compensation, or otherwise hurt its brand image, Canon's operating results or reputation for quality may be adversely affected.

Canon's success depends in part on the value of its brand name, and if the value of the brand is diminished, Canon's operating results and prospects will be adversely affected.

Canon's success depends in part on the value of its brand name. Any negative publicity regarding the quality of Canon's products could have an adverse impact on operations, especially negative publicity involving consumer products. There can be no assurance that such adverse publicity will not occur or that such claims will not be made in the future. Furthermore, Canon cannot predict the impact of such adverse publicity on its business and operating results. If Canon fails to maintain its overall compliance regime, especially legal or regulatory compliance, this also could result in damage to Canon's credibility and brand value.

A substantial portion of Canon's business activity is conducted outside Japan, exposing Canon to the risks of international operations.

A substantial portion of Canon's business activity is conducted outside Japan, including in developing and emerging markets in Asia. There are a number of risks inherent in doing business in such markets, including the following:

- underdeveloped technological infrastructure, which can affect production or other activities or result in lower customer acceptance of Canon's services;
- difficulties in recruiting and retaining qualified personnel;
- potentially adverse tax consequences, including transfer pricing issues and increases in corporate tax rates;
- longer payment cycles;
- political turmoil or unfavorable economic factors; and
- unexpected legal or regulatory changes.

Any inability to manage the risks inherent in Canon's international activities could adversely affect its business and operating results. In order to reduce costs and produce Canon's products competitively, Canon maintains several production facilities and more than ten sales bases in Asia, including China, Thailand and Vietnam, and is vigorously conducting significant production and sales activities in Asia. Under such circumstances, unexpected events may occur, including political or legal change, labor shortages or strikes, increased personnel costs or changes in economic conditions. In particular, a large revaluation of local currencies, or a sudden significant change in the tax system or other regulatory regimes could adversely affect Canon's overall performance. Given the importance of Canon's research and development, production and sales activities in Asia, Canon's business may be more acutely exposed to such risks than to the global economy in general.

Table of Contents

The outbreak, prevalence or spread of an epidemic disease, such as a new strain of influenza, in any region around the globe could also have a negative effect on Canon's business operations, including its research and development, production and sales activities, along with the disruption of markets for Canon's products.

In addition, unexpected changes in import taxes imposed by foreign governments could adversely affect Canon's business and operating results.

Canon may unintentionally infringe international trade laws and regulations, and any such infringement may lead to an adverse effect on its business. The extent of the effect on Canon's business will depend upon the nature of the infringement and the severity of fines or other sanctions potentially imposed upon Canon. A major infringement could result in a temporary or permanent suspension of Canon's trading rights in one or more jurisdictions. In addition to any sanctions prescribed by law, adverse publicity regarding an alleged infringement of trade laws and regulations by Canon may also have a negative effect on the Canon brand and image.

Any of the above factors regarding international operations could have an adverse effect on Canon's operating results.

Canon's cooperation and alliances with, strategic investments in, and acquisitions of, third parties may not produce successful results. The unexpected emergence of strong competitors through mergers and acquisitions may affect Canon's business environment.

Canon is engaged in alliances, joint ventures, and strategic investments with other companies. Canon also acquires other companies. These activities can help to promote Canon's technological development process and expand its customer base. However, weak business trends or disappointing performance by partners or targets may adversely affect the success of such activities. In addition, the success of such activities may be adversely affected by the inability of Canon and its partners or targets to successfully define and reach common objectives. Even if Canon and its partners or targets succeed in designing a structure that allows for the definition and achievement of common objectives, synergies may not be created between the businesses of Canon and its partners or targets. Integration of operations may take more time than expected. An unexpected cancellation of a major business alliance may disrupt Canon's overall business plans and may also result in a delayed return on, or reduced recoverability of, the investment, adversely affecting Canon's operating results and financial position.

In addition, the unexpected emergence of strong competitors through mergers and acquisitions or the formation of competitive business alliances may change the competitive environment of the businesses areas in which Canon participates, thereby affecting Canon's future operating results.

Canon's operating and financing activities expose it to foreign currency exchange and interest rate risks that may adversely affect its revenues and profitability.

Canon derives a significant portion of its revenue from its international operations. As a result, Canon's operating results and financial position have been and may continue to be significantly affected by changes in the value of the yen versus foreign currencies. Sales of Canon's products denominated in foreign currencies, as well as its margins have been and may continue to be adversely affected by the strength of the yen against foreign currencies. Conversely, a strengthening of foreign currencies against the yen will generally be favorable to Canon's foreign currency sales. Canon's consolidated financial statements are presented in yen. As such, the yen value of Canon's assets and liabilities arising from foreign currency business transactions and the yen value of Canon's foreign currency-denominated equity investments have fluctuated and may continue to fluctuate. These fluctuations may have unpredictable effects on Canon's consolidated financial statements. Moreover, Canon's consolidated financial statements have been and may continue to be affected by currency translations from the financial statements of Canon's foreign affiliates, which are denominated in various foreign currencies. Furthermore, the values of a number of foreign currencies, such as the U.S. dollar and the euro, have weakened

Table of Contents

significantly more than expected against the yen, which has negatively affected and may continue to affect Canon's operating results and financial position. Although Canon strives to mitigate the effects of foreign currency fluctuations arising from its international business activities, Canon's operating results and financial position could continue to be adversely affected if the current strong yen environment persists. Canon is also exposed to the risk of interest rate fluctuations, which may affect the value of Canon's financial assets and liabilities.

Canon depends on efficient logistics services to distribute its products worldwide.

Canon depends on efficient logistics services to distribute its products worldwide. Problems with Canon's computerized logistics systems, an outbreak of war or strife within Canon's operating regions or regional labor disputes, such as a dockworkers' strike, could lead to a disruption of Canon's operations and result not only in increased logistical costs, but also in the loss of sales opportunities owing to delays in delivery. Moreover, because demand for Canon's consumer products may fluctuate throughout the year, transportation means, such as cargo vessels or air freight, and warehouse space must be appropriately managed to take such fluctuations into account. Failure to do so could result in either a loss of sales opportunities or the incurrence of unnecessary costs.

In addition, the increasing levels of precision required of semiconductor lithography equipment and LCD lithography equipment and the resulting increase in the value and the size of such equipment in recent years have resulted in a concurrent increase in the need for sensitive handling and transportation of these products. Because of their precise nature, even a minor shock during the handling and transportation process can potentially cause irreparable damage to such products. If unforeseen accidents during the handling and transportation process render a significant portion of Canon's high-end precision products unmarketable, costs will increase, and Canon may lose sales opportunities and the customer confidence.

Substantially higher crude oil prices and the supply-and-demand balance of transportation means could lead to increases in the cost of freight, which could adversely affect Canon's operating results.

Furthermore, earthquakes or volcanic eruptions may cause a breakdown of transportation facilities, such as ports or airports, or otherwise interrupt critical logistics services, which may have an adverse effect on production or sales activities.

Other Risks

Canon's business is subject to environmental laws and regulations.

Canon is subject to certain Japanese and foreign environmental laws and regulations in areas such as energy resource conservation, reduction of hazardous substances, product recycling, clean air, clean water and waste disposal.

In particular outlays required to address climate change could vary widely depending on circumstances of the Kyoto Protocol extension and corresponding measures.

In other cases, such as the Directive Establishing a Framework for the Setting of EcoDesign Requirements for Energy-related Products across the European Union, detailed implementation standards responsive to environmental requirements remain under review. Canon strives to comply with such standards to the extent possible in advance of official adoption. If, however, Canon's current measures are deemed insufficient to satisfy such standards when adopted, Canon may be required to take further action and incur additional compliance costs.

Furthermore, Canon may incur rework or repair expenses if non-qualifying products are shipped in violation of the European Union Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS Directive) or if other legal regulations are not fully followed by parts suppliers. Such extra costs may exceed compensation from parts suppliers or coverage from insurance contracts and could have an adverse effect on Canon's overall business and operating results.

Table of Contents

Environmental cleanup and remediation costs relating to Canon's properties and associated litigation could decrease Canon's net cash flow, adversely affect its operating results and impair its financial condition.

Canon is subject to potential liability for the investigation and cleanup of environmental contamination at each of the properties that it owns or operates and at certain properties Canon formerly owned or operated. If Canon is held responsible for such costs in any future litigation or proceedings, such costs may not be covered by insurance and may be material.

In addition, Canon may face liability for alleged personal injury or property damage because of exposure to chemicals or other hazardous substances from its facilities. Canon may also face liability for personal injury, property damage or natural resource damage, and decontamination costs for alleged pollution from its facilities. A significant increase in the number, success and cost of these claims could adversely affect Canon's business and operating results.

Canon may be subject to intellectual property litigation and infringement claims, which could cause it to incur significant expenses or prevent it from selling its products.

Because of the emphasis on product innovation in the markets for Canon's products, many of which are subject to frequent technological innovations, patents and other intellectual property are an important competitive factor. Canon relies primarily on internally developed technology, and seeks to protect such technology through a combination of patents, trademarks and other intellectual property rights.

Canon faces risks that:

- competitors will be able to develop similar technology independently;
- Canon's pending patent applications may not be issued;
- the steps Canon takes to prevent misappropriation or infringement of its intellectual property may be unsuccessful; and
- intellectual property laws may not adequately protect Canon's intellectual property, particularly in certain emerging markets.

To the extent that Canon is unaware of actual or potential infringements of, or adverse claims to, its rights in such technologies, any interference with Canon's rights to use such technologies could adversely affect its operating results.

In addition, Canon may need to litigate in order to enforce its patents, copyrights or other intellectual property rights, to protect its trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement, which can be expensive and time-consuming. If any government agency or third party is adjudicated to have a valid claim against Canon, Canon could be required to:

- refrain from selling the relevant product in certain markets;
- pay monetary damages;
- pursue development of non-infringing technologies, which may not be feasible; or
- attempt to acquire licenses to the infringed technology and to make royalty payments, which may not be available on commercially reasonable terms, if at all.

Canon also licenses its patents to third parties in exchange for payment or cross-licensing. The terms and conditions of such licensing or changes in the renewal conditions of such licenses could affect Canon's business.

Canon's businesses, corporate image and operating results could be adversely affected by any of these developments.

Table of Contents

Disputes involving payment of remuneration for employee inventions may adversely affect Canon's brand image as well as its business.

Canon may face disputes involving payment of remuneration for employee inventions, the rights to which have been assigned to Canon. This risk is particularly relevant in countries such as Japan and Germany, where patent laws require companies to remunerate employees for the assignment of employee invention rights to the company. Canon maintains company rules and an evaluation system for employee inventions. Canon believes it has been making adequate payments to employees for the assignment of invention rights based on these rules. However, there can be no assurance that disputes will not arise with respect to the amount of these payments to employees. Such disputes may adversely affect Canon's brand image as well as its business.

Canon's facilities, information systems and information security systems are subject to damage as a result of disasters, outages or similar events.

Canon's headquarters functions, information systems and research and development centers are located in or near Tokyo, Japan, where the possibility of damage from earthquakes is generally higher than in other parts of the world. In addition, Canon's facilities or offices, including those for research and development, materials procurement, manufacturing, logistics, sales and services are located throughout the world and subject to the possibility of outage or similar disruption as a result of a variety of events, including natural disasters such as earthquake, flood, computer viruses, cyber attacks and terrorist attacks. Although Canon is working to establish appropriate backup structures for its facilities and information systems, there can be no assurance that Canon will be able to prevent or mitigate the effect of such events or developments the leakage of harmful substances, shutdowns of information systems, and leakage, falsification, and loss of internal databases. Although Canon has implemented backup plans to permit the manufacture of its products at multiple production facilities, such plans do not cover all product models. In addition, such backup arrangements may not be adequate to maintain production quantity at sufficient levels. Such factors may adversely affect Canon's operating activities, generate expenses relating to physical or personal damage, or hurt Canon's brand image, and its operating results may consequently be adversely affected.

Canon must attract and retain highly qualified professionals.

Canon's future operating results depend in significant part upon the continued contributions of its employees. In addition, Canon's future operating results depend in part on its ability to attract, train and retain qualified personnel in development, production, sales and management. The competition for human resources in the high-tech industries in which Canon operates has intensified in recent years. Moreover, owing to the accelerating pace of technological change, the importance of training new personnel in a timely manner to meet product research and development requirements will increase. Failure by Canon to recruit and train qualified personnel or the loss of key employees could delay development or slow production and could increase the risks of outflow of technologies and know-how. These factors may adversely affect Canon's business and operating results.

Maintaining a high level of expertise in Canon's manufacturing technology is critical to Canon's business. However, it is difficult to secure the requisite expertise for specialized skill areas, such as lens processing, in a short time period. While Canon engages in advance planning to obtain the expertise needed for each skill area, Canon cannot guarantee that such expertise will be acquired in a timely manner and retained, and failure to do so may adversely affect Canon's business and operating results.

Canon may be adversely affected by fluctuations in the stock and bond markets.

Canon's assets include investments in publicly traded securities. As a result, Canon's operating results and general financial position may be affected by price fluctuations in the stock and bond markets. The current volatility in financial markets and overall economic uncertainty increase the risk that the actual amounts realized

Table of Contents

in the future on Canon's investments could differ significantly from the fair values currently assigned to them. In addition, if valuations of investment assets decrease because of conditions in stock or bond markets, for example, additional funding and accruals with respect to Canon's pension and other obligations may be required, and such funding and accruals may adversely affect Canon's operating results and consolidated financial condition.

Confidential information may be inadvertently disclosed, which could lead to damage claims or harm Canon's reputation, and may have an adverse effect on Canon's business.

In connection with certain projects, Canon may receive confidential or sensitive information (such as personal information) from its customers relating to these customers or to other affected individuals or parties. In addition, Canon uses computer systems and electronic data in managing information relating to its employees. Although Canon makes best efforts to maintain the confidentiality of such information through procedures designed to prevent accidental release of confidential or sensitive information, such information may be inadvertently disclosed without Canon's knowledge. If this occurs, Canon may be subject to claims for damages from the affected individuals or parties, suffer harm to its reputation or be subject to liabilities or penalties under applicable statutes.

Inadvertent disclosure of confidential information regarding new technology could also have a material adverse effect on Canon's business.

Item 4. Information on the Company

A. History and development of the Company

Canon Inc. is a joint stock corporation (*kabushiki kaisha*) formed under the Corporation Law of Japan. Its principal place of business is at 30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan. The telephone number is +81-3-3758-2111.

The Company was incorporated under the laws of Japan on August 10, 1937 to produce and sell Japan's first focal plane shutter 35mm still camera, which was developed by its predecessor company, Precision Optical Research Laboratories, which was organized in 1933.

In the late 1950s, Canon entered the business machines field utilizing technology obtained through the development of photographic and optical products. With the successful introduction of electronic calculators in 1964, Canon continued to expand its operations to include plain paper copying machines, faxes, laser printers, bubble jet printers, computers, video camcorders and digital cameras.

The following are important recent events in the development of Canon's business.

On June 21, 2007, Canon Marketing Japan Inc. acquired the shares of Argo21 Corporation (reorganized to Canon IT Solutions Inc.) through a tender offer, and made it into a subsidiary. In addition, Canon Marketing Japan Inc. made it into a wholly-owned subsidiary on November 1, 2007 by a share exchange for outstanding common stock in order to strengthen its IT solutions business. On December 28, 2007, Canon acquired the shares of Tokki Corporation (changed its name to Canon Tokki Corporation as of January 1, 2012) through a tender offer, and made it into a subsidiary. With Canon Tokki Corporation as a subsidiary, Canon aims to accelerate the development of its display business.

In July 2008, Nagasaki Canon Inc. was newly established as a wholly-owned subsidiary of Canon Inc., to boost production of digital single-lens reflex (SLR) cameras and compact digital cameras.

On February 19, 2010, Canon acquired shares of OPTOPOL Technology S.A. (OPTOPOL) through a tender offer and made it into a subsidiary. By making OPTOPOL into a subsidiary, Canon aims to achieve the world's No. 1 position within the overall ophthalmic diagnostic equipment segment.

Table of Contents

On March 9, 2010, Canon acquired shares of Océ N.V. (Océ) through a public cash tender offer in addition to interest Canon held before the public cash tender offer and made it into a subsidiary. By making Océ into a subsidiary, Canon aims to further strengthen its business foundation in order to solidify its position as one of the global industry leaders. The combination capitalizes on an excellent complementary fit in product mix, channel mix, R&D, and business lines resulting in an outstanding customer offer spanning the entire industry.

In fiscal 2011, 2010, and 2009, Canon's increases in property, plant and equipment were ¥226,869 million, ¥158,976 million and ¥216,128 million, respectively. In fiscal 2011, the increases in property, plant and equipment were mainly used to expand production capabilities in both domestic and overseas regions, and to bolster Canon's production-technology-related infrastructure. In addition, Canon has been continually investing in tools and dies for business machines, in which the amount invested is generally the same each year.

For fiscal 2012, Canon projects an increase in property, plant and equipment of approximately ¥300,000 million, mainly in Japan. This amount is expected to be spent for investments in new production plants and new facilities of Canon. Canon anticipates that the funds needed for this increase will be generated internally through operations.

B. Business overview

Canon is one of the world's leading manufacturers of network digital multifunction devices (MFDs), plain paper copying machines, laser printers, inkjet printers, cameras and lithography equipment.

Canon sells its products principally under the Canon brand name and through sales subsidiaries. Each of these subsidiaries is responsible for marketing and distribution to retail dealers in an assigned territory. 80.5% of consolidated net sales in fiscal 2011 were generated outside Japan, with approximately 27.0%, 31.3% and 22.2% generated in the Americas, Europe and Asia and Oceania, respectively.

Canon's strategy is to develop innovative, high value-added products incorporating advanced technologies.

Canon's research and development activities range from basic research to product-oriented research directed at maintaining and increasing Canon's technological leadership in the marketplace.

Canon manufactures the majority of its products in Japan, but in an effort to reduce currency exchange risk and production costs, Canon has increased its overseas production and the use of local components. Canon has manufacturing subsidiaries in a variety of countries, including the United States, Germany, France, Netherlands, Taiwan, China, Malaysia, Thailand and Vietnam.

As a concerned member of the world community, Canon emphasizes recycling and has increased its use of clean energy sources and cleaner manufacturing processes. Canon has also launched programs to collect and recycle used Canon cartridges and to refurbish used Canon copying machines. In addition, Canon has removed virtually all environmentally unfriendly chemicals from its manufacturing processes.

Products

Canon operates its business in three segments: the Office Business Unit, the Consumer Business Unit and the Industry and Others Business Unit.

- Office Business Unit -

Canon manufactures, markets and services a wide range of monochrome network digital MFDs, color network digital MFDs, office copying machines and personal-use copying machines. Canon also delivers value added to customers through software, services and solutions. In the office market, together with Océ, which we

Table of Contents

consolidated in 2010, Canon is now in a much improved position compared to our position in fiscal 2010 to serve customers in terms of sales coverage, product portfolio and service capabilities to address needs in the imaging and document space.

In fiscal 2011, despite disruptions in our supply chain due to the Great East Japan Earthquake and collateral events, and notwithstanding a persistently strong yen and a global economic downturn triggered by the Eurozone crisis, Canon was able to maintain total sales at levels comparable to those of fiscal 2010.

The office market is subject to rapid change, and customer preferences have been shifting from monochrome to color products and from devices to services. In fiscal 2011, Canon strengthened its product lineup of digital color MFDs with the introduction of the imageRUNNER 1730/1740/1750 series, Canon's first mid-to-high speed letter-sized devices that cater to the needs of our Managed Document Services customers. Canon also launched low-end ledger-sized models tailored to the emerging markets. For example, the imageRUNNER 2420/2422 series targets growing markets in Asia, Latin America and parts of Europe.

Canon offers color network digital MFDs for a wide range of environments from offices to professional graphic arts. The print industry is increasingly turning to short-run, print-on-demand and variable data printing in recent years. In fiscal 2011, Canon introduced the imagePRESS C7010 VPS, a digital color press jointly developed with Océ. We believe this system combines our respective best-of-class strengths, teaming Canon's digital color technology with Océ's workflow innovation. The model has been well accepted in the marketplace.

Canon is also marketing diverse expansion modules, software and business solutions to increase customer value. Canon's function expandable platform, the Multifunctional Embedded Application Platform (MEAP), enables quick integration of fast, high quality image processing into customer's IT infrastructure. Such integration not only boosts productivity but also allows users to take advantage of the power of MFD cloud services. In fiscal 2011, Canon began delivering form creation and print services to salesforce.com users in Japan through an integration with salesforce.com's cloud services. Canon also announced a strategic alliance with Oracle expected to bring together Canon's imaging and Oracle's software expertise to jointly develop new products and technologies to create new services and offerings for our customers.

Canon Managed Document Services (Canon MDS) is a unified global initiative for outsourced printing and document management services, setting a new standard for delivering managed print services to customers. The Canon MDS offering leverages innovative technologies and tools that combine the device functions, software solutions and professional service capabilities offered through Canon. With Canon MDS, Canon aims to help customers improve efficiency and reduce total cost of ownership. This initiative is taking hold in the market and we are seeing steady growth in our MDS customer base.

Canon's expanded alliance with Hewlett-Packard contributed to our being awarded several large enterprise deals. For example, in fiscal 2011, Canon and Hewlett-Packard were together awarded major MDS deals from large enterprises. We believe Canon and Hewlett-Packard continue to offer unmatched office workflow solutions that are highly responsive to customer needs in this market.

Canon made Océ a consolidated subsidiary in 2010 to strengthen our printing business. The integration is well underway. In fiscal 2011, we introduced the imagePRESS C7010VPS, the first jointly-developed product with Océ. The portfolio available for cross selling has expanded over time and we believe we offer to our respective customer bases a broader and richer set of combined offerings. This undertaking has been effective in terms of channel coverage, complementary assets and capabilities, and incremental sales growth.

Developed and fostered by Canon, laser printers are standard output peripherals for offices. Canon's laser printers are relatively small and have high-quality capabilities attributable to Canon's expertise with the relevant technologies. Canon's adoption of a user-replaceable toner cartridge system containing optical components makes its printers easy to maintain. Most of Canon's laser printer sales are on an Original Equipment Manufacturer (OEM) basis.

Table of Contents

On a global basis, the production and sales of monochrome and color laser printers, mainly low-end products, expanded rapidly and achieved unit growth in excess of 10% in the past years. Unit growth of both monochrome and color laser printers was negative in fiscal 2008 and 2009 due to the recent economic downturn but returned to positive growth in fiscal 2010 and 2011 due to improved global economic conditions.

The large format inkjet printer market size is approaching the record set in 2008, and has accordingly been on a continuous recovery trend spurred by the accelerating shift to color, from black and white, and the contributions of emerging market expansion. Despite the earthquake in Japan, the floods in Thailand and the economic downturn in developed nations triggered by the Eurozone crisis, Canon large format inkjet printer main unit sales in 2011 exceeded those of 2010, setting a new post-2008 record. Canon believes it was able to achieve this result because it was able to solidify its position in the industry, not only by maintaining its high reputation in the large format inkjet printer market for high productivity and excellent usability, but also as a result of the successful launch of two new models featuring improved image features, the iPF8300S/6300S for graphic market.

An important growth strategy for Canon in the near term is to solidify its global position in the large format inkjet printer market by strengthening the business relationships with Océ and achieving the expansion of its large format inkjet printer lineup.

The Office Business Unit also includes the related sales of paper and chemicals, service and replacement parts.

- Consumer Business Unit -

Canon manufactures and markets digital cameras and digital video camcorders, as well as lenses and various related accessories.

The worldwide compact digital camera market declined by 5% year-on-year in fiscal 2011, primarily due to depressed consumer spending in developed markets and supply shortages caused by the natural disasters in Japan and Thailand. Canon maintained its formidable position in the industry by bringing seventeen new models to market in 2011. Three new models in particular have contributed to our sales: the PowerShot ELPH 100 HS, the PowerShot ELPH 300 HS, and the PowerShot SX230 HS.

In September 2011, the cumulative production of EOS-series SLR cameras topped 50 million units. Moreover, we produced the last 10 million units in only 16 months. In March 2011, Canon launched two new entry class products, the EOS Rebel T3i and EOS Rebel T3, to the SLR market which continued to experience robust growth. The EOS Rebel T3i is equipped with features, such as a fully automatic shooting function called Scene Intelligent Auto, a function to facilitate video shooting and the first variable-angle LCD monitor in an entry-class product, making it in our opinion the ideal high-performance digital SLR camera for beginner-level users wishing to shoot, express, and watch/present their creations. In addition to a full range of basic features, the EOS Rebel T3 offers color variation features, making it an attractive digital SLR camera capable of drawing in new users.

The launch of both models was challenging due to the earthquake and collateral events in Japan, but in the second half of the year, sales grew satisfactorily for both models, as well as for the older EOS Rebel T2i model. Meanwhile, sales of existing advanced-amateur class models including the EOS 5D Mark II, EOS 7D, and EOS 60D remained satisfactory, contributing to increased overall market share in terms of value, and in the United States in particular, ranking first among mid-range class models in terms of units sold.

The market for interchangeable lenses for digital cameras grew robustly as well. Canon has been introducing high-quality, high-performance lenses built on superior technology (e.g., special Sub-Wavelength Coating, multi-layer diffractive optical elements and image stabilizers), which we believe allowed us to maintain our advantage over the competition in this field, as well as in the digital SLR camera field. In October 2011, the

Table of Contents

cumulative production of EF lens series interchangeable lens topped 70 million. Including three new products launched in March 2011, the interchangeable lens lineup currently tops 60 products. With high expectations for further growth in this market, Canon expects to continue boosting both revenue and market share.

Canon maintains a leading position in the digital video camcorder market, having introduced a series of flash memory models in fiscal 2008 followed by high-end models in fiscal 2009, to successfully promote Canon's brand reputation for high image quality. In fiscal 2010, Canon added general-purpose models, allowing Canon to cover the full range with flash memory models. In the field of professional camcorders, Canon introduced flash memory models, our XF series, in 2010 and 2011 for use in broadcast news, documentary and independent filmmaking. Furthermore, in November 2011, Canon announced its full-fledged entry into digital high-resolution motion picture production by launching Cinema EOS System which consists of new interchangeable lens digital cinema cameras featuring a newly developed Super 35mm-equivalent, approximately 8.29 megapixel Complementary Metal Oxide Semiconductor (CMOS) sensor, and new EF Cinema Lens lineup. Despite a continuing slowdown in the overall digital video camcorder market, there is a steady, positive trend in HD and flash memory sales and volume. Canon has been expanding its flash memory model lineups in order to expand sales and to take advantage of this growth of the HD and flash memory markets.

Canon began aggressively expanding its lineup of network cameras used for business surveillance video and monitoring applications in the second half of 2008 and has achieved a reputation for high-quality images due to the strength of its optical performance and video processing technology. This market is expected to expand further through improvements in high-quality imaging and image analysis, both of which are trends that will enable Canon to apply its traditional strengths. In fact Canon launched four new HD products in the second half of 2011 to contribute to societal safety and security.

As the inventor of bubble jet printing technology, Canon believes that it continues to provide customers with the best performing inkjet printer models. Canon offers high-performance and high value-added multifunction and single function inkjet printers. In response to intense competition in this segment, Canon launched a new lineup of Multifunction Printers (MFP) and single function printers in fiscal 2011. All of these models feature print heads based on Canon's Full-photolithography Inkjet Nozzle Engineering (FINE) technology, which boosts print speed and image quality up to 9600 x 2400 dpi, and the ChromaLife100+ system, which provides high quality and long-lasting photographic images using a combination of genuine ink and paper. Canon PIXMA photo printers offer many advanced features, including the Intelligent Touch System, Full HD Movie Print, PIXMA Cloud Link and wireless printing, each of which makes printer operation more user friendly for diversified users. With an advanced printer lineup, Canon has expanded its sales volume and expects that its consumables business will expand accordingly, excluding adverse affects from currency fluctuations.

Beginning in February 2011 in Japan, followed by some other parts of the world, Canon announced the company's entry into the commercial photo printing market with the launch of the DreamLabo 5000, which incorporates inkjet technologies. In the autumn of 2011, Canon also introduced the PIXMA PRO-1, a professional photo inkjet printer, which produces professional quality prints up to A3+ with 12-ink system. With the addition of these products, Canon aims to further expand its business leveraging its strength in the photo printing market.

Canon markets a wide variety of scanners geared toward a broad spectrum of user needs, including image scanners in the CanoScan LiDE series using Contact Image Sensor (CIS) and scanners with Charge-Coupled Devices (CCD) for high resolution. CIS is a close-contact method that allows for a significant reduction in scanner weight and size. Canon has applied its expertise to developing space-saving and energy-efficient scanners, as well as easy personal computer connections via Universal Serial Bus interfaces (USB) for data and power. Although the scanner market has continued to shrink and has shifted toward MFPs, Canon has maintained a high market share.

Canon is the leader in the market for television lenses used by television stations for live sports, news broadcasts, concerts, dramatic productions, and other applications. In 2011, Canon released the XJ95x8.6B high

Table of Contents

definition zoom lens for outdoor broadcasts. This lens achieves not only the world's widest angle, but also 95x optical zoom magnification, which has bolstered Canon's position as the broadcast television lens market leader.

We believe Canon's television lenses are easily the most popular for broadcasting all manner of sporting and other events around the world, and continue to deliver thrilling true depictions of events to television viewers, while inspiring viewers and conveying to them a realistic picture of news stories around the world.

Canon's calculator operations from development to production to marketing are centered in Hong Kong. Canon's tradition of technological innovation began with its focus on personal information products, including calculators with built-in printers and electronic dictionaries. Canon continues to develop appealing personal information products that reflect demand trends.

- Industry and Others Business Unit -

In the market for semiconductor lithography equipment, the recovery trend from 2010 continued and the market grew roughly 20% in 2011 to about 360 units. By the type of lighting source, cutting-edge equipment using Argon-Fluoride (ArF) immersion now account for roughly one-third of the market as memory makers and foundries have been aggressively investing in miniaturization. At the same time, manufacturers are starting to invest in equipment using i-line for small diameter wafers used in image sensors, power devices and LEDs, as well as for new markets such as 3D integration for Through Silicon Via (TSV).

In order to respond more flexibly to these market changes, Canon has been rationalizing production systems to better match market changes, creating new systems with overall responsibility for each stepper model, and integrating manufacturing and sales functions so that customer needs can be more quickly addressed in development. Through these activities, a design-in business style have been taking hold and are making steady progress in developing and marketing products with high added value. For example, Canon made its first foray into the semiconductor back-end packaging equipment market in 2011 with the introduction of the new FPA-5510iV, which we believe offers the best solution for TSV and bump lithography.

In 2011, the market for LCD lithography equipment remained relatively flat compared to the previous year at around 110 units. The market for LCD lithography equipment under 5.5th generation grew roughly 170% in 2011 from the previous year due to the rapid growth in the markets for smartphones and media tablets. However, the market for LCD lithography equipment over 6th generation fell to one-half in 2011 from the previous year due to weak investment in 2011 resulting from aggressive investment in 2010, and price reductions for large LCD panels. In China, although the 8th generation production lines of LCD panels launched in 2011 led to a significant expansion in the Chinese market, the growth could not fully absorb the effects of decreased demand in the overall LCD lithography equipment market.

The MPAsp-H700 series supporting 7th and 8th generation large LCD panels has offered customers an ability to maintain high productivity by allowing for quick equipment installation at existing production sites. This has helped Canon capture a leading share of the South Korean market. Furthermore, Canon's sales and service support systems have earned high accolades in China.

Medical imaging equipment sold by Canon includes X-ray image sensors, retinal cameras, autorefractometers and image-processing equipment for computerized systems. Canon's pioneering digital radiography system takes X-ray photography and medical imaging into the digital age.

Other Canon products, such as electronic components, including magnetic heads and micro-motors, are sold primarily to equipment manufacturers. In addition, Canon provides industrial machines such as die bonder and magnetic disk film deposition equipment. Canon also offers business information products, which primarily consist of personal computers, servers and document scanners.

Table of Contents

With the trend toward digitization, the demand for scanning documents into text or image data is expanding. Canon's document scanners rapidly and efficiently digitize large volumes of printed information. Canon offers a wide range of scanner models, including color-capable compact sheet-fed types and a flatbed model suitable for scanning book format documents. Canon also offers a hybrid model that can create microfilm records. Canon's diverse lineup seeks to meet increased demand by business customers for digitizing office documents, which enables such customers to share documents across Internet or intranet platforms or to capture forms with optical character recognition.

Personal computers and servers sold by Canon are manufactured by third parties under the manufacturers' own brand names.

Marketing and distribution

Canon sells its products primarily through subsidiaries organized under regional marketing subsidiaries. These regional marketing subsidiaries are: Canon Marketing Japan Inc. in Japan; Canon U.S.A., Inc. in North and South America; Canon Europe Ltd. and Canon Europa N.V. in Europe, Russia, Africa and the Middle East; Canon (China) Co., Ltd. in Asia outside Japan; and Canon Australia Pty. Ltd. in Oceania. Each subsidiary is responsible for its own market research and for determining its sales channels, advertising and promotional activities. Each subsidiary provides tailor-made solutions to a diverse range of unique customers and aims to advance Canon's reputation as a highly trusted brand.

In Japan, Canon sells its products primarily through Canon Marketing Japan Inc., mainly to dealers and retail outlets.

In the Americas, Canon sells its products primarily through Canon U.S.A., Inc., Canon Canada Inc. and Canon Latin America, Inc., mainly to dealers and retail outlets.

In Europe, Canon sells its products primarily through Canon Europa N.V., which sells mainly through subsidiaries or independent distributors to dealers and retail outlets in each locality. In addition, copying machines are sold directly to end-users by several subsidiaries such as Canon (UK) Ltd. in the United Kingdom and Canon France S.A.S. in France.

In Southeast Asia and Oceania, Canon sells its products through subsidiaries located in those areas. In addition, copying machines are sold directly to end-users in Australia by Canon Australia Pty. Ltd.

Canon also sells laser printers on an OEM basis to Hewlett-Packard Company. Hewlett-Packard resells these printers under the HP LaserJet Printers' name. During fiscal 2011, such sales constituted 19.3% of Canon's consolidated net sales, and 20.1% in the previous fiscal year.

Canon continues to enhance its distribution system by promoting the continuing education of its sales personnel and by improving inventory management and business planning through weekly analysis of sales data.

Service

In Japan and overseas, product service is provided in part by independent retail outlets and designated service centers that receive technical training assistance from Canon. Canon also services its products directly.

Most of Canon's business machines carry warranties of varying terms, depending upon the model and country of sale. Cameras and camera accessories carry warranties that vary depending upon the model and country of sale.

Canon services its copying machines and supplies replacement drums, parts, toner and paper. Most customers enter into a contract under which Canon provides maintenance services, replacement drums and parts in return for a stated amount of the contract plus a per copy charge. Copying machines not covered by a service contract may be serviced from time to time by Canon or local dealers for a fee.

Table of Contents

Seasonality

Canon's sales for the fourth quarter are typically higher than for the other three quarters, mainly due to strong demand for consumer products, such as cameras and inkjet printers, during the year-end holiday season.

In Japan, corporate demand for office products peaks in the first quarter, as many Japanese companies end their fiscal years in March. Sales also tend to increase at the start of the new school year in each region.

Sources of supply

Canon purchases materials such as glass, aluminum, plastic, steel and chemicals for use in various product components and in the manufacturing process. Canon procures raw materials from all over the world and selects suppliers based on a number of criteria, including environmental friendliness, quality, cost, supply stability and financial condition.

Prices of some raw materials fluctuate according to market trends. In fiscal 2011, the earthquake in Japan and collateral events, as well as the floods in Thailand, caused acute shortages of raw materials and damaged production and other facilities. Although Canon is currently focusing on globalizing supplies and improving raw material resource management strategies, and believes that it will be able to continue procuring sufficient quantities of raw materials to meet its needs, there can be no assurance that supply shortages will not reoccur or that raw materials, such as crude oil, will be available at competitive prices, or at all in the future.

NET SALES BY SEGMENT

The following table presents our net sales by segment for each of the periods shown.

	2011	change	Years ended December 31		2009
			2010	change	
(Millions of yen, except percentage data)					
Office	¥ 1,917,943	-3.5%	¥ 1,987,269	20.8%	¥ 1,645,076
Consumer	1,312,044	-5.7	1,391,327	6.9	1,301,160
Industry and Others	420,863	-2.8	432,958	20.9	357,998
Eliminations	(93,417)		(104,653)		(95,033)
Total	¥ 3,557,433	-4.0%	¥ 3,706,901	15.5%	¥ 3,209,201

NET SALES BY GEOGRAPHIC AREA

The following table presents our net sales by geographic area for each of the periods shown.

	2011	change	Years ended December 31		2009
			2010	change	
(Millions of yen, except percentage data)					
Japan	¥ 694,450	-0.2%	¥ 695,749	-0.9%	¥ 702,344
Americas	961,955	-6.0	1,023,299	14.4	894,154
Europe	1,113,065	-5.1	1,172,474	17.8	995,150
Asia and Oceania	787,963	-3.4	815,379	32.0	617,553
Total	¥ 3,557,433	-4.0%	¥ 3,706,901	15.5%	¥ 3,209,201

Competition

Edgar Filing: CANON INC - Form 20-F

Canon encounters intense global competition in all areas of its business. Canon's competitors range from some of the world's major multinational corporations to smaller, highly specialized companies. Canon competes

Table of Contents

in a number of different business areas, whereas many of its competitors focus on one or more individual areas. Consequently, Canon may face significant competition from entities that apply greater financial, technological, sales and marketing or other resources than Canon to their activities in a particular market segment.

The principal elements of competition that Canon faces in each of its markets are technology, quality, reliability, performance, price and customer service and support. Canon believes that its ability to compete effectively depends in large part on conducting successful research and development activities that enable it to create new or improved products and release them on a timely basis and at commercially attractive prices.

The competitive environments in which each product group operates are described below:

- Office Business Unit -

The markets for this segment are highly competitive. Canon's primary competitors are Xerox Corporation/Fuji Xerox Co., Ltd.; Ricoh Company, Ltd.; Konica Minolta Holdings, Inc.; Hewlett-Packard Company; Samsung Electronics Co., Ltd.; and Lexmark International, Inc. Canon believes that it is one of the leading global manufacturers of digital network MFPs, copying machines and laser printers. In addition to the general elements of competition described above, Canon's ability to compete successfully in these markets also depends significantly on whether it can provide effective, broad-based business solutions to its customers and respond to interrelated customer needs. In particular, the ability to provide equipment and software that connect effectively to networks (ranging in scope from local area networks to the Internet) is often a key to Canon's competitive strength. In the United States, Europe and Japan, Canon is one of the market leaders in all areas of the business machine market. In China, the current market leaders for business machines are Toshiba TEC Corporation, Sharp Corporation and Konica Minolta Holdings, Inc. Canon hopes to join this group by introducing products tailored to the Chinese market and by strengthening sales and service channels. In the color printing market, Ricoh, Xerox and Konica Minolta have been very aggressive, especially in Europe and the United States, and competition in this market has become fierce.

- Consumer Business Unit -

In addition to the traditional camera manufacturers, other electrical manufacturers have also started aggressively launching interchangeable lens digital cameras and related products in fiscal 2011. Nevertheless, Canon has continued to invest aggressively in competitive new products and intends to maintain its leadership position in this market.

Canon's primary competitors in the interchangeable lens digital camera market are Nikon Corporation, Sony Corporation and Panasonic Corporation. Another major competitor is Sigma Corporation, which produces lenses for use with Canon's digital SLR products.

The compact digital camera market is extremely competitive, and a large number of Canon's competitors are relying on electronic manufacturing service (EMS) manufacturers to do their development and production work.

Except for Japan, where competition is so fierce that expansion of market size is generally possible only by greatly reducing sales prices, average prices in the industry did not decline much in fiscal 2011 from levels seen in the previous year. Nevertheless, prices have been rapidly declining as measured by the standard of specification price value, and the commoditization of products has been progressing. Market contraction and exchange rate fluctuation risks caused by the financial crisis are having a major impact, resulting in a severe profit profile in the digital camera market. Despite these difficulties, Canon will seek to take advantage of its status as the number one brand in the industry, along with its economies of scale, in order to maintain profitability.

Table of Contents

Canon's primary competitors in the compact digital camera market are Sony Corporation; Nikon Corporation; Panasonic Corporation; Fujifilm Co., Ltd.; Samsung Electronics Co., Ltd.; Olympus Corporation; Hoya Corporation; Eastman Kodak Company; and Casio Computer Co., Ltd. Canon's primary competitors in the digital video camcorder market are Sony Corporation; Panasonic Corporation; and JVC KENWOOD Corporation. Canon's primary competitors in the inkjet printer market are Hewlett-Packard Company and Seiko Epson Corporation.

- Industry and Others Business Unit -

There continues to be very stiff competition in the markets for lithography equipment used in the production of semiconductor devices and LCD panels. In order to produce lithography equipment that can provide ultra-fine processing, there needs to be an integration of advanced optical, control and system technologies, along with continuous investment in technology development. The main competitors in these markets are Nikon Corporation, in the markets for semiconductor and LCD lithography equipment, and ASML Holding N.V., in the market for semiconductor lithography equipment only.

Canon has helped its customers to improve their productivity by continuously improving the cost performance of semiconductor lithography equipment using the i-line and KrF laser light sources. In particular, the equipment using i-line have captured a large share of the global market. Canon has also been meeting the needs of image sensor manufacturers by quickly adapting to various unique specifications.

Canon's LCD lithography equipment for LCD panels with a common platform offering excellent productivity and reliability have captured large shares of the industry-leading South Korean market and the promising Chinese market.

Patents and licenses

Canon holds a large number of patents, design rights and trademarks in Japan and abroad to protect proprietary technologies stemming from its research and development activities. Canon utilizes these intellectual property rights as important strategic management tools. For example, Canon leverages its intellectual property rights to expand its product lines and business operations and to form alliances and exchange technologies with other companies.

Canon has granted licenses with respect to its patents to various Japanese and foreign companies, most often with respect to electrophotography, laser printers, multifunction printers, facsimile machines and cameras.

Companies to which Canon has granted licenses include:

Oki Electric Industry Co., Ltd.	LED printers, multifunction printers and facsimile machines
Panasonic Corporation	Electrophotography
Ricoh Company, Ltd.	Electrophotography
Sanyo Electric Co., Ltd.	Electronic cameras
Samsung Electronics Co., Ltd.	Laser printers, multifunction printers and facsimile machines
Kyocera Mita Corporation	Electrophotography
Sharp Corporation	Electrophotography
Brother Industries, Ltd.	Electrophotography and facsimile machines

Canon has also been granted licenses with respect to patents held by other companies.

Table of Contents

Companies that have granted licenses to Canon include:

Jerome H. Lemelson Patent Incentives, Inc.	Computer systems, image recording apparatus and communication apparatus
Energy Conversion Devices, Inc.	Solar battery
Honeywell International Inc.	Camera and video products
Gilbert P. Hyatt U.S. Philips Corporation	Microcomputer
Applied Nanotech Holdings, Inc.	Field Emission Display (FED) technology
St. Clair Intellectual Property Consultants, Inc.	Selection of digital camera image format

Canon has also entered into cross-licensing agreements with other major industry participants.

Companies with which Canon has entered into cross-licensing agreements include:

International Business Machines Corporation	Information handling systems
Hewlett-Packard Company	Bubble jet printers
Xerox Corporation	Business machines
Panasonic Corporation	Video tape recorders and video cameras
Eastman Kodak Company	Electrophotography and image processing technology
Ricoh Company, Ltd.	Electrophotography products, facsimile machines and word processors
Seiko Epson Corporation	Information-related instruments

Canon has placed a high priority on the management of its intellectual property. Some products that are material to Canon's operating results incorporate patented technology. Patented technology is critical to the continued success of Canon's products, which typically incorporate technology from dozens of different patents. However, Canon does not believe that its business, as a whole, is dependent on, or that its profitability would be materially affected by the revocation, termination, expiration or infringement upon any particular patent, copyright, license or intellectual property rights or group thereof.

Environmental regulations

Canon is subject to a wide variety of laws, regulations and industry standards relating to energy and resource conservation, recycling, global warming, pollution prevention, pollution remediation and environmental health and safety. Some of the environmental laws that affect Canon's businesses are summarized below.

1. Kyoto Protocol to the United Nations Framework Convention on Climate Change

Fiscal 2011 was the fourth year of the first commitment period (2008-2012) under the Kyoto Protocol. The Japanese government has called upon the manufacturing, transport, services and household sectors to take further action for energy conservation.

The revised Energy Saving Law in Japan (Law Concerning the Rational Use of Energy) and the revised Act on Promotion of Global Warming Countermeasures came into full effect in April 2010. These laws require business operators to report their energy consumption and mid and long-term energy conservation plans in an effort to encourage energy efficiency. The Japanese government is also implementing multifaceted measures to reduce emissions, including the granting of a domestic credit to any large company that helps small and medium enterprises to conserve energy. This credit is expected to provide substantial incentives, as it will be deemed an emission reduction for participating companies. Trial implementation of an emissions trading scheme was launched in October 2008.

Despite the economic downturn, Canon has been working to achieve its voluntary action plan target (which is consistent with the plan of the Japan Electrics and Electronics Industrial Associations) and has been strengthening its group structure to comply with revised environmental laws. Canon has been participating in the

Table of Contents

trial emissions trading scheme and managed through dedicated efforts to achieve the year 2010 target. However, due to electricity shortages and related rolling blackouts in Tokyo and other regions from damage to the nuclear power facilities in Fukushima caused by the earthquake and tsunami, Canon has been asked to achieve further electricity saving and energy conservation. These activities including a response to this request could increase Canon's management costs and have adverse effects on its operating results and financial condition.

2. Post-Kyoto Initiatives

In September 2009, the Japanese government announced its conditional commitment to a 25% reduction of CO₂ emissions from the calendar year 1990 level by 2020. The announcement was made in the interest of concluding an agreement to establish binding CO₂ emission reduction targets at the Fifteenth Conference of the Parties to the United Nations Framework Convention on Climate Change (COP15), which was held in December 2009. The United States, the European Union and China also indicated their respective targets; however, results of the COP15 negotiations were not clarified, and the agenda was postponed to the COP16 held in 2010 and the COP 17 in 2011. The agenda of COP17 was again postponed until the COP18 conference to be held in December 2012. Prospects for a legally binding scheme, and any eventual implementation thereof by participant countries, including Japan, still remain unclear.

Canon continues to pursue CO₂ emission reductions through energy-efficient product design, logistics and factory operations on the basis of its understanding of the COP discussions. However, its efforts could increase Canon's management costs and have adverse effects on its operating results and financial condition.

3. Tokyo Metropolitan Government Environmental Protection Ordinance

The Tokyo Metropolitan Government has mandated that the owners of certain large CO₂ emitters, including office buildings, reduce CO₂ emissions from April 2010. The target for the first compliance period (April 2010 to March 2015) has been set at 8% or 6% (according to the type of the building) below base emissions, which can be determined based on the amount of emissions from the building in recent years. In order for the owners of the large buildings to fulfill the requirement, they must reduce CO₂ emissions from their respective buildings and, if such reduction is insufficient, obtain certain Tokyo Metropolitan government-sanctioned credits. We expect to fulfill the requirement during the first compliance period.

Canon continues to pursue CO₂ emission reductions through energy-efficient office operations. However, such efforts could increase Canon's management costs and have adverse effects on its operating results and financial condition.

4. Soil Pollution Prevention Law of Japan

A 2010 amendment to the Soil Pollution Prevention Law of Japan tightens certain requirements to survey soil to measure certain pollution levels. If soil pollution exceeds specified limits, a prefecture governor may designate the land as "Measure required area" when effects to human health due to soil pollution (and with exposure to pollutant) are foreseen, and the prefecture governor orders removal of pollutants. When exposures to pollutants are blocked and effects to human health are not foreseen, the area is declared "designated area for notification of changes of the land character." The prefecture governor may publicly announce such designation and make the investigation report available upon request. The substances designated as pollutants consist of twenty-five chemical groups, including lead, arsenic and trichloroethylene. If an investigation shows that there is a likelihood that soil contamination may affect human health, the prefecture governor may issue an order to the landowner to take designated remedial actions and may restrict the changes of the land character. Canon has commenced a detailed survey and measurement of soil and groundwater to check for pollution at all of Canon's operational sites in Japan. Additional costs may arise if these investigations reveal that remedial measures are necessary. These factors could adversely affect Canon's operating results and financial condition of the sites.

Table of Contents

See Risk Factors Other Risks Environmental cleanup and remediation costs relating to Canon's properties and associated litigation could decrease Canon's net cash flow, adversely affect its operating results and impair its financial condition.

5. *Law for Promotion of Effective Utilization of Resources*

The Law for Promotion of Effective Utilization of Resources, administered by the Japanese Ministry of Economy, Trade and Industry, was enacted in 2001. This law requires manufacturers of specified reuse-promoted products, including copying machines, to promote the use of recyclable resources and recovered products (designing and manufacturing products that may be easily reused or recycled). Failure to comply with the law could adversely affect Canon's operating results.

6. *European Union Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (the RoHS Directive) and Directive on Waste Electrical and Electronic Equipment (the WEEE Directive)*

These two directives were published in the Official Journal of the European Union in 2003, and member states were required to enact laws necessary to comply with these directives by 2004.

According to the RoHS Directive from July 1, 2006, companies have been required to ensure that electrical and electronic equipment sold in the European Union does not contain lead, cadmium, hexavalent chromium, mercury, polybrominated biphenyls or polybrominated diphenyl ethers if placed on the market after that date. Pursuant to the RoHS Directive, Canon adapted its products so that they do not contain the prohibited hazardous substances. The RoHS recast Directive was published on July 1, 2011. As a result, manufacturers, like Canon, will be required to prepare new declarations of conformity and compliance documentation from January 2013, in addition to meeting current restrictions on substances. Furthermore, the scope of products covered will be expanded to medical and measurement equipment from July 2014.

The WEEE Directive requires that companies selling electrical and electronic equipment bearing their trade names in the European Union must arrange and pay for collection, treatment, recycling, recovery and disposal of their equipment. Canon has become a member company of collective compliance schemes in each member state of the European Union and has achieved the required recycling levels for electrical and electronic equipment waste. Revisions to the WEEE Directive are now under consideration, and expected to be published in 2012. For the WEEE recast Directive, it has been proposed to set collection rates based on the sales volume in previous years and to raise rates for recycling and recovery.

If tighter restrictions are enforced in 2013 and beyond, Canon's compliance costs could increase, including with costs related to the actions for newly-covered products and the development and adoption of substitute materials or processes. Such increased costs may have an adverse effect on Canon's operating results.

7. *European Framework for the Management of Chemical Substances (REACH Regulation)*

The REACH Regulation was published in the Official Journal of the European Union, and was implemented in 2007. This regulation covers almost all chemicals (products in gaseous, liquid, paste or powder form) and articles (products in solid state) manufactured in or imported into the European Union.

All chemicals manufactured in or imported into the European Union that exceed specific content thresholds must be registered. Registration requires disclosure of information about usage and chemical characteristics. The registration of new chemicals commenced in June 2008. For chemical substances in use before existing chemicals, pre-registration was accepted from June 1 to December 1, 2008. Substances that were not pre-registered cannot be used until formally registered. Pre-registered substances are subject to compliance with formal registration procedures according to their quantity and hazardous properties. Canon uses some chemicals which are subject to pre-registration requirements and has completed the necessary pre-registrations.

Table of Contents

If certain substances are contained in an article, the substances must be communicated to the recipient or consumer of the article. This requirement has been in place since October 2008. Moreover, starting in 2011, certain cases required notifying the European Chemical Agency of more specific information.

Furthermore, the addition of restrictions on the use of certain substances has been proposed, and if adopted, manufacturers such as Canon will need to take measures to address such new restrictions.

Canon has been implementing these requirements under the REACH Regulation, which could increase Canon's management costs and have adverse effects on its operating results and financial condition.

8. The European Framework for the Setting of Requirements for Energy-Related Products (ErP Directive)

The ErP Directive applies in Europe to all energy-using products, although implementing measures for specific product categories have yet to be adopted. Until these implementing measures are adopted, it is difficult to predict the potential effects of the ErP Directive. However, implementing measures with respect to off-mode and standby mode and external power supplies were adopted and applied since 2010. Currently, a horizontal implementing measure covering home and office electric and electronic equipment which can be connected to a network is also under consideration, and is expected to be published in 2012. For imaging equipment, the industry has made a public commitment to attain certain targets on environmentally conscious designs from 2012 by an industrial voluntary agreement and began implementation in 2011. Furthermore, implementing measures for AV equipment including projectors will be finalized after finalizing regulations for networked products described above (2012). Canon is continuing its preparations to comply with the ErP Directive. However, the requirements are expected to be challenging and achieving compliance will likely increase Canon's costs, especially by required design changes.

9. State Legislation in the United States Concerning Recycling of Waste Electric and Electronic Products

Electrical and electronic equipment recycling laws have been enacted or proposed in more than twenty American states. Although most of such laws cover only displays or television sets, printers and other products are covered by some states, such as Illinois, Michigan and Hawaii, among others. These laws require manufacturers to bear the costs of collecting and recycling electrical and electronic equipment based on sales volume or market share by brand of covered products. Canon expects that compliance with such state requirements might increase its costs, such as recycling fees and product guarantees.

10. Chinese Administrative Measures on the Control of Pollution Caused by Electronic Information Products

The Chinese Ministry of Information Industry published Administrative Measures on the Control of Pollution Caused by Electronic Information Products in February, 2006. These measures are modeled on the European Union RoHS Directive described above and regulate six substances: lead, mercury, hexavalent chromium, cadmium, polybrominated biphenyls and polybrominated diphenyl ethers in electronic information products. The measures establish two stages of implementation. Stage 1 is in effect and covers nearly all Canon products.

To comply with Stage 1 requirements, a China-specific label must be placed on any covered product if any of the six regulated substances are contained therein, and use of the six regulated substances must be disclosed in each product manual. In addition, each product's environmental protection use period (EPUP) must be stated within its recycling mark and include the production date. Packaging material markings must be displayed on the boxes of the covered products.

Stage 2 requires that the contents of six regulated substances in specific electronic information products (as specified by the Chinese Government in the list for emphasized management) to be restricted by limitations similar to the European Union RoHS Directive. A China-specific compulsory product certification system will be introduced for such products. Standards to implement these measures and the emphasized management list are under discussion, including with regard to printers.

Table of Contents

If these requirements are applied to Canon's products, this could increase Canon's costs and have an adverse effect on its operating results and financial condition.

11. Chinese Regulation for the Management of the Recycling and Disposal of Waste Electrical and Electronic Products

The Regulation for the Management of the Recycling and Disposal of Waste Electrical and Electronic Products was issued by the Chinese government on February 25, 2009. This regulation concerns the management of recycling and disposal activities with regard to waste electrical and electronic products in the interest of promoting comprehensive utilization of resources and the development of a circular economy. Producers and importers will be required to pay a fee to a government fund. This regulation was implemented on January 1, 2011. The first list of products falling under the waste electrical and electronic products catalogue has been issued and includes four types of household appliance as well as personal computers, but the funding scheme remains under review.

If these requirements are applied to Canon's products, this could increase Canon's costs and have an adverse effect on its operating results and financial condition.

12. Other Environmental Regulations

In addition to the laws described above, various environmental laws and regulations may have been promulgated or enacted by European Union member states, states of the United States, emerging countries such as China, India, Russia, Vietnam and others. Compliance with any such additional regulations may increase Canon's costs and may adversely affect Canon's operating results and financial condition.

C. Organizational structure

Canon Inc. and its subsidiaries and affiliates form a group of which Canon Inc. is the parent company. As of December 31, 2011, Canon had 277 consolidated subsidiaries and 11 affiliated companies accounted for by the equity method.

The following table lists the significant subsidiaries owned by Canon Inc., all of which are consolidated as of December 31, 2011.

Name of company	Head office location	Proportion of ownership interest owned	Proportion of voting power held
Canon Marketing Japan Inc.	Tokyo, Japan	50.1%	55.3%
Canon U.S.A., Inc.	New York, U.S.A.	100.0%	100.0%
Canon Europa N.V.	Amstelveen, The Netherlands	100.0%	100.0%

Table of Contents**D. Property, plants and equipment**

Canon's manufacturing is conducted primarily at 27 plants in Japan and 17 plants in other countries. Canon owns all of the buildings and the land on which its plants are located, with the exception of certain immaterial leases of land and floor space of certain of its subsidiaries. The names and locations of Canon's plants and other facilities, their approximate floor space and the principal activities and products manufactured therein as of December 31, 2011 are as follows:

Name and location Domestic	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Headquarters, Tokyo	2,556	R&D, corporate administration and other functions
Canon Global Management Institute, Tokyo	164	Training and administration
Kawasaki Office, Kanagawa	1,236	R&D and manufacturing of production equipment and semiconductor devices; R&D of laser printers and toner cartridges
Kosugi Office, Kanagawa	395	Development of software for office imaging products
Fuji-Susono Research Park, Shizuoka	1,038	R&D in electrophotographic technologies
Ayase Office, Kanagawa	393	R&D and manufacturing of semiconductor devices
Hiratsuka Plant, Kanagawa	1,141	R&D and manufacturing of semiconductor devices
Tamagawa Office, Kanagawa	155	Quality engineering
Oita Plant, Oita	199	Manufacturing of semiconductor devices
Yako Office, Kanagawa	903	Development of inkjet printers, inkjet chemical products
Utsunomiya Plant, Tochigi	2,752	Manufacturing of lenses for cameras and other applications; R&D in optical technologies; development and sales of broadcasting equipment; R&D, manufacturing, sales and servicing of semiconductor production equipment
Toride Plant, Ibaraki	3,233	R&D in electrophotographic technologies, mass-production trials and support; manufacturing of office imaging products, chemical products; training of manufacturing
Ami Plant, Ibaraki	1,149	Manufacturing of LCD production equipment
Oita Manufacturing Training Center, Oita	71	Training for enhancing practical technologies and skills of production division
Canon Electronics Inc., Saitama, Gunma and Tokyo	1,311	Components, magnetic heads, document scanners and laser printers

Table of Contents

Name and location Domestic	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Canon Finetech Inc., Saitama, Ibaraki and Fukui	990	Large format inkjet printers, business-use printers, business machines peripherals and chemical products
Canon Precision Inc., Aomori	1,507	Toner cartridges, sensors and micromotors
Canon Optron Inc., Ibaraki	143	Optical crystals (for lithography equipment, cameras, telescopes) and vapor deposition materials
Canon Chemicals Inc., Ibaraki	2,098	Toner cartridges and rubber functional components
Canon Components, Inc., Saitama	539	Contact image sensors, inkjet cartridges and medical equipment
Oita Canon Inc., Oita	1,227	Digital cameras, lenses and digital video camcorders
Nagahama Canon Inc., Shiga	1,092	Laser printers, toner cartridges and A-Si drums
Oita Canon Materials Inc., Oita	3,049	Chemical products for copying machines and printers, and inkjet cartridges
Ueno Canon Materials Inc., Mie	654	Chemical products for copying machines and printers
Fukushima Canon Inc., Fukushima	971	Inkjet printers and inkjet cartridges
Canon Semiconductor Equipment Inc., Ibaraki	462	Development and production of semiconductor production-related equipment
Canon Ecology Industry Inc., Ibaraki	496	Recycling of toner cartridges, repair and recycling of business machines
Nisca Corporation, Yamanashi	388	Copying machine peripherals, scanner units and optical equipment
Miyazaki Daishin Canon Inc., Miyazaki	167	Digital cameras
Canon Mold Co., Ltd., Ibaraki	201	Molds
Canon ANELVA Corporation, Kanagawa and Yamanashi	735	Production equipment for electron devices, flat panel display and semiconductors
Canon Machinery Inc., Shiga	626	Automated production equipment and semiconductor production-related equipment
Canon Tokki Corporation, Niigata, Kanagawa and Tokyo	219	Vacuum technology-related equipment
Nagasaki Canon Inc., Nagasaki	413	Digital cameras

Table of Contents

Name and location	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Overseas		
<i>Europe</i>		
Canon Giessen GmbH, Giessen, Germany	336	Remanufacturing of copying machines and semiconductor production equipment
Canon Bretagne S.A.S., Liffre, France	506	Manufacturing and recycling of toner cartridges
Océ-Technologies B.V., Venlo, Netherlands	2,675	R&D, manufacturing copying machines, corporate administration, and other functions
Océ-Printing Systems GmbH, Poing, Germany	1,287	R&D, manufacturing copying machines, corporate administration, and other functions
<i>Americas</i>		
Canon Virginia, Inc., Virginia, U.S.	1,952	Toner cartridges, molds and remanufacturing of copying machines
Industrial Resource Technologies, Inc., Virginia, U.S.	185	Recycling of toner cartridges
<i>Asia</i>		
Canon Inc., Taiwan, Taiwan	761	Lenses, digital cameras
Canon Opto (Malaysia) Sdn. Bhd., Selangor, Malaysia	584	Digital cameras, lenses and optical lens parts
Canon Dalian Business Machines, Inc., Dalian, China	1,742	Production and recycling of toner cartridges, production of laser printers
Canon Zhuhai, Inc., Zhuhai, China	752	Laser printers, MFPs, digital cameras, digital video camcorders and contact image sensors
Tianjin Canon Inc., Tianjin, China	148	Copying machines
Canon Hi-Tech Thailand Ltd., Ayutthaya and Nakohon Ratchasima, Thailand	2,544	Inkjet printers, MFPs, scanners, molds and plastic injection molded parts
Canon Zhongshan Business Machines Co., Ltd., Zhogshan, China	496	Laser printers
Canon Vietnam Co., Ltd., Hanoi and Bac Ninh, Vietnam	3,245	Inkjet printers, laser printers, MFPs, scanners and contact image sensors
Canon (Suzhou) Inc., Suzhou, China	1,516	Copying machines
Canon Finetech Nisca (Shenzhen) Inc., Shenzhen, China	669	Copying machines and laser printer peripherals
Canon Electronics Vietnam Co., Ltd., Hung Yen Province, Vietnam	182	Components

Canon considers its manufacturing and other facilities to be well maintained and believes that its plant capacity is adequate for its current requirements. None of the buildings or land are subject to any major encumbrances.

Table of Contents**Main facilities under construction for establishment/expansion**

Name and location	Principal activities and products manufactured
Domestic	
Hita Canon Materials Inc., Oita	New administration and welfare building / New production base* (Office business unit)
	*To be leased to Hita Canon Materials Inc. by the Company
Canon Chemicals Inc., Ibaraki	New production base* (Office business unit)
	*To be leased to Canon Chemicals Inc. by the Company
Overseas	
Canon Zhuhai, Inc., Zhuhai, China	New production base (Consumer business unit)
Canon Inc., Taiwan, Taiwan	New production base (Consumer business unit)
Canon Zhongshan Business Machines Co., Ltd., Zhogshan, China	New production base (Office business unit)

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects**A. Operating Results**

The following discussion and analysis provides information that management believes to be relevant to understanding Canon's consolidated financial condition and results of operations.

Overview

Canon is one of the world's leading manufacturers of plain paper copying machines, digital multifunction devices (MFDs), laser printers, cameras, inkjet printers, semiconductor lithography equipment and liquid crystal display (LCD) lithography equipment. Canon earns revenues primarily from the manufacture and sale of these products domestically and internationally. Canon's basic management policy is to contribute to the prosperity and well-being of the world while endeavoring to become a truly excellent global corporate group targeting continued growth and development.

Canon divides its businesses into three segments: the Office Business Unit, the Consumer Business Unit, and the Industry and Others Business Unit.

Economic environment

Looking back at the global economy in 2011, amid increasing uncertainty in the second half of the year as the pace of recovery decelerated due to economic downturn in the United States and Europe, the economy as a whole continued to grow moderately, primarily driven by emerging economies. In the United States, a lack of improvement in employment conditions and housing problems led to a lower rate of growth, while in Europe, the sovereign debt crisis negatively affected the real economy, which led to a noticeable slowdown in recovery. Emerging markets, such as China and India, maintained a high rate of growth amid concerns over the effects of tight monetary policies. In Japan, severe circumstances persisted following the Great East Japan Earthquake in March and, just as production activities began showing signs of recovery, Thailand was hit with massive flooding in October, resulting in a slowdown of the economy.

Table of Contents*Market environment*

As for the markets in which Canon operates amid these conditions, within the office equipment market, demand for color network digital MFDs showed growth in all regions around the globe. As for laser printers, while robust demand in emerging markets fueled growth, European markets cooled in the second half of the year. Within the consumer products market, demand for digital SLR cameras continued to display healthy growth across global markets while demand for compact digital cameras grew in emerging nations but remained sluggish in developed countries. Overall demand for inkjet printers was supported by steady growth in emerging economies. In the industry and others market, despite somewhat restrained investment in semiconductor lithography equipment used to manufacture DRAM memory devices, the market recorded robust growth overall. As for LCD lithography equipment, despite solid demand for equipment to manufacture mid- and small-size LCD panels used in smartphones, demand for equipment used to manufacture large-size LCD panels remained sluggish.

The average value of the yen during the year was ¥79.55 against the U.S. dollar, a year-on-year appreciation of approximately ¥8 or 9%, and ¥110.72 against the euro, a year-on-year appreciation of approximately ¥4 or 4%.

Summary of operations

Owing to the historically high valuation of the yen combined with the effects of the earthquake and floods, all of Canon's businesses faced extremely demanding conditions throughout the year. Amid this harsh environment, Group-wide efforts to swiftly restore production in the aftermath of the disasters, coupled with efforts to maximize production and boost sales, led to net sales for the year totaling ¥3,557.4 billion, a year-on-year decline of 4.0%. Despite the significant negative impact of the strong yen and the effects of the earthquake and floods, the gross profit ratio rose 0.7 points year-on-year to 48.8%, owing to the further acceleration of production innovation activities. Gross profit, however, decreased by 2.6% to ¥1,736.8 billion for the year. Operating expenses totaled ¥1,358.7 billion, a decrease of 2.6%, owing to comprehensive spending cuts across the Canon Group implemented after the earthquake to control expenses more efficiently. Cost-reduction and expense-cutting activities contributed to further reinforcing the company's financial structure, which helped make up for the significant drop in revenue in the first half of the year mainly triggered by the earthquake, while also absorbing the financial impact of the strong yen and the floods in the second half of the year. As a result, operating profit dipped 2.4% to ¥378.1 billion for the year and other income (deductions) declined ¥8.9 billion, mainly due to foreign currency exchange losses, leading to income before income taxes of ¥374.5 billion, a decrease of 4.7% year-on-year. Net income attributable to Canon Inc., however, grew by 0.8% to ¥248.6 billion for the year owing to the lower effective income tax rate compared with the previous year.

Key performance indicators

The following are the key performance indicators (KPIs) that Canon uses in managing its business. The changes from year to year in these KPIs are set forth in the table shown below.

KEY PERFORMANCE INDICATORS

	2011	2010	2009	2008	2007
Net sales (Millions of yen)	¥ 3,557,433	¥ 3,706,901	¥ 3,209,201	¥ 4,094,161	¥ 4,481,346
Gross profit to net sales ratio	48.8%	48.1%	44.5%	47.3%	50.1%
R&D expense to net sales ratio	8.7%	8.5%	9.5%	9.1%	8.2%
Operating profit to net sales ratio	10.6%	10.5%	6.8%	12.1%	16.9%
Inventory turnover measured in days	46 days	35 days	39 days	47 days	44 days
Debt to total assets ratio	0.3%	0.3%	0.3%	0.4%	0.6%
Canon Inc. stockholders' equity to total assets ratio	64.9%	66.4%	69.9%	67.0%	64.8%

Note: Inventory turnover measured in days; Inventory divided by net sales for the previous six months, multiplied by 182.5.

Table of Contents

-Revenues-

As Canon pursues the goal to become a truly excellent global company, one indicator upon which Canon's management places strong emphasis is revenue. The following are some of the KPIs related to revenue that management considers to be important.

Net sales is one such KPI. Canon derives net sales primarily from the sale of products and, to a much lesser extent, provision of services associated with its products. Sales vary depending on such factors as product demand, the number and size of transactions within the reporting period, market acceptance for new products, and changes in sales prices. Other factors involved are market share and market environment. In addition, management considers the evaluation of net sales by segment to be important for the purpose of assessing Canon's sales performance in various segments, taking into account recent market trends.

Gross profit ratio (ratio of gross profit to net sales) is another KPI for Canon. Through its reforms of product development, Canon has been striving to shorten product development lead times in order to launch new, competitively priced products at a faster pace. Furthermore, Canon has further achieved cost reductions through enhancement of efficiency in its production. Canon believes that these achievements have contributed to improving Canon's gross profit ratio, and will continue pursuing the curtailment of product development lead times and reductions in production costs.

Operating profit ratio (ratio of operating profit to net sales) and research and development (R&D) expense to net sales ratio are considered to be KPIs by Canon. Canon is focusing on two areas for improvement. Canon is striving to control and reduce its selling, general and administrative expenses as its first key point. Secondly, Canon's R&D policy is designed to maintain a certain level of spending in core technology to sustain Canon's leading position in its current business areas and to seek possibilities in other markets. Canon believes such investments will create the basis for future success in its business and operations.

-Cash flow management-

Canon also places significant emphasis on cash flow management. The following are the KPIs with regard to cash flow management that Canon's management believes to be important.

Inventory turnover measured in days is a KPI because it measures the adequacy of supply chain management. Inventories have inherent risks of becoming obsolete, physically damaged or otherwise decreasing significantly in value, which may adversely affect Canon's operating results. To mitigate these risks, management believes that it is crucial to continue reducing inventories and decrease production lead times in order to promptly recover related product expenses by strengthening supply chain management.

Canon's management seeks to meet its liquidity and capital requirements primarily with cash flow from operations. Management also seeks debt-free operations. For a manufacturing company like Canon, it generally takes considerable time to realize profit from a business as the process of R&D, manufacturing and sales has to be followed for success. Therefore, management believes that it is important to have sufficient financial strength so that the Company does not have to rely on external funds. Canon has continued to reduce its dependency on external funds for capital investments in favor of generating the necessary funds from its own operations.

Canon Inc. stockholders' equity to total assets ratio is another KPI for Canon. Canon believes that its stockholders' equity to total assets ratio measures its long-term sustainability. Canon also believes that achieving a high or rising stockholders' equity ratio indicates that Canon has maintained a strong financial position or further improved its ability to fund debt obligations and other unexpected expenses. In the long-term, Canon will be able to maintain a high level of stable investments for its future operations and development. As Canon puts strong emphasis on its R&D activities, management believes that it is important to maintain a stable financial base and, accordingly, a high level of its stockholders' equity to total assets ratio.

Table of Contents

Critical accounting policies and estimates

The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) and based on the selection and application of significant accounting policies which require management to make significant estimates and assumptions. Canon believes that the following are the more critical judgment areas in the application of its accounting policies that currently affect its financial condition and results of operations.

Revenue recognition

Canon generates revenue principally through the sale of consumer products, equipment, supplies, and related services under separate contractual arrangements. Canon recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have been transferred to the customer or services have been rendered, the sales price is fixed or determinable, and collectibility is probable.

Revenue from sales of office products, such as office network digital multifunction devices and laser printers, and consumer products, such as digital cameras and inkjet multifunction printers, is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

Revenue from sales of optical equipment, such as semiconductor lithography equipment and LCD lithography equipment that are sold with customer acceptance provisions related to their functionality, is recognized when the equipment is installed at the customer site and the specific criteria of the equipment functionality are successfully tested and demonstrated by Canon. Service revenue is derived primarily from separately priced product maintenance contracts on equipment sold to customers and is measured at the stated amount of the contract and recognized as services are provided.

Canon also offers separately priced product maintenance contracts for most office imaging products, for which the customer typically pays a stated base service fee plus a variable amount based on usage. Revenue from these service maintenance contracts is measured at the stated amount of the contract and recognized as services are provided and variable amounts are earned.

Revenue from the sale of equipment under sales-type leases is recognized at the inception of the lease. Income on sales-type leases and direct-financing leases is recognized over the life of each respective lease using the interest method. Leases not qualifying as sales-type leases or direct-financing leases are accounted for as operating leases and the related revenue is recognized ratably over the lease term. When equipment leases are bundled with product maintenance contracts, revenue is first allocated considering the relative fair value of the lease and non-lease deliverables based upon the estimated relative fair values of each element. Lease deliverables generally include equipment, financing and executory costs, while non-lease deliverables generally consist of product maintenance contracts and supplies.

For all other arrangements with multiple elements, Canon allocates revenue to each element based on its relative selling price if such element meets the criteria for treatment as a separate unit of accounting. Otherwise, revenue is deferred until the undelivered elements are fulfilled and accounted for as a single unit of accounting.

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions in sales are based upon historical trends and other known factors at the time of sale. In addition, Canon provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

Estimated product warranty costs are recorded at the time revenue is recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure.

Table of Contents

Allowance for doubtful receivables

Allowance for doubtful receivables is determined using a combination of factors to ensure that Canon's trade and financing receivables are not overstated due to uncollectibility. These factors include the length of time receivables are past due, the credit quality of customers, macroeconomic conditions and historical experience. Also, Canon records specific reserves for individual accounts when Canon becomes aware of a customer's inability to meet its financial obligations to Canon, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted.

Valuation of inventories

Inventories are stated at the lower of cost or market value. Cost is determined by the average method for domestic inventories and principally the first-in, first-out method for overseas inventories. Market value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make a sale. Canon routinely reviews its inventories for their salability and for indications of obsolescence to determine if inventories should be written-down to market value. Judgments and estimates must be made and used in connection with establishing such allowances in any accounting period. In estimating the market value of its inventories, Canon considers the age of the inventories and the likelihood of spoilage or changes in market demand for its inventories.

Impairment of long-lived assets

Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Determining the fair value of the asset involves the use of estimates and assumptions. These estimates and assumptions include future market conditions, net sales growth rate, gross margin and discount rate. Though Canon believes that the estimates and assumptions are reasonable, actual future results may differ from these estimates and assumptions.

Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally by the declining-balance method, except for certain assets which are depreciated by the straight-line method over the estimated useful lives of the assets.

Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful life of 3 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years.

Table of Contents

Income taxes

Canon considers many factors when evaluating and estimating income tax uncertainties. These factors include an evaluation of the technical merits of the tax positions as well as the amounts and probabilities of the outcomes that could be realized upon settlement. The actual resolutions of those uncertainties will inevitably differ from those estimates, and such differences may be material to the financial statements.

Valuation of deferred tax assets

Canon currently has significant deferred tax assets, which are subject to periodic recoverability assessments. Realization of Canon's deferred tax assets is principally dependent upon its achievement of projected future taxable income. Canon's judgments regarding future profitability may change due to future market conditions, its ability to continue to successfully execute its operating restructuring activities and other factors. Any changes in these factors may require possible recognition of significant valuation allowances to reduce the net carrying value of these deferred tax asset balances. When Canon determines that certain deferred tax assets may not be recoverable, the amounts, which may not be realized, are charged to income tax expense and will adversely affect net income.

Employee retirement and severance benefit plans

Canon has significant employee retirement and severance benefit obligations that are recognized based on actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets. Management must consider current market conditions, including changes in interest rates, in selecting these assumptions. Other assumptions include assumed rate of increase in compensation levels, mortality rate, and withdrawal rate. Changes in these assumptions inherent in the valuation are reasonably likely to occur from period to period. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect future pension expenses. While management believes that the assumptions used are appropriate, the differences may affect employee retirement and severance benefit costs in the future.

In preparing its financial statements for fiscal 2011, Canon estimated a weighted-average discount rate of 2.1% for Japanese plans and 4.9% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.6% for Japanese plans and 5.7% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income governmental and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. A decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately 8%. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For fiscal 2011, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥3,204 million in net periodic benefit cost. Canon multiplies management's expected long-term rate of return on plan assets by the value of its plan assets, to arrive at the expected return on plan assets that is included in pension expense. Canon defers recognition of the difference between this expected return on plan assets and the actual return on plan assets. The net deferral affects future pension expense.

Table of Contents

Canon recognizes the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in its consolidated balance sheets, with a corresponding adjustment to accumulated other comprehensive income (loss), net of tax.

Consolidated results of operations**Fiscal 2011 compared with fiscal 2010**

Summarized results of operations for fiscal 2011 and fiscal 2010 are as follows:

	2011	Change	2010
	(Millions of yen, except per share)		
	amounts and percentage data)		
Net sales	¥ 3,557,433	-4.0%	¥ 3,706,901
Operating profit	378,071	-2.4	387,552
Income before income taxes	374,524	-4.7	392,863
Net income attributable to Canon Inc.	248,630	0.8	246,603
Net income attributable to Canon Inc. stockholders per share:			
Basic	204.49	2.4	199.71
Diluted	204.48	2.4	199.70

Note: See notes to Item 3A Selected Financial Data .

Sales

Canon's consolidated net sales in fiscal 2011 totaled ¥3,557,433 million, representing a 4.0% decrease from the previous fiscal year. This decrease of sales was owing to the historically high valuation of the yen combined with the effects of the earthquake and floods. All of Canon's businesses faced extremely demanding conditions throughout the year.

Overseas operations are significant to Canon's operating results and generated 80.5% of total net sales in fiscal 2011. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen in fiscal 2011 was ¥79.55 to the U.S. dollar, and ¥110.72 to the euro, representing a significant appreciation of about ¥8 or 9% to the U.S. dollar, and an appreciation of approximately ¥4 or 4% against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively affected net sales by approximately ¥161,900 million in 2011. This unfavorable impact consisted of approximately ¥111,600 million for U.S. dollar denominated sales, ¥40,600 million for euro denominated sales and ¥9,700 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses along with rent expenses. The ratio of cost of sales to net sales for fiscal 2011 and 2010 was 51.2% and 51.9%, respectively.

Table of Contents*Gross profit*

Canon's gross profit in fiscal 2011 decreased by 2.6% to ¥1,736,763 million from fiscal 2010. The gross profit ratio, however, rose by 0.7 points year on year to 48.8%. Despite the significant negative impact of the strong yen and the effects of the earthquake and floods, this gross profit ratio improvement was achieved due to the further acceleration of production innovation activities.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Owing to thorough spending cuts across the Canon Group implemented after the earthquake to control expenses more efficiently, total operating expenses decreased by 2.6% to ¥1,358,692 million in fiscal 2011.

Operating profit

Operating profit in fiscal 2011 decreased 2.4% to a total of ¥378,071 million from fiscal 2010. The ratio of operating profit to net sales increased 0.1% to 10.6% from fiscal 2010.

Other income (deductions)

Other income (deductions) for fiscal 2011 decreased ¥8,858 million to ¥ (3,547) million, mainly due to foreign currency exchange losses and earnings and losses on investments in affiliated companies.

Income before income taxes

Income before income taxes in fiscal 2011 was ¥374,524 million, a decrease of 4.7% from fiscal 2010, and constituted 10.5% of net sales.

Income taxes

Provision for income taxes in fiscal 2011 decreased by ¥19,745 million from fiscal 2010. The effective tax rate during fiscal 2011 dropped by 3.5% compared with fiscal 2010.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in fiscal 2011 increased by 0.8% to ¥248,630 million, which represents a 7.0% return on net sales.

Segment information

Canon divides its businesses into three segments: the Office Business Unit, the Consumer Business Unit and the Industry and Others Business Unit.

The Office Business Unit mainly includes office network digital multifunction devices (MFDs), color network digital MFDs, personal-use network digital MFDs, office copying machines, full-color copying machines, personal-use copying machines, laser printers, large format inkjet printers and digital production printers.

The Consumer Business Unit mainly includes digital SLR cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction printers, single function inkjet printers, image scanners, broadcast equipment and calculators.

The Industry and Others Business Unit mainly includes semiconductor lithography equipment, LCD lithography equipment, medical image recording equipment, ophthalmic products, magnetic heads, micromotors, computers, handy terminals and document scanners.

Table of Contents**Sales by segment**

Please refer to the table of sales by segment in Note 22 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

	2011 (Millions of yen, except percentage data)	Change	2010
Office	¥ 1,917,943	-3.5%	¥ 1,987,269
Consumer	1,312,044	-5.7	1,391,327
Industry and Others	420,863	-2.8	432,958
Eliminations	(93,417)		(104,653)
Total	¥ 3,557,433	-4.0%	¥ 3,706,901

Sales of the Office Business Unit constituting 53.9% of consolidated net sales. Sales volume of color and monochrome network digital MFDs continued to increase. As for laser printers, while booming demand in emerging economies fueled steady unit sales growth of primarily monochrome models in the first half of the year, demand slowed in the second half, mainly in European markets. However, the appreciation of the yen also significantly impacted sales for the segment, resulting a decrease in sales by 3.5% to ¥1,917,943 million in fiscal 2011.

Sales of the Consumer Business Unit constituting 36.9% of consolidated net sales. Although Canon was affected by supply shortages caused by the quake and flooding, efforts to ramp up production and boost sales in response to robust demand resulted in significant increases in year-on-year sales volumes for such digital SLR cameras as the competitively priced EOS Digital Rebel T3i/T2i/T3, along with the EOS 5D Mark II and the new EOS 60D advanced-amateur models. As for compact digital cameras, while such models as the PowerShot ELPH 100 HS/300 HS, PowerShot SX230 HS and PowerShot ELPH 310 HS recorded healthy sales, unit sales for the year declined due to sluggish markets in developed countries and the impact on production following the earthquake and floods. With respect to inkjet printers, although the floods in Thailand had a negative impact on production, unit sales increased year on year, largely owing to growth in emerging markets. As a result, sales for the segment, which were also negatively affected by the strong yen, dropped 5.7% in fiscal 2011 to ¥1,312,044 million.

Sales of the Industry and Others Business Unit decreased by 2.8% in fiscal 2011, to ¥420,863 million. Within this segment, i-line steppers recorded healthy sales thanks to active investment in semiconductor lithography equipment for the manufacture of digital semiconductor devices, which are used in smartphones and environmentally friendly products. Unit sales of LCD lithography equipment, on the other hand, dropped substantially in the face of shrinking demand for equipment used in the production of large-size panels. Sales of the Industry and Others Business Unit constituted 11.8% of consolidated net sales in fiscal 2011.

Intersegment sales of ¥93,417 million, representing 2.6% of total sales, are eliminated from the total sales of the three segments, and are described as Eliminations.

Sales by geographic area

Please refer to the table of sales by geographic area in Note 22 of the Notes to Consolidated Financial Statements.

Table of Contents

A summary of net sales by geographic area in fiscal 2011 and fiscal 2010 is provided below:

	2011 (Millions of yen, except percentage data)	Change	2010
Japan	¥ 694,450	-0.2%	¥ 695,749
Americas	961,955	-6.0	1,023,299
Europe	1,113,065	-5.1	1,172,474
Asia and Oceania	787,963	-3.4	815,379
Total	¥ 3,557,433	-4.0%	¥ 3,706,901

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customers. A geographical analysis indicates that net sales in fiscal 2011 decreased in all geographic areas.

In Japan, sales decreased by 0.2% in fiscal 2011.

In the Americas, net sales decreased by 6.0% on yen basis in fiscal 2011, due to foreign currency exchange losses. Net sales in local currency basis increased by 2.5%.

In Europe, net sales decreased by 5.1% on yen basis in fiscal 2011, mainly due to sluggish demand for laser printers.

Sales in Asia and Oceania decreased by 3.4% on a yen basis in fiscal 2011, largely due to shrinking demand for LCD lithography equipment and foreign currency exchange losses.

Operating profit by segment

Please refer to the table of segment information in Note 22 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in fiscal 2011 decreased by ¥34,057 million to ¥259,265 million. This decrease resulted primarily from the decrease in sales.

Operating profit for the Consumer Business Unit in fiscal 2011 decreased by ¥26,771 million to ¥211,294 million. This decrease resulted primarily from the decrease in sales.

Operating profit for the Industry and Others Business Unit in fiscal 2011 recorded a profit of ¥24,300 million a turnaround from fiscal 2010, largely owing to the improvement of the gross profit ratio.

Fiscal 2010 compared with fiscal 2009

Summarized results of operations for fiscal 2010 and fiscal 2009 are as follows:

	2010	Change	2009
	(Millions of yen, except per share amounts and percentage data)		
Net sales	¥ 3,706,901	15.5%	¥ 3,209,201
Operating profit	387,552	78.6	217,055
Income before income taxes	392,863	79.1	219,355

Edgar Filing: CANON INC - Form 20-F

Net income attributable to Canon Inc.	246,603	87.3	131,647
Net income attributable to Canon Inc. stockholders per share:			
Basic	199.71	87.3	106.64
Diluted	199.70	87.3	106.64

Note: See notes to Item 3A Selected Financial Data .

Table of Contents

Sales

Canon's consolidated net sales in fiscal 2010 totaled ¥3,706,901 million, representing a 15.5% increase from the previous fiscal year. This increase of sales was due to a substantial recovery in sales of laser printers among office products, continued robust sales of such consumer products as digital SLR cameras, the increase in sales within the Industry and Others Business Unit, and the effects of consolidation arising from corporate acquisitions, such as Océ N.V. (Océ). Canon made Océ into a consolidated subsidiary in March 2010 to strengthen the printing business. Océ is engaged in research and development, manufacture and sale of document management systems, printing systems for professionals and high-speed, wide-format digital printing systems. The amounts of net sales of Océ included in the Canon's consolidated statement of income from the acquisition date to the year ended December 31, 2010 was ¥246,518 million.

Overseas operations are significant to Canon's operating results and generated approximately 81.2% of total net sales in fiscal 2010. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen in fiscal 2010 was ¥87.40 to the U.S. dollar, and ¥114.97 to the euro, representing an appreciation of about ¥6 or 6% to the U.S. dollar, and a significant appreciation of approximately ¥15 or 12% against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively affected net sales by approximately ¥193,900 million in 2010. This unfavorable impact consisted of approximately ¥86,700 million for U.S. dollar denominated sales, ¥101,100 million for euro denominated sales and ¥6,100 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses along with rent expenses. The ratio of cost of sales to net sales for fiscal 2010 and 2009 was 51.9% and 55.5%, respectively.

Gross profit

Canon's gross profit in fiscal 2010 increased by 24.9% to ¥1,783,088 million from fiscal 2009. The gross profit ratio rose by 3.6 points year on year to 48.1%. Despite the significant impact of the strong yen, this improvement was achieved due to the launch of new products and ongoing cost-reduction efforts, along with heightened production turnover accompanying ramped-up production.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Despite the negative impact of consolidation of ¥172,800 million, continued Group-wide efforts to significantly reduce spending contributed to a decline in total operating expenses to sales ratio of 37.6% for fiscal 2010, a 0.1 point improvement compared with fiscal 2009.

Operating profit

Operating profit in fiscal 2010 increased 78.6% to a total of ¥387,552 million from fiscal 2009, constituting 10.5% of net sales.

Table of Contents*Other income (deductions)*

Other income (deductions) for fiscal 2010 improved by ¥3,011 million, mainly due to earnings and losses on investments in affiliated companies.

Income before income taxes

Income before income taxes in fiscal 2010 was ¥392,863 million, an increase of 79.1% from fiscal 2009, and constituted 10.6% of net sales.

Income taxes

Provision for income taxes in fiscal 2010 increased by ¥56,038 million from fiscal 2009, primarily as a result of the increase in income before income taxes. The effective tax rate during fiscal 2010 dropped by 2.6% compared with fiscal 2009. This was due mainly to an increase in tax deduction for R&D expenses in fiscal 2010.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in fiscal 2010 increased by 87.3% to ¥246,603 million, which represents a 6.7% return on net sales.

Segment information

Canon divides its businesses into three segments: the Office Business Unit, the Consumer Business Unit and the Industry and Others Business Unit.

The Office Business Unit mainly includes office network digital multifunction devices(MFDs), color network digital MFDs, personal-use network digital MFDs, office copying machines, full-color copying machines, personal-use copying machines, laser printers, large format inkjet printers and digital production printers.

The Consumer Business Unit mainly includes digital SLR cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction peripheral, single function inkjet printers, image scanners and broadcast equipment.

The Industry and Others Business Unit mainly includes semiconductor lithography equipment, LCD lithography equipment, medical image recording equipment, ophthalmic devices, magnetic heads, micromotors, computers, handy terminals, document scanners and calculators.

Sales by segment

Please refer to the table of sales by segment in Note 22 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

	2010	Change	2009
	(Millions of yen, except percentage data)		
Office	¥ 1,987,269	20.8%	¥ 1,645,076
Consumer	1,391,327	6.9	1,301,160
Industry and Others	432,958	20.9	357,998
Eliminations	(104,653)		(95,033)
Total	¥ 3,706,901	15.5%	¥ 3,209,201

Sales of the Office Business Unit constituting 53.6% of consolidated net sales, increased by 20.8% to ¥1,987,269 million in fiscal 2010. Sales volume of both color and monochrome network digital MFDs increased,

Table of Contents

boosted by the recovery in demand for office equipment along with the introduction of new imageRUNNER ADVANCE-series products. Laser printers recorded a substantial increase in sales volume. The consolidation of Océ also contributed to the sales increase.

Sales of the Consumer Business Unit constituting 37.5% of consolidated net sales, increased by 6.9% to ¥1,391,327 million in fiscal 2010. Sales volumes increased significantly for such digital SLR cameras as EOS Digital Rebel T1i (EOS 500D) and new EOS Digital Rebel T2i (EOS 550D), the competitively priced model, along with the EOS 5D Mark II, EOS 7D and new 60D, the advanced-amateur models. As for compact digital cameras, the Company launched five new ELPH (IXUS)-series models and seven new PowerShot-series models, boosting sales volumes particularly in emerging markets. As for inkjet printers, sales volume increased from year-ago level particularly in Asia.

Sales of the Industry and Others Business Unit increased by 20.9% in fiscal 2010, to ¥432,958 million. Within this segment, sales volume of LCD lithography equipment, semiconductor lithography and semiconductor-related independent business sales by Group subsidiaries increased. Sales of the Industry and Others Business Unit constituted 11.7% of consolidated net sales in fiscal 2010.

Intersegment sales of ¥104,653 million, representing 2.8% of total sales, are eliminated from the total sales of the three segments, and are described as Eliminations .

Sales by geographic area

Please refer to the table of sales by geographic area in Note 22 of the Notes to Consolidated Financial Statements.

A summary of net sales by geographic area in fiscal 2010 and fiscal 2009 is provided below:

	2010	Change	2009
	(Millions of yen, except percentage data)		
Japan	¥ 695,749	-0.9%	¥ 702,344
Americas	1,023,299	14.4	894,154
Europe	1,172,474	17.8	995,150
Asia and Oceania	815,379	32.0	617,553
Total	¥ 3,706,901	15.5%	¥ 3,209,201

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customers. A geographical analysis indicates that net sales in fiscal 2010 increased in the major geographic areas.

In Japan, sales decreased by 0.9% in fiscal 2010.

In the Americas, net sales increased by 14.4% on yen basis in fiscal 2010, due to an increase in sales volume of digital SLR cameras and laser printers.

In Europe, net sales increased by 17.8% on yen basis in fiscal 2010, mainly due to rebounded sales of laser printers.

Sales in Asia and Oceania increased by 32.0% on a yen basis in fiscal 2010, largely due to the increased sales of digital SLR cameras.

Operating profit by segment

Please refer to the table of segment information in Note 22 of the Notes to Consolidated Financial Statements.

Table of Contents

Operating profit for the Office Business Unit in fiscal 2010 increased by ¥63,926 million to ¥293,322 million. This increase resulted primarily from the increase in sales.

Operating profit for the Consumer Business Unit in fiscal 2010 increased by ¥54,573 million to ¥238,065 million. This increase resulted primarily from the increase in sales.

Operating profit for the Industry and Others Business Unit in fiscal 2010 was a loss of ¥9,831 million. Significant recovery of sales volume contributed to reduction of loss amount by ¥66,125 million.

Foreign operations and foreign currency transactions

Canon's marketing activities are performed by subsidiaries in various regions in local currencies, while the cost of sales is generally in yen. Given Canon's current operating structure, appreciation of the yen has a negative impact on net sales and the gross profit ratio. To reduce the financial risks from changes in foreign exchange rates, Canon utilizes derivative financial instruments, which consist principally of forward currency exchange contracts.

The operating profit on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. Please refer to the table of geographic information in Note 22 of the Notes to Consolidated Financial Statements.

B. Liquidity and capital resources

Cash and cash equivalents in fiscal 2011 decreased by ¥67,352 million to ¥773,227 million, compared with ¥840,579 million in fiscal 2010 and ¥795,034 million in fiscal 2009. Canon's cash and cash equivalents are typically denominated both in Japanese yen and in U.S. dollar, with the remainder denominated in foreign currencies.

Net cash provided by operating activities in fiscal 2011 decreased by ¥274,851 million from the previous year to ¥469,562 million. Cash flow from operating activities consisted of the following key components: the major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, and income taxes.

For fiscal 2011, cash inflow from cash received from customers decreased due to the decrease of sales. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials increased, as a result of our efforts to optimize inventory levels in order to avoid losing potential sales opportunities while simultaneously increasing flexibility in response to unexpected risks and events. Cash outflow for payments for selling, general and administrative expenses decreased owing to thorough spending cuts across the Canon Group implemented after the earthquake to control expenses more efficiently. Cash outflow for income taxes decreased due to decrease of taxable income.

Net cash used in investing activities in fiscal 2011 was ¥256,543 million, decreased by ¥85,590 million from ¥342,133 million in fiscal 2010, mainly as a result of corporate acquisition conducted in the previous year. The purchases of fixed assets, which totaled ¥238,129 million in fiscal 2011, were focused on items relevant to raising production capacity and reducing production cost.

Canon defines "free cash flow" by deducting the cash flows from investing activities from the cash flows from operating activities. For fiscal 2011, free cash flow totaled ¥213,019 million as compared with ¥402,280 million for fiscal 2010. Canon's management recognizes that constant and intensive investment in facilities and R&D is required to maintain and strengthen the competitiveness of its products. Canon's management seeks to meet its capital requirements with cash flow principally earned from its operations,

Table of Contents

therefore, its capital resources are primarily sourced from internally generated funds. Accordingly, Canon has included the information with regard to free cash flow as its management frequently monitors this indicator, and believes that such indicator is beneficial to the understanding of investors. Furthermore, Canon's management believes that this indicator is significant in understanding Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities. Canon refers to this indicator together with relevant U.S. GAAP financial measures shown in its consolidated statements of cash flows and consolidated balance sheets for cash availability analysis.

Net cash used in financing activities totaled ¥257,513 million in fiscal 2011, mainly resulting from the dividend payout of ¥152,784 million, and repurchase of treasury stock. The Company paid dividends in fiscal 2011 of ¥125.00 per share.

To the extent Canon relies on external funding for its liquidity and capital requirements, it generally has access to various funding sources, including the issuance of additional share capital, long-term debt or short-term loans. While Canon has been able to obtain funding from its traditional financing sources and from the capital markets, and believes it will continue to be able to do so in the future, there can be no assurance that adverse economic or other conditions will not affect Canon's liquidity or long-term funding in the future.

Short-term loans (including the current portion of long-term debt) amounted to ¥8,343 million at December 31, 2011 compared with ¥7,200 million at December 31, 2010. Long-term debt (excluding the current portion) amounted to ¥3,368 million at December 31, 2011 compared with ¥4,131 million at December 31, 2010.

Canon's long-term debt (excluding the current portion) mainly consists of lease obligations.

In order to facilitate access to global capital markets, Canon obtains credit ratings from two rating agencies: Moody's Investors Services, Inc. (Moody's) and Standard and Poor's Ratings Services (S&P). In addition, Canon maintains a rating from Rating and Investment Information, Inc. (R&I), a rating agency in Japan, for access to the Japanese capital market.

As of March 15, 2012, Canon's debt ratings are: Moody's: Aa1 (long-term); S&P: AA (long-term), A-1+ (short-term); and R&I: AA+ (long-term). Canon does not have any rating downgrade triggers that would accelerate the maturity of a material amount of its debt. A downgrade in Canon's credit ratings or outlook could, however, increase the cost of its borrowings.

Increase in property, plant and equipment on an accrual basis in fiscal 2011 amounted to ¥226,869 million compared with ¥158,976 million in fiscal 2010 and ¥216,128 million in fiscal 2009. For fiscal 2012, Canon projects its increase in property, plant and equipment will be approximately ¥300,000 million.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥30,510 million in fiscal 2011, ¥21,435 million in fiscal 2010 and ¥18,232 million in fiscal 2009. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥12,511 million in fiscal 2011, ¥11,780 million in fiscal 2010, and ¥9,148 million in fiscal 2009.

Working capital in fiscal 2011 increased by ¥25,969 million, to ¥1,259,457 million, compared with ¥1,233,488 million in fiscal 2010 and ¥1,234,089 million in fiscal 2009. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for fiscal 2011 was 2.41 compared to 2.38 for fiscal 2010 and to 2.57 for fiscal 2009.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 6.3% in fiscal 2011, compared to 6.3% in fiscal 2010 and 3.4% in fiscal 2009.

Table of Contents

Return on Canon Inc. stockholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. stockholders' equity) was 9.6% in fiscal 2011 compared with 9.2% in fiscal 2010 and 4.9% in fiscal 2009.

Debt to total assets ratio was 0.3%, 0.3% and 0.3% as of December 31, 2011, 2010 and 2009, respectively. Canon had short-term loans and long-term debt of ¥11,711 million as of December 31, 2011, ¥11,331 million as of December 31, 2010 and ¥9,781 million as of December 31, 2009.

C. Research and development, patents and licenses

Year 2011 marks the first year of the Excellent Global Corporation Plan, its 5-year (2011-2015) management plan. The slogan of the fourth phase (Phase IV) is "Aiming for the Summit Speed & Sound Growth" and there are three core strategies related to R&D:

Achieve the overwhelming No.1 position in all core businesses and related and peripheral businesses;
Develop new business through globalized diversification and establish the Three Regional Headquarters management system; and
Build the foundations of an environmentally advanced corporation.

Canon has been striving to implement the three R&D related strategies as follows:

Achieve the overwhelming No.1 position in all core businesses and related and peripheral businesses: Continue to introduce competitive products through innovation and shift to a business that can gain profit through solutions and services.
Develop new business through globalized diversification and establish the Three Regional Headquarters management system:
Reinforce capability to create innovative products and systems of commercial printing sector, medical imaging sector, industrial equipment sector and security and safety sector. Expand our innovation center by enhancing research and development operations in Europe and the United States. Seek M&A opportunities to accelerate this strategy.
Build the foundations of an environmentally advanced corporation; Focus our attention on energy- and resource-conserving technologies to create products with the highest environmental performance.

Canon has developed and strengthened relationships with universities and other research institutes, such as Kyoto University, Tokyo Institute of Technology, Stanford University, the University of Arizona, the New Energy and Industrial Technology Development Organization and the National Institute of Advanced Industrial Science and Technology to assist with fundamental research and to develop cutting-edge technologies.

Canon has fully introduced 3D-CAD systems across the Canon group, boosting R&D efficiency to curtail product development times and costs. Moreover, Canon enhanced and evolved its simulation, measurement, and analysis technologies by establishing leading-edge facilities, including one of Japan's highest-performance cluster computers. As such, Canon has succeeded in further reducing the need for prototypes, dramatically lowering costs and shortening product development lead times.

Canon has R&D centers worldwide. Each R&D center is collaborating with other centers to achieve synergies, and is cultivating closer ties in fields ranging from basic research to product development.

Canon's consolidated R&D expenses were ¥307,800 million in fiscal 2011, ¥315,817 million in fiscal 2010 and ¥304,600 million in fiscal 2009. The ratios of R&D expenses to the consolidated total net sales for fiscal 2011, 2010 and 2009 were 8.7%, 8.5% and 9.5%, respectively.

Canon believes that new products protected by patents will not easily allow competitors to compete with them, and will give them an advantage in establishing standards in the market and industry. According to the United States patent annual list, which IFI CLAIMS® Patent Services released, Canon obtained the third greatest number of private sector patents in 2011.

Table of Contents

D. Trend information

Looking at prospects for the global economy, considerable time will likely be required before the economies of developed nations such as the United States and Europe see an accelerated economic recovery. As for emerging markets, although these economies are expected to continue growing, the pace of growth will likely slow down slightly. As for Japan, the economy is expected to move towards a gradual recovery, supported by reconstruction-based demand.

Amid these conditions, in 2012, the second year of Phase IV (2011-2015) of our Excellent Global Corporation Plan, Canon aims to again return to a path of growth, overcoming such challenges as the earthquake and flooding. The Company's basic policy for this year is to pursue fundamental reforms, embracing the challenging environment as an opportunity to leap forward. Under this theme, we hope to build a solid foundation for growth as a means to achieve our Phase IV goals.

In order to achieve our targets, Canon has set and will actively pursue the following eight priority goals.

Boost the competitiveness of current core products, by refining and further accelerating development and design capabilities with the aid of information technologies to enable planning and timely launch of exceptional products and services that are unmatched by the competition. We expect to focus on the creation of products and services that integrate cloud computing to quickly seize business opportunities in this new era.

Launch and expand new businesses, by carving out new business segments through the launch of strategic products, such as DreamLabo and the Cinema EOS System. As for the practical application of promising new technologies, we aim to realize rapid commercialization and will actively make use of M&A opportunities as needed.

Strengthen sales capacity in accordance with market characteristics, by expanding market share in developed countries and expanding profits by strengthening direct sales of Group companies, solutions, and service businesses. In emerging countries, we aim to achieve sales growth that exceeds the pace of market growth by realizing sales methods and systems tailored to the actual market conditions in each country.

Pursue cost reductions while accelerating the optimization of global production, by continuing to pursue the strategies we have implemented to date, such as automated production and in-house production, and explore cost-reduction methods based on new ideas and innovative technologies. In addition, we will work to minimize transportation costs while, at the same time, strive to position manufacturing bases and allocate production in ways that minimize costs and risks from a comprehensive perspective, taking into account such factors as exchange rates, tax policies, labor costs, procurement and logistics.

Establish an R&D structure and cultivate technologies that will open future possibilities, by establishing R&D centers in the United States and Europe with the aim of creating continuous innovation in concert with efforts in Japan. In addition, cultivating basic technologies in the medical and industrial equipment fields, areas positioned as next-generation business domains.

Achieve optimization of company-wide business processes, by thoroughly utilizing Canon's company-wide integrated IT systems, pursuing total optimization of all business processes, including development, production, sales and service.

Further instill a commitment to quality first, by targeting the elimination of quality problems, advancing the methods used to manage material defects and working to embed quality from the upstream stages of product planning and design.

Strengthen foundation as an excellent company, by strengthening global management functions and cultivating human resources to lead these reforms, and promoting thorough compliance and executing Canon's environmental vision based on its newly drafted CSR activity policy.

Table of Contents

Office Business Unit

In 2011, despite disruptions in our supply chain due to the Great East Japan Earthquake and collateral events, and notwithstanding a persistently strong yen and the global economic downturn triggered by the Eurozone crisis, Canon was able to maintain its sales of copying machines and MFD businesses on par with the 2010 levels in constant currency.

The importance of providing added value in the form of networking, integration, color printing, multifunction and solutions has grown in the office imaging products business. Canon seeks to maintain its leading position in both the printing and in the office markets.

Canon has matched its business strategy to market trends by strengthening its lineup of digital network MFDs and print-on-demand machines. In 2011, Canon further expanded the imageRUNNER series with the introduction of Canon's first mid-to-high speed letter-sized devices and low-end ledger-sized models. We also launched the imagePRESS C7010VPS series, a digital color press jointly developed with Océ, integrating Canon's digital color technology and Océ's workflow innovation. To maintain and enhance its competitive edge and to meet increasingly sophisticated customer demands, Canon will continue reinforcing its hardware and software product lineups and solutions capability.

Canon's laser printer business has a strong market position. However, due to the global economic downturn initiated by Europe, the sense of uncertainty about the future of the market has been heightened.

In the monochrome laser printer market, the transition to a low price category is expected to expand sales in the micro-office/ home office market and in emerging markets.

The color laser printer market is expected to grow over the long term, while temporary negative growth was observed due to the global-scale economic recession. Competition has intensified as competitors have pursued aggressive pricing strategies to establish market share.

Canon is promoting technological development in this market in order to provide competitive products in all categories with a focus on introducing new and improved product offerings to market in a well-timed manner.

In 2011, the large format inkjet printer market has been on a continuous recovery trend, despite the earthquake, the floods in Thailand and the economic downturn in developed nations triggered by the Eurozone Crisis. Canon recorded a higher growth rate than the overall industry in large format inkjet printer main unit sales in 2011. This growth is attributable to demand from emerging markets and particularly strong demand from the graphic art market. In the CAD market for large format inkjet printers, unit sales to emerging countries increased primarily due to an expansion in the sales area. In addition, improved penetration in the poster/proof market for large format inkjet printers has been achieved by the launch of eight color models with new pigment ink, LUCIA EX for the graphic art market. Canon expects to continuously introduce competitive large format inkjet printer products currently under development in response to market demand and competitive trends.

Consumer Business Unit

The demand for high-resolution digital photos remained high, and as a result the interchangeable lens digital camera market continued to show robust growth in 2011. By market category, growth remained strong in developed countries, and was particularly robust in Asia outside Japan and other emerging markets, contributing strongly to an overall global growth rate. By product category, the digital single-lens-reflex (SLR) camera market showed steady growth, while mirrorless cameras represented a new category stimulating consumer demand.

In terms of interchangeable lens digital cameras, on top of the need for higher resolution and more compact and lightweight sizes, there is also consumer demand for video recording functions which manufacturers are

Table of Contents

meeting with a full high definition (HD) format and which is becoming a standard feature. We believe there remains considerable room for future growth in this category through development of new products based on state-of-the-art technology. In emerging markets, sales volumes of interchangeable lens digital cameras are increasing rapidly, and there is a pressing need for improvement of sales and support frameworks in these regions.

As for the interchangeable lens market, interchangeable lens digital cameras have made dramatic advances in popularity, and further growth is expected in the future. Canon will continue to endeavor to market products that meet customer needs, such as lenses equipped with image stabilization function, so as to expand sales and market share.

Overall, the compact digital camera market shrank year-on-year due to the ongoing economic stagnation in the developed world, but there was considerable growth led by Southeast Asia and other emerging markets. Notwithstanding the Great East Japan Earthquake and collateral events, as well as the floods in Thailand, Canon managed to maintain a high market share consistent with that of the previous fiscal year. The size of the compact digital camera market in 2012 is expected to be consistent with that of the previous fiscal year in the developed world, while positive growth is expected to continue in emerging markets, adding up to a slight expansion in market size worldwide.

In the digital camera market, Canon faced intense price competition. This combined with the value of the yen remaining at historical highs throughout the year, placed serious constraints on our profit margins. Throughout the industry, there has been a strong tendency toward reliance on EMS (electronic manufacturing services), and intense price competition is expected to continue for the foreseeable future. Canon's strategies to address these challenges include boosting the added value of products, pressing forward with 100% internal production leveraging the economies of scale that come with being the industry leader, and building an optimum cost structure to combat the pressures of the strong yen.

In the digital video camcorder market, there was at one point rapid diversification on a global scale of recording media such as DVD, HDD and flash memory. During fiscal year 2011, it became clear that flash memory was becoming the dominant format, and that the move toward high definition would continue to progress. Despite the global economic stagnation that began in the second half of 2008, the markets for HD and flash memory have continued to grow steadily year-on-year. At the same time, in the North American market and elsewhere, a new product category, web cameras priced at under \$200, has emerged, and sales of such cameras have been increasing. Canon will aim to expand sales in this market with a powerful product lineup including higher added value based around our distinctive high-definition, high-resolution technologies.

In the business-use digital video camcorder field, Canon announced its full-fledged entry into digital high-resolution motion picture production by launching Cinema EOS System, which consists of new interchangeable lens digital cinema camcorders. EOS Movie has rapidly expanded the demand for interchangeable lens digital cameras in the digital cinema market. By introducing a new series of interchangeable lens cinema camcorders and cinema lenses to the market as the Cinema EOS System, Canon is aiming to solidify its top position in the motion picture production market.

In 2011, we experienced robust growth in the field of projectors for business applications, and in particular the transition to wide format. In this wide-format market, we launched the new install-type WUX4000 prior with great success in 2011. Moving forward, Canon expects to extend its competitive product lineup based around the optical technology on which the company prides itself, and push for expanded sales.

In the field of network cameras for video surveillance and monitoring applications, the fiscal year 2011 showed double-digit growth compared to 2010. In the second half of 2011, Canon introduced four HD-compatible models to the market, building on improvements in image resolution and image analysis technology and industry-wide action command standardization. As a result, Canon achieved double-digit year-on-year growth in terms of both units sold and monetary amount in 2011.

Table of Contents

There was gradual recovery overall in the broadcast TV lens market. While specialized demand due to digitalization of broadcast formats, and market growth in emerging economies, contributed to increased revenue, the persistently strong yen and the progressive lowering of equipment prices accompanying downsizing meant that profits in 2011 were nearly flat year-on-year. From 2012 onward, while specialized demand is expected to drop off due to the switchover to digital broadcasting in developed countries, continued market growth in emerging markets means that the overall global market is expected to show gradual expansion.

In 2011, the inkjet printer market was declined slightly compared to 2010 due primarily to downward pressure by the economic stagnation in Europe and other regions, as well as the effect of the Great East Japan Earthquake and the floods in Thailand. Vendors expanded their lineup of products to meet increased demands for cloud solutions and wireless networking functions in this market. In response, Canon enhanced its lineup introducing new models which make printer operation more user-friendly for diversified users. With an advanced printer lineup, Canon expanded its unit sales and its consumables excluding adverse affects from currency fluctuations compared to 2010.

In 2011, the Canon inkjet printer business was adversely affected both in terms of sales and production by the Great East Japan Earthquake and collateral events, as well as the floods in Thailand. Canon was able to limit the affect from the earthquake by implementing expediting recovery actions. In addition, although some factories were forced to close operations as a result of the floods in Thailand, Canon has taken prompt measures to switch production to other factories and implemented recovery measures to restore affected factories. Owing to the swift actions, production at the damaged facilities was resumed within the year.

Industry and Others Business Unit

In fiscal 2011, the semiconductor device market continued to recover strongly from the economic downturn which began in the second half of fiscal 2008. There were noteworthy improvements for semiconductor device market categories such as NAND-flash memories and image sensors, due to strong sales of smartphones and media tablets, as well as the so-called green products such LEDs and power devices attracting attention in the environment-related fields. This was partially offset by the fact that DRAM makers tended to reduce equipment procurements in 2011 due to the continuous fall in DRAM prices.

In the market for semiconductor lithography equipment, the recovery trend from 2010 continued and grew strongly in 2011. By the type of lighting source, cutting-edge equipment using ArF immersion now account for roughly one-third of the market as memory makers and foundries have been aggressively investing in miniaturization. At the same time, manufacturers are starting to invest in equipment using i-line for small diameter wafers used in image sensors, power devices and LEDs, as well as for new markets such as 3D mountings for TSV connections.

As a result, our shipments of semiconductor lithography equipment in 2011 significantly increased compared to 2010. By region, sales in South Korea have been increasing steadily, while in Japan demand has significantly increased sales of the equipment for sensors and image devices.

In 2011, the market for LCD lithography equipment remained relatively flat compared to the previous year. The market for LCD lithography equipment under 5.5th generation grew significantly in 2011 from the previous year due to the rapid growth in the markets for smartphones and media tablets. However, the market for LCD lithography equipment over 6th generation decreased in 2011 from the previous year due to weak investment in 2011 resulting from aggressive investment in 2010, and price reductions for large LCD panels. In China, although the 8th generation production lines of LCD panels launched in 2011 led to a significant expansion in the Chinese market, the growth could not fully absorb the effects of decreased demand in the overall LCD lithography equipment market.

Table of Contents

In 2011, our shipments of LCD lithography equipment markedly fell compared to the previous year due primarily to the shrinkage of the over 6th generation market, where Canon is particularly competitive, and the delay of development of LCD lithography equipment under 5.5th generation, for which the market has been growing rapidly.

The market for static digital X-ray equipment has been expanding, although competition has become more severe through the entry of computed radiography manufacturers into the market. The medical equipment market in Asia (mainly China) is expanding rapidly, and the static digital X-ray equipment market has followed this trend.

In 2011, Canon's overall sales in market for static digital X-ray equipment increased steadily compared to the previous fiscal year. The thin and lightweight CXDI-70C Wireless digital radiography system, which we released in 2010, contributed to the increase of sales. We also focused on emerging markets and have been successful in increasing sales there, especially in China. In addition, Canon accelerated sales of CXDI-50RF dynamic/static digital radiography system in Europe and the United States. During 2011, new products, CXDI-401C/G, CXDI-401C/G COMPACT, CXDI-501C/G and CXDI-80C Wireless were launched.

Regarding the ophthalmic products, the optical coherence tomography (OCT) market has been expanding year by year. In order to keep pace with these trends, Canon is striving to increase sales by expanding competitive lineup of products to gain the market acceptance.

Our sales of TX-20/TX-20P full auto tonometer, which was released in 2011, and our CR-2 compact non-mydratric retinal camera increased steadily and contributed to our 2011 result. Moreover, in 2011 we released CR-2 Plus digital non-mydratric retinal camera with a Fundus Autofluorescence (FAF) mode and aim to increase sales in this market.

Sales in 2011 of document scanners manufactured by Canon Electronics Inc. declined at a level in line with the decline recorded in 2010, primarily due to stagnation in sales of check scanners (i.e., image scanners specialized for scanning bills and checks) to North American financial institutions, which was partially offset by higher sales in Japan, Europe and other regions.

Sales of organic EL display manufacturing equipment made by Canon Tokki Corporation recorded significant gains in 2011 deriving primarily from robust capital investments by organic EL panel manufacturers.

Die bonders made by Canon Machinery Inc. booked lower sales in 2011 as semiconductor manufacturers reduced capital investments, but FA system-related devices recorded a significant sales increase, due primarily to the continuation of strong demand trend which began in 2010 for facilities related to secondary automobile batteries in places like China and South Korea.

In 2011, Canon ANELVA Corporation sales of film deposition equipment for magnetic heads and discs fell, while LED film deposition equipment rose and semiconductor film deposition equipment maintained levels recorded in 2010.

E. Off-balance sheet arrangements

As part of its ongoing business, Canon does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to

Table of Contents

30 years in the case of employees with housing loans, and 1 year to 10 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥15,245 million at December 31, 2011. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees were insignificant.

F. Contractual obligations

The following summarizes Canon's contractual obligations at December 31, 2011.

	Total	Less than 1 year	Payments Due By Period		More than 5 years
			1-3 years (Millions of yen)	3-5 years	
Contractual obligations:					
Long-Term Debt:					
Capital Lease Obligations	¥ 4,597	¥ 2,026	¥ 2,055	¥ 398	¥ 118
Other Long-Term Debt	2,473	1,676	605	164	28
Operating Lease Obligations	72,798	22,259	27,475	12,593	10,471
Purchase commitments for:					
Property, Plant and Equipment	66,287	66,287			
Parts and Raw Materials	75,823	75,823			
Other long-term liabilities					
Contribution to Defined Benefit Pension Plans	30,877	30,877			
Total	¥ 252,855	¥ 198,948	¥ 30,135	¥ 13,155	¥ 10,617

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 12, Income Taxes in the Notes to Consolidated Financial Statements for further details. Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2011, accrued product warranty costs amounted to ¥11,691 million.

At December 31, 2011, commitments outstanding for the purchase of property, plant and equipment were approximately ¥66,287 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥75,823 million, both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During fiscal 2012, Canon expects to contribute ¥21,946 million to its Japanese defined benefit pension plans and ¥8,931 million to its foreign defined benefit pension plans.

Canon's management believes that current financial resources, cash generated from operations and Canon's potential capacity for additional debt and/or equity financing will be sufficient to fund current and future capital requirements.

Table of Contents**Item 6. Directors, Senior Management and Employees****A. Directors and senior management**

Directors and corporate auditors of the Company as of March 29, 2012 and their respective business experience are listed below.

Name	Position	Date of commencement	Business experience (*current position/function)
(Date of birth)	(Group executive/function)		
Fujio Mitarai (Sept. 23, 1935)	Chairman & CEO	4/1961	Entered the Company
		1/1979	President of Canon U.S.A., Inc.
		3/1981	Director
		3/1985	Managing Director
		1/1989	In charge of HQ administration
		3/1989	Senior Managing Director
		3/1993	Executive Vice President
		9/1995	President & CEO
		3/2006	Chairman of the Board & President & CEO
		5/2006	Chairman & CEO*
Toshizo Tanaka (Oct. 8, 1940)	Executive Vice President & CFO (Group Executive of Finance & Accounting HQ)	4/1964	Entered the Company
		1/1992	Deputy Group Executive of Finance & Accounting HQ
		3/1995	Director
		4/1995	Group Executive of Finance & Accounting HQ
		3/1997	Managing Director
		3/2001	Senior Managing Director
		1/2007	Group Executive of Policy and Economy Research HQ
		3/2007	Executive Vice President & Director
		3/2008	Executive Vice President & CFO*
		1/2010	Group Executive of General Affairs HQ
		3/2010	Group Executive of External Relations HQ
		4/2011	Group Executive of Finance & Accounting HQ*
Toshiaki Ikoma (Mar. 5, 1941)	Executive Vice President & CTO (Group Executive of Corporate R&D HQ)	4/1982	Professor of Institute of Industrial Science, the University of Tokyo
		2/1997	President of Texas Instruments Japan Limited
		2/2002	Chairman of the Board of Texas Instruments Japan Limited
		10/2004	Director-General of Center for Research and Development Strategy (CRDS), Japan Science and Technology Agency (JST)
		4/2005	Entered the Company Adviser of the Company
		12/2008	President of Canon Foundation*
		1/2009	Group Executive of Corporate R&D HQ*
		3/2009	Executive Vice President*
		7/2009	Chief Executive of Optical Products Operations

Table of Contents

Name	Position	Date of commencement	Business experience
(Date of birth)	(Group executive/function)		(*current position/function)
Kunio Watanabe (Oct. 3, 1944)	Executive Vice President (Group Executive of Corporate Planning Development HQ)	4/1969	Entered the Company
		4/1995	Group Executive of Corporate Planning Development HQ*
		3/1999	Director
		3/2003	Managing Director
		1/2007	Deputy Group Executive of Policy and Economy Research HQ
		3/2008	Senior Managing Director
		3/2012	Executive Vice President*
Yoroku Adachi (Jan. 11, 1948)	Senior Managing Director	4/1970	Entered the Company
		3/2001	Chairman of Canon Singapore Pte. Ltd. Chairman of Canon Hong Kong Co., Ltd. Director
		4/2003	President of Canon (China) Co., Ltd.
		3/2005	Managing Director
		4/2005	President of Canon U.S.A., Inc.*
		3/2009	Senior Managing Director*
Yasuo Mitsuhashi (Nov. 23, 1949)	Senior Managing Director (Chief Executive of Peripheral Products HQ)	4/1974	Entered the Company
		2/2001	Chief Executive of Chemical Products HQ
		3/2001	Director
		4/2003	Chief Executive of Peripheral Products HQ*
		3/2005	Managing Director
		3/2009	Senior Managing Director*
		4/2009	Chief Executive of Chemical Products Operations
Shigeyuki Matsumoto (Nov. 15, 1950)	Senior Managing Director (Group Executive of Device Technology Development HQ)	4/1977	Entered the Company
		1/2002	Group Executive of Device Technology Development HQ*
		3/2004	Director
		3/2007	Managing Director
		3/2011	Senior Managing Director*
Toshio Honma (Mar. 10, 1949)	Senior Managing Director (Chief Executive of L Printer Products HQ,	4/1972	Entered the Company
		4/2001	Deputy Chief Executive of i Printer Products HQ
	Group Executive of Global Procurement HQ)	3/2003	Director
		4/2003	Group Executive of Business Promotion HQ
		7/2003	Group Executive of L Printer Business Promotion HQ
		1/2007	Chief Executive of L Printer Products HQ*
		3/2008	Managing Director
		3/2012	Senior Managing Director*
		3/2012	Group Executive of Global Procurement HQ*

Table of Contents

Name	Position	Date of commencement	Business experience
(Date of birth)	(Group executive/function)		(*current position/function)
Masaki Nakaoka (Jan. 3, 1950)	Senior Managing Director (Chief Executive of Office Imaging Products HQ)	4/1975	Entered the Company
		4/2001	Deputy Chief Executive of Office Imaging Products HQ
		3/2004	Director
		4/2005	Chief Executive of Office Imaging Products HQ*
		3/2008	Managing Director
		3/2012	Senior Managing Director*
Haruhisa Honda (Oct. 14, 1948)	Senior Managing Director (Group Executive of Production Engineering HQ)	4/1974	Entered the Company
		4/1995	Senior General Manager of Cartridge Development Center
		3/2004	Director
		4/2004	Chief Executive of Chemical Products Operations
		3/2007	Group Executive of Production Engineering HQ
		3/2008	Managing Director
		4/2010	Group Executive of Manufacturing HQ
		7/2011	Group Executive of Production Engineering HQ*
		3/2012	Senior Managing Director*
Hideki Ozawa (Apr. 28, 1950)	Managing Director	4/1973	Entered Canon Sales Co., Inc. (renamed Canon Marketing Japan Inc.)
		7/1980	Entered the Company
		4/2005	President of Canon (China) Co., Ltd.*
		3/2007	Director
		3/2010	Managing Director*
Masaya Maeda (Oct. 17, 1952)	Managing Director (Chief Executive of Image Communication Products HQ)	4/1975	Entered the Company
		1/2006	Group Executive of Digital Imaging Business Group
		3/2007	Director
		4/2007	Chief Executive of Image Communications Products HQ*
		3/2010	Managing Director*
Yasuhiro Tani (Jul. 30, 1956)	Director (Group Executive of Digital Platform Technology Development HQ)	4/1980	Entered the Company
		1/2008	Group Executive of Digital Platform Technology Development HQ*
		4/2008	Executive Officer
		3/2011	Director*
Makoto Araki (Jul. 16, 1954)	Director (Group Executive of Information & Communication Systems HQ)	4/1978	Entered the Company
		10/2009	Group Executive of Information & Communication Systems HQ*
		4/2010	Executive Officer
		3/2011	Director*

Table of Contents

Name	Position	Date of commencement	Business experience
(Date of birth)	(Group executive/function)		(*current position/function)
Hiroyuki Suematsu (Nov. 15, 1955)	Director (Group Executive of Quality Management HQ, Group Executive of Environment HQ)	4/1980	Entered the Company
		4/2007	Chief Executive of Chemical Products Operations
		4/2008	Executive Officer
		4/2009	Deputy Chief Executive of Chemical Products Operations
		1/2010	Deputy Chief Executive of Peripheral Products Operations
		3/2012	Director*
		3/2012	Group Executive of Quality Management HQ*
		3/2012	Group Executive of Environment HQ*
Shigeyuki Uzawa (Jan. 30, 1953)	Director (Chief Executive of Optical Products Operations)	12/1986	Entered the Company
		7/2009	Group Executive of Semiconductor Production Equipment Operations
		4/2010	Executive Officer
		7/2010	Deputy Chief Executive of Optical Products Operations
		1/2011	Chief Executive of Optical Products Operations*
		3/2012	Director*
Kenichi Nagasawa (Jan. 31, 1959)	Director (Group Executive of Corporate Intellectual Property and Legal HQ)	4/1981	Entered the Company
		3/2010	Deputy Group Executive of Corporate Intellectual Property and Legal HQ
		4/2010	Executive Officer Group Executive of Corporate Intellectual Property and Legal HQ*
		3/2012	Director*
Naoji Otsuka (Apr. 24, 1958)	Director (Chief Executive of Inkjet Products Operations)	4/1981	Entered the Company
		1/2010	Group Executive of Inkjet Products Development Group
		4/2011	Executive Officer Deputy Chief Executive of Inkjet Products Operations
		3/2012	Director*
		3/2012	Chief Executive of Inkjet Products Operations*
Shunji Onda (Mar. 13, 1950)	Corporate Auditor	4/1972	Entered Canon Sales Co., Inc. (renamed Canon Marketing Japan Inc.)
		7/1980	Entered the Company
		4/2004	Senior General Manager of Optical Products Business Administration Center
		3/2006	Director
		4/2006	Deputy Group Executive of Finance & Accounting HQ
		4/2007	Group Executive of Global Procurement HQ
		3/2010	Corporate Auditor*

Table of Contents

Name	Position	Date of commencement	Business experience
(Date of birth)	(Group executive/function)		(*current position/function)
Kengo Uramoto (Aug. 23, 1953)	Corporate Auditor	4/1978	Entered the Company
		10/2007	Deputy Group Executive of Human Resources Management & Organization HQ
		4/2008	Executive Officer Group Executive of Human Resources Management & Organization HQ
		1/2009	Deputy Group Executive of Human Resources Management & Organization HQ
		4/2010	Group Executive of Human Resources Management & Organization HQ
		4/2012	Corporate Auditor*
Tadashi Ohe (May 20, 1944)	Corporate Auditor	4/1969	Registration as a lawyer*
		4/1989	Instructor of Judicial Research and Training Institute
		3/1994	Corporate Auditor*
Kazunori Watanabe (Oct. 9, 1950)	Corporate Auditor	9/1978	Registration as a Certified Public Accountant*
		8/2008	Senior Executive of Ernst & Young ShinNihon LLC
		3/2010	Corporate Auditor*
Kuniyoshi Kitamura (Apr. 8, 1956)	Corporate Auditor	4/1981	Entered The Dai-Ichi Mutual Life Insurance Co.
		4/2002	General Manager of Network Service Management Department of The Dai-Ichi Mutual Life Insurance Co.
		4/2004	General Manager of Corporate Relations Department No.2 of The Dai-Ichi Mutual Life Insurance Co.
		4/2006	General Manager of Research Department of The Dai-Ichi Mutual Life Insurance Co.
		11/2007	General Manager of Corporate Planning Department No.2 of The Dai-Ichi Mutual Life Insurance Co.
		4/2009	General Manager of Corporate Relations Department No.8 of The Dai-Ichi Mutual Life Insurance Co.
		3/2010	Corporate Auditor*

Term

All directors and corporate auditors are elected by the shareholders at their general meeting.

The term of office of directors is one year. The current term of all directors expires in March 2012. The term of office of corporate auditors is four years. The current term for Mr. Ohe expires in March 2015, and the current term for Mr. Onda, Mr. Watanabe and Mr. Kitamura, who were elected in the general meeting of shareholders in March 2010, expires in March 2014, and the current term for Mr. Uramoto, who was elected in the general meeting of shareholders in March 2012, expires in March 2016.

Table of Contents

Board members and corporate auditors may serve any number of consecutive terms.

There is no arrangement or understanding between any director or corporate auditor and any major shareholder, customer, supplier or other material stakeholders in connection with the selection of such director or corporate auditor.

Board of Directors and Corporate Auditors

The Company's articles of incorporation provide for a board of directors of not more than 30 members and for not more than five corporate auditors. Currently the number of board members is 18 and the number of corporate auditors is five. There is no maximum age limit for members of the board. Board members and corporate auditors may be removed from office at any time by a resolution of a general meeting of shareholders.

The board of directors has ultimate responsibility for the administration of the Company's affairs. By resolution, the board of directors designates, from among its members, representative directors who have authority individually to represent the Company generally in the conduct of its affairs.

Under the Corporation Law of Japan, board members must refrain from engaging in any business competing with the Company unless approved by a board resolution, and no board member may vote on a proposal, arrangement or contract in which that board member is deemed to be materially interested.

The Corporation Law of Japan requires a resolution of the board of directors for a company to acquire or dispose of material assets, to borrow substantial amounts of money, to employ or discharge important employees such as corporate officers, and to establish, change or abolish material corporate organizations such as a branch office.

The corporate auditors are not required to be certified public accountants, although Mr. Watanabe is a certified public accountant. At least half of the corporate auditors must be persons who have not been either board members or employees of the Company or any of its subsidiaries. A corporate auditor may not at the same time be a board member or an employee of the Company or any of its subsidiaries. The corporate auditors have the statutory duty of examining the Company's financial statements and the Company's business reports to be submitted annually by the board of directors at the general meetings of shareholders and of reporting their opinions to the shareholders. They also have the statutory duty of supervising the administration by the board members of the Company's affairs. They shall participate in the meetings of the board of directors but are not entitled to vote.

The corporate auditors constitute the board of corporate auditors. Under the Corporation Law of Japan, the board of corporate auditors has a statutory duty to prepare and submit its audit report to the board of directors each year. A corporate auditor may note an opinion in the auditor report if a corporate auditor's opinion is different from the opinion expressed in the audit report. The board of corporate auditors is empowered to establish audit principles, the method of examination by corporate auditors of the Company's affairs and financial position and other matters concerning the performance of the corporate auditors' duties. The Company does not have an audit committee.

The amount of remuneration payable to the Company's board members as a group and that of the Company's corporate auditors as a group in respect of a fiscal year is subject to approval by a general meeting of shareholders. Within those authorized amounts, the compensation for each board member and corporate auditor is determined by the board of directors and a consultation with the corporate auditors, respectively. The Company does not have a remuneration committee.

Under the Corporation Law of Japan and the Company's articles of incorporation, the board of directors may, by resolution, release current and former directors and corporate auditors from liability for damages

Table of Contents

resulting from negligence in the fulfillment of their respective duties to the extent permitted by law. Furthermore, the Company may enter into contracts with outside corporate auditors limiting their liability for damages resulting from negligence in the fulfillment of their respective duties in an amount consistent with the limitation stipulated by law.

In fiscal 2004, Canon established a standing committee, the Internal Control Committee, with the president appointed as chairman of the group. The Internal Control Committee has built a highly effective internal control system unique to Canon, which not only serves to ensure the reliability of the Company's financial reporting, but also aims to ensure the effectiveness and efficiency of its business operations, as well as compliance with related laws, regulations and internal controls.

Additionally, in fiscal 2005, the Disclosure Committee was established with the president appointed as chairman. This committee was formed to ensure that Canon is not only in compliance with applicable laws, rules and regulations, but also to ensure that information disclosed to shareholders and capital markets is both correct and comprehensive.

Executive Officer System

Canon adopted an Executive Officer System effective April 1, 2008. Executive Officers are appointed and discharged by the Board of Directors and have a term of office of one year. Taking into consideration growth in the scope of its business activities, Canon recognizes the need to bolster its management execution structure. By promoting capable human resources with accumulated executive knowledge across specific business areas, the Company is endeavoring to realize more flexible and efficient management operations. To this end, Canon intends to gradually increase the number of Executive Officers and further solidify its management systems.

Executive Officers of the Company appointed by the Board of Directors meeting held on January 30, 2012, whom are expected to take the assigned positions on April 1, 2012, are listed below.

Name		Position (Group executive/function)
Sachio Kageyama	Senior Executive Officers	Group Executive of Global Manufacturing HQ
Masanori Yamada	Senior Executive Officers	Deputy Chief Executive of Office Imaging Products HQ
Akio Noguchi	Senior Executive Officers	Deputy Chief Executive of Peripheral Products HQ
Seymour Liebman	Executive Officers	Executive Vice President of Canon U.S.A., Inc.
Masato Okada	Executive Officers	Deputy Chief Executive of Image Communication Products HQ
Yukiaki Hashimoto	Executive Officers	Group Executive of Medical Equipment Group
Akiyoshi Kimura	Executive Officers	Deputy Chief Executive of Office Imaging Products HQ
Kazuto Ogawa	Executive Officers	President of Canon Canada Inc.
Kenji Kobayashi	Executive Officers	President of Canon France S.A.S
Ryuichi Ebinuma	Executive Officers	Group Executive of Core Technology Development Group
Rokus van Iperen	Executive Officers	Chairman & CEO of Océ N.V.
Yuichi Ishizuka	Executive Officers	Executive Vice President of Canon U.S.A., Inc.
Aitake Wakiya	Executive Officers	Deputy Group Executive of Finance & Accounting HQ
Kazuhiko Noguchi	Executive Officers	Group Executive of External Relations HQ
Kazuto Ono	Executive Officers	Group Executive of Human Resources Management & Organization HQ
Eiji Osanai	Executive Officers	Senior General Manager of Production Engineering Research Laboratory
Hiroaki Takeishi	Executive Officers	Group Executive of Semiconductor Production Equipment Group

Table of Contents**B. Compensation**

In the fiscal year ended December 31, 2011, Canon paid an aggregate of approximately ¥1,575 million to its directors and corporate auditors. This amount includes bonuses but excludes retirement allowances.

Directors and corporate auditors are not covered by the Company's retirement program. However, in accordance with customary Japanese business practices, directors and corporate auditors receive lump-sum retirement benefits, subject to shareholder approval.

Beginning from the fiscal year ended December 31, 2010, the Company is required to disclose the compensation of any director who receives total aggregate annual compensation exceeding ¥100 million in accordance with the Financial Instruments and Exchange Act of Japan and related ordinances. The following table sets forth the amount of compensation paid or planned to be paid directors whose aggregate compensation exceeded ¥100 million in fiscal 2011.

Name (Position)	Company	Category of remuneration					Total
		Basic Compensation	Bonus	SubTotal (Millions of yen)	Retirement Allowance	Stock Option	
Fujio Mitarai (Director)	Canon Inc.	¥ 167	¥ 32	¥ 199	¥ 39	¥ 34	¥ 272
Tsuneji Uchida (Director)	Canon Inc.	102	22	124	23	34	181
Toshizo Tanaka (Director)	Canon Inc.	79	18	97	17	30	144
Toshiaki Ikoma (Director)	Canon Inc.	74	16	90	19	27	136
Kunio Watanabe (Director)	Canon Inc.	55	13	68	11	22	101
Yasuo Mitsuhashi (Director)	Canon Inc.	55	13	68	11	22	101

Notes:

- (1) Bonus amounts represent the increased portion of accrued directors' bonuses in fiscal year 2011.
- (2) Retirement allowance amounts represent the increased portion of accrued directors' retirement benefits in fiscal year 2011.
- (3) The stock option amounts represent an expense recognized during fiscal year 2011 determined based on the fair value on the date of grant using the Black-Scholes option pricing model.
- (4) Apart from the remuneration contained in the above table, Océ N.V. paid ¥5 million to Toshizo Tanaka Executive Vice President & CFO as basic compensation. Toshizo Tanaka Executive Vice President & CFO received ¥149 million in aggregate compensation including remuneration from Océ N.V. Compensation amounts from Océ N.V. are translated from euros based on the average rate for fiscal year 2011 of ¥111.10 = Euro 1.

The following three elements comprise remuneration to directors:

Basic Compensation: compensation for executing of business operations

Bonus: bonus links to business results of current fiscal year

Retirement Allowance: remuneration for the contribution to the Company during tenure

In addition to the above, the Company issues stock options for the purpose of providing effective incentives to improve business results on a medium and long-term basis. The remuneration to corporate auditors consists of only basic compensation, which is not affected by the performance of the Company.

The determination methods of remuneration are as follows:

Basic Compensation

Each maximum amount of total compensation to directors and corporate auditors is determined by the Ordinary General Meeting of Shareholders. The remuneration to each director is determined by the meeting of the Board of Directors based on criteria set by the Company, and the remuneration to each corporate auditor is determined by the meeting of corporate auditors.

Table of Contents

Bonus

Director bonuses are calculated based on internal criteria considering the performance of the Company. The total amount is proposed to and approved by the Ordinary General Meeting of Shareholders. The bonus amount paid to individual directors is determined at a meeting of the Board of Directors, based on the total approved amount, taking into account the position and performance of each director.

Retirement Allowance

Retirement allowances are paid at the time of retirement in appreciation of their services during their terms in offices. The amount of allowance is calculated based on monthly basic compensation and the number of years of service, etc. to the Company and is proposed to and approved by the Ordinary General Meeting of Shareholders.

Stock Option

The Company issues stock option plans for the purpose of enhancing directors' motivation and morale to improve the Company's performance. Issuance of share options as stock options without compensation and features of such stock options is proposed to and approved by the Ordinary General Meeting of Shareholders.

The Company has four stock option (share option) plans. These plans were approved at the meeting of the Board of Directors in accordance with the Ordinary General Meeting of Shareholders for the 107th, 108th, 109th and 110th Business Term of the Company, pursuant to Articles 236, 238 and 239 of the Corporation Law of Japan, held on March 28, 2008, March 27, 2009, March 30, 2010, and March 30, 2011. Under and pursuant to these plans, share options will be issued as stock options to the Company's directors, executive officers and senior employees.

The descriptions of the stock option plans are below.

The Stock Option Plan Approved on March 28, 2008

1. The Reason for the Necessity to Solicit Those Who Subscribe for Share Options on Particularly Favorable Conditions

Share options were issued to the Company's directors, executive officers and senior employees for the purpose of further enhancing their motivation and morale to improve the Company's performance, with a view to long-term improvement of its corporate value.

2. Grantees of Share Options

The Company's directors, 8 executive officers, and 30 senior employees who are entrusted with important functions.

3. Number of Share Options

The number of share options that the Board of Directors are authorized to issue is 5,920.

4. Cash Payment for Share Options

No cash payment will be required for the share options.

5. Exercise Price

The exercise price is ¥5,502 per share.

Table of Contents

6. Features of Share Options

The features of share options are as follows:

(1) Number of Shares acquired upon Exercise of a Share Option

The number of shares acquired upon exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 592,000 common shares.

However, if the Company effects a share split (including allotment of common shares without compensation; this inclusion being applicable below) or a share consolidation after the date of the allotment of the share options, the Allotted Number of Shares will be adjusted by the following calculation formula:

Allotted Number of Shares after Adjustment

= Allotted Number of Shares before Adjustment × Ratio of Share Splitting or Share Consolidation

Such adjustment will be made only with respect to the number of issued share options that have not then been exercised, and any fractional number of less than one share resulting from such adjustment will be rounded off.

(2) Amount of Property to Be Contributed upon Exercise of Share Options

The amount of property to be contributed upon the exercise of each share option is the amount obtained by multiplying the amount to be paid in for one share (the Exercise Price) to be delivered upon the exercise of a share option by the Allotted Number of Shares. The Exercise Price is the product of the multiplication of 1.05 and the closing price of one common share of the Company in ordinary trading at the Tokyo Stock Exchange as of the date of allotment of the share options (or if no trade is made on such date, the date immediately preceding the date on which such ordinary shares are traded), with any fractional amount of less than one yen to be rounded up to one yen.

The Exercise Price will be adjusted as follows:

(i) If the Company effects a share split or a share consolidation after the date of the allotment of the share options, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen:

Exercise Price after Adjustment

=Exercise Price before adjustment × $\frac{1}{\text{Ratio of Share Splitting or Share Consolidation}}$

(ii) If, after the date of allotment of share options, the Company issues common shares at a price lower than the then market price thereof (other than by way of conversion of the third series of Unsecured Convertible Debentures Due 2008 of the Company) or disposes of common shares owned by it, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen; however, the Exercise Price will not be adjusted in the case of the exercise of share options:

Exercise Price after Adjustment = Exercise Price before Adjustment ×

$$\frac{\text{Number of Issued and Outstanding Shares} + \frac{\text{Number of Newly Issued Shares} \times \text{Payment amount per Share}}{\text{Market Price}}}{\text{Number of Issued and Outstanding Shares} + \text{Number of Newly Issued Shares}}$$

Table of Contents

The Number of Issued and Outstanding Shares is the number of shares already issued by the Company after subtraction of the number of shares owned by the Company. In the case of the Company's disposal of shares owned by it, the Number of Newly Issued Shares will be replaced with the Number of Own Shares to Be Disposed.

(iii) In the case of a merger, a company split or capital reduction after the date of allotment of share options, or in any other analogous case requiring the adjustment of the Exercise Price, the Exercise Price shall be appropriately adjusted within a reasonable range.

(3) Period during Which Share Options Are Exercisable

From May 1, 2010 to April 30, 2014.

(4) Matters regarding Stated Capital and Capital Reserves Increased When Shares Are Issued upon Exercise of Share Options

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc. to be calculated in accordance with Article 40, Paragraph 1 of the Companies Accounting Regulations (*Kaisha Keisan Kisoku*).

Any fractional amount of less than one yen resulting from such calculation will be rounded up to one yen.

(ii) The increased amount of capital reserves shall be the amount of the maximum amount of increases of stated capital, etc., mentioned in (i) above, after the subtraction of increased amount of stated capital mentioned in (i) above.

(5) Restriction on Acquisition of Share Options by Transfer

An acquisition of share options by way of transfer requires the approval of the Board of Directors.

(6) Events for the Company's Acquisition of Share Options

If a proposal for the approval of a merger agreement under which the Company will become an extinguishing company or a proposal for the approval for a share exchange agreement or a share transfer plan under which the Company will become a wholly-owned subsidiary is approved by the Company's shareholders at a shareholders meeting (or by the Board of Directors if no resolution of a shareholders meeting is required for such approval), the Company will be entitled to acquire the share options, without compensation, on a date separately designated by the Board of Directors.

(7) Handling of Fractions

Any fraction of a share (less than one share) to be delivered to any holder of share options who has exercised share options will be disregarded.

(8) Other Conditions for Exercise of Share Options

(i) One share option may not be exercised partially.

(ii) Each holder of share options must continue to be a director, executive officer or employee of the Company until the end of the Company's general meeting of shareholders regarding the final business term within 2 years from the end of the Ordinary General Meeting of Shareholders for the 107th Business Term of the Company.

Table of Contents

(iii) Holders of share options will be entitled to exercise their share options for 2 years, and during the exercisable period, even after they lose their positions as directors, executive officers or employees. However, if a holder of share options loses such position due to resignation at his/her initiative, or due to dismissal or discharge by the Company, his/her share options will immediately lose effect.

(iv) No succession by inheritance is authorized for the share options.

(v) Any other conditions for the exercise of share options may be established by the Board of Directors.

7. Specific Method of Calculation of Remuneration to Directors

The amount of share options issued to the directors of the Company, as remuneration, is the amount obtained by multiplying the fair market value per share option as of the allotment date thereof by the total number of share options allotted to the directors existing as of such allotment date. The fair market value of a share option was calculated with the use of the Black-Scholes model on the basis of various conditions applicable on the allotment date.

The Stock Option Plan Approved on March 27, 2009

1. The Reason for the Necessity to Solicit Those Who Subscribe for Share Options on Particularly Favorable Conditions

Share options were issued to the Company's directors, executive officers and senior employees for the purpose of further enhancing their motivation and morale to improve the Company's performance, with a view to long-term improvement of its corporate value.

2. Grantees of Share Options

The Company's directors, 10 executive officers, and 29 senior employees who are entrusted with important functions.

3. Number of Share Options

The number of share options that the Board of Directors are authorized to issue is 9,540.

4. Cash Payment for Share Options

No cash payment will be required for the share options.

5. Exercise Price

The exercise price is ¥3,287 per share.

6. Features of Share Options

The features of share options are as follows:

(1) Number of Shares acquired upon Exercise of a Share Option

The number of shares acquired upon exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 954,000 common shares.

Table of Contents

However, if the Company effects a share split (including allotment of common shares without compensation; this inclusion being applicable below) or a share consolidation after the date of the allotment of the share options, the Allotted Number of Shares will be adjusted by the following calculation formula:

Allotted Number of Shares after Adjustment

= Allotted Number of Shares before Adjustment × Ratio of Share Splitting or Share Consolidation

Such adjustment will be made only with respect to the number of issued share options that have not then been exercised, and any fractional number of less than one share resulting from such adjustment will be rounded off.

(2) Amount of Property to Be Contributed upon Exercise of Share Options

The amount of property to be contributed upon the exercise of each share option is the amount obtained by multiplying the amount to be paid in for one share (the Exercise Price) to be delivered upon the exercise of a share option by the Allotted Number of Shares. The Exercise Price is the product of the multiplication of 1.05 and the closing price of one common share of the Company in ordinary trading at the Tokyo Stock Exchange as of the date of allotment of the share options (or if no trade is made on such date, the date immediately preceding the date on which such ordinary shares are traded), with any fractional amount of less than one yen to be rounded up to one yen.

The Exercise Price will be adjusted as follows:

(i) If the Company effects a share split or a share consolidation after the date of the allotment of the share options, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen:

Exercise Price after Adjustment

=Exercise Price before adjustment × $\frac{1}{\text{Ratio of Share Splitting or Share Consolidation}}$

(ii) If, after the date of allotment of share options, the Company issues common shares at a price lower than the then market price thereof or disposes common shares owned by it, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen; however, the Exercise Price will not be adjusted in the case of the exercise of share options:

Exercise Price after Adjustment = Exercise Price before Adjustment ×

$\frac{\text{Number of Issued and Outstanding Shares} + \frac{\text{Number of Newly Issued Shares} \times \text{Payment amount per Share}}{\text{Market Price}}}{\text{Number of Issued and Outstanding Shares} + \text{Number of Newly Issued Shares}}$

The Number of Issued and Outstanding Shares is the number of shares already issued by the Company after subtraction of the number of shares owned by the Company. In the case of the Company's disposal of shares owned by it, the Number of Newly Issued Shares will be replaced with the Number of Own Shares to Be Disposed.

(iii) In the case of a merger, a company split or capital reduction after the date of allotment of share options, or in any other analogous case requiring the adjustment of the Exercise Price, the Exercise Price shall be appropriately adjusted within a reasonable range.

Table of Contents

(3) Period during Which Share Options Are Exercisable

From May 1, 2011 to April 30, 2015.

(4) Matters regarding Stated Capital and Capital Reserves Increased When Shares Are Issued upon Exercise of Share Options

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc. to be calculated in accordance with Article 40, Paragraph 1 of the Companies Accounting Regulations (*Kaisha Keisan Kisoku*).

Any fractional amount of less than one yen resulting from such calculation will be rounded up to one yen.

(ii) The increased amount of capital reserves shall be the amount of the maximum amount of increases of stated capital, etc., mentioned in (i) above, after the subtraction of increased amount of stated capital mentioned in (i) above.

(5) Restriction on Acquisition of Share Options by Transfer

An acquisition of share options by way of transfer requires the approval of the Board of Directors.

(6) Events for the Company's Acquisition of Share Options

If a proposal for the approval of a merger agreement under which the Company will become an extinguishing company or a proposal for the approval for a share exchange agreement or a share transfer plan under which the Company will become a wholly-owned subsidiary is approved by the Company's shareholders at a shareholders meeting (or by the Board of Directors if no resolution of a shareholders meeting is required for such approval), the Company will be entitled to acquire the share options, without compensation, on a date separately designated by the Board of Directors.

(7) Handling of Fractions

Any fraction of a share (less than one share) to be delivered to any holder of share options who has exercised share options will be disregarded.

(8) Other Conditions for Exercise of Share Options

(i) One share option may not be exercised partially.

(ii) Each holder of share options must continue to be a director, executive officer or employee of the Company until the end of the Company's general meeting of shareholders regarding the final business term within 2 years from the end of the Ordinary General Meeting of Shareholders for the 108th Business Term of the Company.

(iii) Holders of share options will be entitled to exercise their share options for 2 years, and during the exercisable period, even after they lose their positions as directors, executive officers or employees. However, if a holder of share options loses such position due to resignation at his/her initiative, or due to dismissal or discharge by the Company, his/her share options will immediately lose effect.

(iv) No succession by inheritance is authorized for the share options.

(v) Any other conditions for the exercise of share options may be established by the Board of Directors.

Table of Contents

7. Specific Method of Calculation of Remuneration to Directors

The amount of share options issued to the directors of the Company, as remuneration, is the amount obtained by multiplying the fair market value per share option as of the allotment date thereof by the total number of share options allotted to the directors existing as of such allotment date. The fair market value of a share option was calculated with the use of the Black-Scholes model on the basis of various conditions applicable on the allotment date.

The Stock Option Plan Approved on March 30, 2010

1. The Reason for the Necessity to Solicit Those Who Subscribe for Share Options on Particularly Favorable Conditions

Share options were issued to the Company's directors, executive officers and senior employees for the purpose of further enhancing their motivation and morale to improve the Company's performance, with a view to long-term improvement of its corporate value.

2. Grantees of Share Options

The Company's directors, 13 executive officers, and 33 senior employees who are entrusted with important functions.

3. Number of Share Options

The number of share options that the Board of Directors are authorized to issue is 8,900.

4. Cash Payment for Share Options

No cash payment will be required for the share options.

5. Exercise Price

The exercise price is ¥4,573 per share.

6. Features of Share Options

The features of share options are as follows:

(1) Number of Shares acquired upon Exercise of a Share Option

The number of shares acquired upon Exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 890,000 common shares.

However, if the Company effects a share split (including allotment of common shares without compensation; this inclusion being applicable below) or a share consolidation after the date of the allotment of the share options, the Allotted Number of Shares will be adjusted by the following calculation formula:

Allotted Number of Shares after Adjustment

= Allotted Number of Shares before Adjustment × Ratio of Share Splitting or Share Consolidation

Such adjustment will be made only with respect to the number of issued share options that have not then been exercised, and any fractional number of less than one share resulting from such adjustment will be rounded off.

Table of Contents

(2) Amount of Property to Be Contributed upon Exercise of Share Options

The amount of property to be contributed upon the exercise of each share option is the amount obtained by multiplying the amount to be paid in for one share (the Exercise Price) to be delivered upon the exercise of a share option by the Allotted Number of Shares. The Exercise Price is the product of the multiplication of 1.05 and the closing price of one common share of the Company in ordinary trading at the Tokyo Stock Exchange as of the date of allotment of the share options (or if no trade is made on such date, the date immediately preceding the date on which such ordinary shares are traded), with any fractional amount of less than one yen to be rounded up to one yen.

The Exercise Price will be adjusted as follows:

(i) If the Company effects a share split or a share consolidation after the date of the allotment of the share options, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen:

Exercise Price after Adjustment

$$= \text{Exercise Price before adjustment} \times \frac{1}{\text{Ratio of Share Splitting or Share Consolidation}}$$

(ii) If, after the date of allotment of share options, the Company issues common shares at a price lower than the then market price thereof or disposes common shares owned by it, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen; however, the Exercise Price will not be adjusted in the case of the exercise of share options:

Exercise Price after Adjustment = Exercise Price before Adjustment ×

$$\frac{\text{Number of Issued and Outstanding Shares} + \frac{\text{Number of Newly Issued Shares} \times \text{Payment amount per Share}}{\text{Market Price}}}{\text{Number of Issued and Outstanding Shares} + \text{Number of Newly Issued Shares}}$$

The Number of Issued and Outstanding Shares is the number of shares already issued by the Company after subtraction of the number of shares owned by the Company. In the case of the Company's disposal of shares owned by it, the Number of Newly Issued Shares will be replaced with the Number of Own Shares to Be Disposed.

(iii) In the case of a merger, a company split or capital reduction after the date of allotment of share options, or in any other analogous case requiring the adjustment of the Exercise Price, the Exercise Price shall be appropriately adjusted within a reasonable range.

(3) Period during Which Share Options Are Exercisable

From May 1, 2012 to April 30, 2016.

(4) Matters regarding Stated Capital and Capital Reserves Increased When Shares Are Issued upon Exercise of Share Options

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc. to be calculated in accordance with Article 40, Paragraph 1 of the Companies Accounting Regulations (*Kaisha Keisan Kisoku*).

Any fractional amount of less than one yen resulting from such calculation will be rounded up to one yen.

Table of Contents

(ii) The increased amount of capital reserves shall be the amount of the maximum amount of increases of stated capital, etc., mentioned in (i) above, after the subtraction of increased amount of stated capital mentioned in (i) above.

(5) Restriction on Acquisition of Share Options by Transfer

An acquisition of share options by way of transfer requires the approval of the Board of Directors.

(6) Events for the Company's Acquisition of Share Options

If a proposal for the approval of a merger agreement under which the Company will become an extinguishing company or a proposal for the approval for a share exchange agreement or a share transfer plan under which the Company will become a wholly-owned subsidiary is approved by the Company's shareholders at a shareholders meeting (or by the Board of Directors if no resolution of a shareholders meeting is required for such approval), the Company will be entitled to acquire the share options, without compensation, on a date separately designated by the Board of Directors.

(7) Handling of Fractions

Any fraction of a share (less than one share) to be delivered to any holder of share options who has exercised share options will be disregarded.

(8) Other Conditions for Exercise of Share Options

(i) One share option may not be exercised partially.

(ii) Each holder of share options must continue to be a director, executive officer or employee of the Company until the end of the Company's general meeting of shareholders regarding the final business term within 2 years from the end of the Ordinary General Meeting of Shareholders for the 109th Business Term of the Company.

(iii) Holders of share options will be entitled to exercise their share options for 2 years, and during the exercisable period, even after they lose their positions as directors, executive officers or employees. However, if a holder of share options loses such position due to resignation at his/her initiative, or due to dismissal or discharge by the Company, his/her share options will immediately lose effect.

(iv) No succession by inheritance is authorized for the share options.

(v) Any other conditions for the exercise of share options may be established by the Board of Directors.

7. Specific Method of Calculation of Remuneration to Directors

The amount of share options issued to the directors of the Company, as remuneration, is the amount obtained by multiplying the fair market value per share option as of the allotment date thereof by the total number of share options allotted to the directors existing as of such allotment date. The fair market value of a share option was calculated with the use of the Black-Scholes model on the basis of various conditions applicable on the allotment date.

The Stock Option Plan Approved on March 30, 2011

1. The Reason for the Necessity to Solicit Those Who Subscribe for Share Options on Particularly Favorable Conditions

Share options will be issued to the Company's directors, executive officers and senior employees for the purpose of further enhancing their motivation and morale to improve the Company's performance, with a view to long-term improvement of its corporate value.

Table of Contents

2. Grantees of Share Options

The Company's directors, 16 executive officers, and 27 senior employees who are entrusted with important functions.

3. Number of Share Options

The number of share options that the Board of Directors are authorized to issue is 9,120.

4. Cash Payment for Share Options

No cash payment will be required for the share options.

5. Features of Share Options

The features of share options are as follows:

(1) Number of Shares acquired upon Exercise of a Share Option

The number of shares acquired upon Exercise of one share option (the Allotted Number of Shares) is 100 common shares, and the total number of shares to be delivered due to the exercise of share options is 912,000 common shares.

However, if the Company effects a share split (including allotment of common shares without compensation; this inclusion being applicable below) or a share consolidation after the date of the allotment of the share options, the Allotted Number of Shares will be adjusted by the following calculation formula:

Allotted Number of Shares after Adjustment

= Allotted Number of Shares before Adjustment × Ratio of Share Splitting or Share Consolidation

Such adjustment will be made only with respect to the number of issued share options that have not then been exercised, and any fractional number of less than one share resulting from such adjustment will be rounded off.

(2) Amount of Property to Be Contributed upon Exercise of Share Options

The amount of property to be contributed upon the exercise of each share option is the amount obtained by multiplying the amount to be paid in for one share (the Exercise Price) to be delivered upon the exercise of a share option by the Allotted Number of Shares. The Exercise Price is the product of the multiplication of 1.05 and the closing price of one common share of the Company in ordinary trading at the Tokyo Stock Exchange as of the date of allotment of the share options (or if no trade is made on such date, the date immediately preceding the date on which such ordinary shares are traded), with any fractional amount of less than one yen to be rounded up to one yen.

The Exercise Price will be adjusted as follows:

(i) If the Company effects a share split or a share consolidation after the date of the allotment of the share options, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen:

Exercise Price after Adjustment

=Exercise Price before adjustment × $\frac{1}{\text{Ratio of Share Splitting or Share Consolidation}}$

Table of Contents

(ii) If, after the date of allotment of share options, the Company issues common shares at a price lower than the then market price thereof or disposes common shares owned by it, the Exercise Price will be adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen; however, the Exercise Price will not be adjusted in the case of the exercise of share options:

Exercise Price after Adjustment = Exercise Price before Adjustment ×

$$\frac{\text{Number of Issued and Outstanding Shares} + \frac{\text{Number of Newly Issued Shares} \times \text{Payment amount per Share}}{\text{Market Price}}}{\text{Number of Issued and Outstanding Shares} + \text{Number of Newly Issued Shares}}$$

The Number of Issued and Outstanding Shares is the number of shares already issued by the Company after subtraction of the number of shares owned by the Company. In the case of the Company's disposal of shares owned by it, the Number of Newly Issued Shares will be replaced with the Number of Own Shares to Be Disposed.

(iii) In the case of a merger, a company split or capital reduction after the date of allotment of share options, or in any other analogous case requiring the adjustment of the Exercise Price, the Exercise Price shall be appropriately adjusted within a reasonable range.

(3) Period during Which Share Options Are Exercisable

From May 1, 2013 to April 30, 2017.

(4) Matters regarding Stated Capital and Capital Reserves Increased When Shares Are Issued upon Exercise of Share Options

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc. to be calculated in accordance with Article 40, Paragraph 1 of the Companies Accounting Regulations (*Kaisha Keisan Kisoku*).

Any fractional amount of less than one yen resulting from such calculation will be rounded up to one yen.

(ii) The increased amount of capital reserves shall be the amount of the maximum amount of increases of stated capital, etc., mentioned in (i) above, after the subtraction of increased amount of stated capital mentioned in (i) above.

(5) Restriction on Acquisition of Share Options by Transfer

An acquisition of share options by way of transfer requires the approval of the Board of Directors.

(6) Events for the Company's Acquisition of Share Options

If a proposal for the approval of a merger agreement under which the Company will become an extinguishing company or a proposal for the approval for a share exchange agreement or a share transfer plan under which the Company will become a wholly-owned subsidiary is approved by the Company's shareholders at a shareholders meeting (or by the Board of Directors if no resolution of a shareholders meeting is required for such approval), the Company will be entitled to acquire the share options, without compensation, on a date separately designated by the Board of Directors.

(7) Handling of Fractions

Any fraction of a share (less than one share) to be delivered to any holder of share options who has exercised share options will be disregarded.

Table of Contents**(8) Other Conditions for Exercise of Share Options**

(i) One share option may not be exercised partially.

(ii) Each holder of share options must continue to be a director, executive officer or employee of the Company until the end of the Company's general meeting of shareholders regarding the final business term within 2 years from the end of the Ordinary General Meeting of Shareholders for the 110th Business Term of the Company.

(iii) Holders of share options will be entitled to exercise their share options for 2 years, and during the exercisable period, even after they lose their positions as directors, executive officers or employees. However, if a holder of share options loses such position due to resignation at his/her initiative, or due to dismissal or discharge by the Company, his/her share options will immediately lose effect.

(iv) No succession by inheritance is authorized for the share options.

(v) Any other conditions for the exercise of share options may be established by the Board of Directors.

6. Specific Method of Calculation of Remuneration to Directors

The amount of share options to be issued to the directors of the Company, as remuneration, is the amount to be obtained by multiplying the fair market value per share option as of the allotment date thereof by the total number of share options to be allotted to the directors existing as of such allotment date. The fair market value of a share option will be calculated with the use of the Black-Scholes model on the basis of various conditions applicable on the allotment date.

C. Board practices

See Item 6A Directors and senior management and Item 6B Compensation.

D. Employees

The following table shows the numbers of Canon's employees as of December 31, 2011, 2010 and 2009.

	Total	Japan	Americas	Europe	Asia and Oceania
December 31, 2011					
Office	99,847	29,874	15,609	19,680	34,684
Consumer	63,105	15,284	2,227	1,827	43,767
Industry and Others	24,779	15,664	1,369	1,232	6,514
Corporate	10,576	9,524			1,052
Total	198,307	70,346	19,205	22,739	86,017
December 31, 2010					
Office	104,173	31,890	16,528	20,278	35,477
Consumer	59,053	16,081	2,157	1,817	38,998
Industry and Others	23,133	13,900	1,497	1,339	6,397
Corporate	11,027	10,083			944
Total	197,386	71,954	20,182	23,434	81,816
December 31, 2009					
Office	79,668	32,561	7,713	9,136	30,258
Consumer	54,543	16,043	2,051	1,796	34,653

Edgar Filing: CANON INC - Form 20-F

Industry and Others	24,220	15,339	1,320	1,072	6,489
Corporate	10,448	9,692			756
Total	168,879	73,635	11,084	12,004	72,156

Table of Contents

There was an increase of approximately 28,500 employees as the end of fiscal 2010 compared to the end of fiscal 2009. This increase is mainly due to employment increases in Asia region to accommodate production increase and acquisition of Océ N.V.

The Company and its subsidiaries have their own independent labor union. Canon has not experienced a labor strike since its establishment. The Company believes that the relationship between Canon and its labor union is good.

E. Share ownership

The following table shows the numbers of shares owned by the directors and corporate auditors of the Company as of March 29, 2012. The total is 364,581 shares, constituting 0.03% of all outstanding shares.

Name	Position	Number of shares
Fujio Mitarai	Chairman & CEO	108,523
Toshizo Tanaka	Executive Vice President & CFO	20,610
Toshiaki Ikoma	Executive Vice President & CTO	11,000
Kunio Watanabe	Executive Vice President	25,049
Yoroku Adachi	Senior Managing Director	20,297
Yasuo Mitsuhashi	Senior Managing Director	19,057
Shigeyuki Matsumoto	Senior Managing Director	15,052
Toshio Honma	Senior Managing Director	21,552
Masaki Nakaoka	Senior Managing Director	11,900
Haruhisa Honda	Senior Managing Director	18,289
Hideki Ozawa	Managing Director	10,800
Masaya Maeda	Managing Director	9,100
Yasuhiro Tani	Director	5,400
Makoto Araki	Director	2,900
Hiroyuki Suematsu	Director	3,800
Shigeyuki Uzawa	Director	4,600
Kenichi Nagasawa	Director	600
Naoji Otsuka	Director	3,500
Shunji Onda	Corporate Auditor	11,702
Kengo Uramoto	Corporate Auditor	2,750
Tadashi Ohe	Corporate Auditor	33,900
Kazunori Watanabe	Corporate Auditor	2,700
Kuniyoshi Kitamura	Corporate Auditor	1,500
	Total	364,581

The number of shares that may be subscribed for under rights granted to the Directors and the Corporate Auditors, listed above, pursuant to the stock option plan approved by the stockholders on March 28, 2008 is 197,000 shares of common stock. The exercise price of the rights is ¥5,502 per share and the rights are exercisable from May 1, 2010 to April 30, 2014.

The number of shares that may be subscribed for under rights granted to the Directors and the Corporate Auditors, listed above, pursuant to the stock option plan approved by the stockholders on March 27, 2009 is 336,000 shares of common stock. The exercise price of the rights is ¥3,287 per share and the rights are exercisable from May 1, 2011 to April 30, 2015.

The number of shares that may be subscribed for under rights granted to the Directors and the Corporate Auditor, listed above, pursuant to the stock option plan approved by the stockholders on March 30, 2010 is 380,000 shares of common stock. The exercise price of the rights is ¥4,573 per share and the rights are exercisable from May 1, 2012 to April 30, 2016.

Table of Contents

The number of shares that may be subscribed for under rights granted to the Directors and the Corporate Auditor, listed above, pursuant to the stock option plan approved by the stockholders on March 30, 2011 is 400,000 shares of common stock. The exercise price of the rights is ¥3,990 per share and the rights are exercisable from May 1, 2013 to April 30, 2017.

For additional information on the stock option plan, see B. Compensation of this Item.

The Company and certain of its subsidiaries encourage its employees to purchase shares of their Common Stock in the market through an employees stock purchase association.

Item 7. Major Shareholders and Related Party Transactions**A. Major shareholders**

The table below shows the numbers of the Company's shares held by the top ten holders of the Company's shares and their ownership percentage as of December 31, 2011:

Name of major shareholder	Shares owned	Percentage Number of shares owned / Number of shares issued
Japan Trustee Services Bank, Ltd. (Trust Account)	72,376,400	5.4%
The Master Trust Bank of Japan, Ltd. (Trust Account)	69,202,000	5.2%
The Dai-Ichi Mutual Life Insurance Company, Limited	62,360,380	4.7%
Moxley & Co.	37,781,492	2.8%
State Street Bank and Trust Company	28,874,479	2.2%
SSBT 0D05 OMNIBUS ACCOUNT TREATY CLIENTS	28,458,100	2.1%
JP Morgan Chase Bank 380055	27,327,271	2.1%
State Street Bank and Trust Company	20,548,258	1.5%
Sompo Japan Insurance Inc.	20,189,987	1.5%
Mellon Bank, N.A. as agent for its client Mellon Omnibus US Pension	18,448,837	1.4%

Notes:

- 1: Moxley & Co. is a nominee of JPMorgan Chase Bank, which is the depository of Canon's ADRs (American Depositary Receipts.)
- 2: Apart from the above shares, The Dai-Ichi Mutual Life Insurance Company, Limited held 6,180,000 shares contributed to a trust fund for its retirement and severance plans.
- 3: Apart from the above shares, the Company owns 132,231,296 shares (9.9% of total issued shares) of treasury stock.
- 4: Mizuho Corporate Bank, Ltd. and its four affiliated companies listed below submitted a report on large share holdings to the Kanto Local Finance Bureau on July 7, 2010 in their joint names and reported that they owned 67,096,536 shares (5.0%) of the Company as of June 30, 2010 in total as detailed below. However, the Company has not confirmed the status of these holdings as of June 30, 2010.

	As of June 30, 2010	
	Number of shares held	Number of shares held / Number of shares issued
Mizuho Corporate Bank, Ltd.	20,123,736	1.5%
Mizuho Bank, Ltd.	11,491,437	0.9%
Mizuho Securities Co., Ltd.	6,701,197	0.5%
Mizuho Trust & Banking Co., Ltd.	26,620,366	2.0%
Dai-Ichi Kangyo Asset Management Co., Ltd.		
(Subsequently renamed as Mizuho Asset Management Co., Ltd.)	2,159,800	0.1%
Total	67,096,536	5.0%

Table of Contents

Canon's major shareholders do not have different voting rights from other shareholders.

As of December 31, 2011, 20.2% of the issued shares of common stock, including the Company's treasury stock, were held of record by 285 residents of the United States of America.

The Company is not directly or indirectly owned or controlled by any other corporation, by any government, or by any other natural or legal person or persons severally or jointly.

B. Related party transactions

During the latest three fiscal years, Canon has not transacted with, nor does Canon currently plan to transact with a related party (other than certain transactions with subsidiaries and affiliates of the Company). For purposes of this paragraph, a related party includes: (a) enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, Canon; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of Canon that gives them significant influence over Canon, and close members of any such individual's family; (d) key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of Canon, including directors and senior management of companies and close member of such individual's families; (e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of Canon and enterprises that have a member of key management in common with Canon. Close members of an individual's family are those that may be expected to influence, or be influenced by, that person in their dealings with Canon. An associate is an unconsolidated enterprise in which Canon has a significant influence or which has significant influence over Canon. Significant influence over an enterprise is the power to participate in the financial and operating policy decisions of the enterprise but is less than control over those policies. Shareholders beneficially owning a 10% interest in the voting power of the Company are presumed to have a significant influence on Canon.

To the Company's knowledge, no person owned a 10% interest in the voting power of the Company as of March 29, 2012.

In the ordinary course of business on an arm's length basis, Canon purchases and sells materials, supplies and services from and to its affiliates accounted for by the equity method. There are 11 affiliates which are accounted for by the equity method. Canon does not consider the amounts of the transactions with the above affiliates to be material to its business.

C. Interests of experts and counsel

Not applicable.

Item 8. Financial Information

A. Consolidated financial statements and other financial information

Consolidated financial statements

This Annual Report contains consolidated financial statements as of December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011 prepared in accordance with U.S. generally accepted accounting principles and audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) by an Independent Registered Public Accounting Firm. The financial statements as of and for the years ended December 31, 2009, 2010, and 2011 have been audited by Ernst & Young ShinNihon LLC, and their audit report covering each of the periods is included in Item 18 of this report.

Refer to Item 18 Financial Statements.

Table of Contents**Legal proceedings**

Other than as described below, neither the Company nor its subsidiaries are involved in any litigation or other legal proceedings that, if determined adversely to the Company or its subsidiaries would individually or in the aggregate have a material adverse effect on the Company or its operations.

In Germany, Verwertungsgesellschaft Wort (VG Wort), a collecting society representing certain copyright holders, has filed a series of lawsuits seeking to impose copyright levies upon digital products such as PCs and printers, that allegedly enable the reproduction of copyrighted materials, against the companies importing and distributing these digital products. VG Wort filed a lawsuit in January 2006 against Canon seeking payment of copyright levies on single-function printers, and the court of first instance in Düsseldorf ruled in favor of the claim by VG Wort in November 2006. Canon lodged an appeal against such decision in December 2006 before the court of appeals in Düsseldorf. Following a decision by the same court of appeals in Düsseldorf on January 23, 2007 in relation to a similar court case seeking copyright levies on single-function printers of Epson Deutschland GmbH, Xerox GmbH and Kyocera Mita Deutschland GmbH, whereby the court rejected such alleged levies, in its judgment of November 13, 2007, the court of appeals rejected VG Wort's claim against Canon. VG Wort appealed further against said decision of the court of appeals before the Federal Supreme Court. In December 2007, for a similar Hewlett-Packard GmbH case relating to single-function printers, the Federal Supreme Court delivered its judgment in favor of Hewlett-Packard GmbH and dismissed VG Wort's claim. VG Wort has already filed a constitutional complaint with the Federal Constitutional Court against said judgment of the Federal Supreme Court. Also, after rejection by the Federal Supreme Court of an appeal by VG Wort in relation to Canon's single-function printers case in September 2008, VG Wort lodged a claim before the Federal Constitutional Court. The Federal Constitutional Court, in the same way as the decision given in the HP case in September 2010, gave its decision in January 2011 that the case should be reverted back to the Federal Supreme Court, admitting VG Wort's claim for lack of due process (i.e., insufficient deliberation before judgment on the merits). The hearing of Canon's case was reverted back to the Federal Supreme Court and it was held in June 2011. During the hearing, the Federal Supreme Court indicated it is possible that Canon's case would be referred to the European Court of Justice for a preliminary ruling. On July 21, 2011, the Federal Supreme Court delivered its decision to refer this case to the European Court of Justice for its preliminary ruling, upon which the Federal Supreme Court will render its final judgment on this case. The timeline of that proceeding from now on is yet to be known. In 2007, an amendment of German copyright law was carried out, and a new law has been effective from January 1, 2008 for both multi-function printers and single-function printers. The new law sets forth that the scope and tariff of copyright levies will be agreed between industry and the collecting society. Industry and the collecting society, based on the requirement under the new law, reached an agreement in December 2008. This agreement is applicable retroactively from January 1, 2008. The timing of the final outcome of the court case regarding the single-function printers sold in Germany before January 1, 2008 remains uncertain.

Dividend policy

Dividends are proposed by the Board of Directors of the Company based on the year-end non-consolidated financial statements of the Company, and are approved at the ordinary general meeting of shareholders, which is held in March of each year. Record holders of the Company's ADSs on the dividends' record dates are entitled to receive payment in full of the declared dividends. In addition to annual dividends, by resolution of the Board of Directors, the Company may declare a cash distribution as an interim dividend. The record date for the Company's year-end dividends and for the interim dividends are December 31 and June 30, respectively.

Canon is being more proactive in returning profits to shareholders, mainly in the form of a dividend, taking into consideration mid-term profit forecast, planned future investments, free cash flow, and other factors.

Table of Contents

In 2011, despite the harsh business environment characterized by the historically strong yen combined with the impact of the quake and floods, Canon was able to achieve net income growth. Additionally, thanks to comprehensive cash flow management, the company realized adequate cash on hand. In light of this situation, Canon plans to distribute a full-year dividend totaling ¥120.00 per share the same amount on an annual basis as was distributed the previous year.

Until our performance returns to a trend of stable expansion, the Company will not declare numerical targets such as a targeted dividend payout ratio. Instead, the Company will take a more comprehensive approach taking into consideration, such factors as our outlook for medium-term profits, planned future investments and free cash flow as the Company works to provide a stable return and actively return profits to shareholders.

B. Significant changes

No significant change has occurred since the date of the annual financial statements.

Item 9. The Offer and Listing

A. Offer and listing details

Trading in domestic markets

The common stock of the Company has been listed on the Tokyo Stock Exchange (TSE), the principal stock exchange market in Japan, since 1949, and is traded on the First Section of the TSE. The shares are also listed on four other regional markets in Japan (Osaka, Nagoya, Fukuoka and Sapporo).

The following table lists the reported high and low sales prices of the shares on the TSE and the closing highs and lows of the Tokyo Stock Price Index (TOPIX) and Nikkei Stock Average for the five most recent years. TOPIX is an index of the market value of stocks listed on the First Section of the TSE. The Nikkei Stock Average, an index of 225 selected stocks on the First Section of the TSE, is another widely accepted index.

Period	TSE (Canon Inc.) (Japanese yen)		TOPIX (Reference data) (Points)		Nikkei Stock Average (Reference data) (Japanese yen)	
	High	Low	High	Low	High	Low
2007 Year	¥ 7,450	¥ 5,190	1,823.89	1,417.47	¥ 18,300.39	¥ 14,669.85
2008 Year	5,820	2,215	1,461.31	721.53	15,156.66	6,994.90
2009 Year	4,070	2,115	987.27	698.46	10,767.00	7,021.28
2010 1(st) quarter	4,400	3,425	984.06	876.77	11,147.62	9,867.39
2(nd) quarter	4,520	3,260	1,001.77	835.91	11,408.17	9,347.07
3(rd) quarter	3,995	3,205	874.25	800.69	9,807.36	8,796.45
4(th) quarter	4,335	3,590	909.67	799.64	10,394.22	9,123.62
2010 Year	4,520	3,205	1,001.77	799.64	11,408.17	8,796.45
2011 1(st) quarter	4,280	3,310	976.28	725.90	10,891.60	8,227.63
2(nd) quarter	3,945	3,470	874.35	801.78	10,017.47	9,318.62
3(rd) quarter	3,935	3,270	879.48	727.33	10,207.91	8,359.70
4(th) quarter	3,630	3,220	779.08	703.88	9,152.39	8,135.79
2011 Year	4,280	3,220	976.28	703.88	10,891.60	8,135.79

Table of Contents

Period	TSE (Canon Inc.) (Japanese yen)		TOPIX (Reference data) (Points)		Nikkei Stock Average (Reference data) (Japanese yen)	
	High	Low	High	Low	High	Low
2011 July	¥ 3,935	¥ 3,680	879.48	841.37	¥ 10,207.91	¥ 9,824.34
August	3,825	3,355	858.53	740.51	10,040.13	8,619.21
September	3,630	3,270	780.99	727.33	9,098.15	8,359.70
October	3,630	3,370	779.08	724.77	9,152.39	8,343.01
November	3,610	3,220	761.04	703.88	8,946.00	8,135.79
December	3,505	3,370	750.61	712.27	8,729.81	8,272.26
2012 January	3,525	3,230	769.36	722.85	8,911.62	8,349.33
February	3,735	3,255	847.83	754.84	9,866.41	8,780.10

Trading in foreign markets

The Company's ADRs are listed on the New York Stock Exchange (NYSE).

Since the Company's 1969 public offering in the United States of U.S.\$9,000,000 principal amount of its 6 1/2 % Convertible Debentures due 1984, there has been limited trading in the over-the-counter market in the Company's ADRs. Since March 16, 1998, each ADR represents one share of the Company's common stock. The Company's ADSs had been quoted on the National Association of Securities Dealers Automated Quotation system (NASDAQ) from 1972 to September 13, 2000 under the symbol CANNY.

On September 14, 2000, Canon listed its ADSs on the NYSE under the symbol CAJ. The table below displays historical high and low prices of our ADSs on the NYSE.

Period	NYSE (Canon Inc.) (U.S. dollars)	
	High	Low
2007 Year	\$ 60.160	\$ 45.680
2008 Year	54.990	24.040
2009 Year	43.950	21.230
2010 1(st) quarter	46.810	38.870
2(nd) quarter	47.540	37.110
3(rd) quarter	47.290	36.800
4(th) quarter	52.150	44.900
2010 Year	52.150	36.800
2011 1(st) quarter	52.300	42.290
2(nd) quarter	48.210	42.150
3(rd) quarter	50.000	42.460
4(th) quarter	47.600	41.700
2011 Year	52.300	41.700

Period	(Canon Inc.) (U.S. dollars)	
	High	Low
2011 July	\$ 50.000	\$ 46.740
August	48.760	43.310
September	47.410	42.460
October	47.600	43.360
November	45.550	41.700
December	44.910	42.910
2012 January	45.370	42.460
February	46.030	42.840

Table of Contents

The depositary and agent of the ADRs is JPMorgan Chase Bank, N.A., located at 1 Chase Manhattan Plaza, Floor 58, New York, N.Y. 10005-1401, U.S.A.

B. Plan of distribution

Not applicable.

C. Markets

See Item 9A Offer and listing details .

D. Selling shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the issue

Not applicable.

Item 10. Additional Information

A. Share capital

Not applicable.

B. Memorandum and articles of association

Objects and Purposes in the Company s Articles of Incorporation

The objects and purposes of the Company, as provided in Article 2 of the Company s Articles of Incorporation, are to engage in the following businesses:

- (1) Manufacture and sale of optical machineries and instruments of various kinds.
- (2) Manufacture and sale of acoustic, electrical and electronic machineries and instruments of various kinds.
- (3) Manufacture and sale of precision machineries and instruments of various kinds.
- (4) Manufacture and sale of medical machineries and instruments of various kinds.
- (5) Manufacture and sale of general machineries, instruments and equipment of various kinds.

Edgar Filing: CANON INC - Form 20-F

- (6) Manufacture and sale of parts, materials, etc. relative to the products mentioned in each of the preceding items.
- (7) Production and sale of software products.
- (8) Manufacture and sale of pharmaceutical products.
- (9) Telecommunications business, and information service business such as information processing service business, information providing service business, etc.
- (10) Contracting for telecommunications works, electrical works and machinery and equipment installation works.

Table of Contents

- (11) Sale, purchase and leasing of real properties, contracting for construction works, design of buildings and supervision of construction works.
- (12) Manpower providing business, property leasing business and travel business.
- (13) Business relative to investigation, analysis of the environment and purification process of soil, water, etc.
- (14) Any and all business relevant to any of the preceding items.

Provisions Regarding Directors

There is no provision in the Company's Articles of Incorporation as to a Director's power to vote on a proposal, arrangement or contract in which the Director is materially interested, but, under the Corporation Law of Japan, the law relating to joint stock corporations (known in Japanese as *kabushiki kaisha*) which came into effect on May 1, 2006, a director is required to refrain from voting on such matters at meetings of the board of directors.

The Corporation Law of Japan provides that compensation for directors is determined at a general meeting of shareholders of a company. Within the upper limit approved at the shareholders' meeting, the board of directors determines the amount of compensation for each director. The board of directors may, by its resolution, leave such decision to the discretion of the company's representative director.

The Corporation Law of Japan provides that the incurrence by a company of a significant loan from a third party should be approved by the company's board of directors. The Company's Regulations of the Board of Directors incorporate this requirement.

There is no mandatory retirement age for the Company's Directors under the Corporation Law of Japan or its Articles of Incorporation.

There is no requirement concerning the number of shares an individual must hold in order to qualify him as a director of the Company under the Corporation Law of Japan or its Articles of Incorporation.

Holding of Shares by Foreign Investors

Other than the Japanese unit share system that is described in "Rights of Shareholders - Japanese Unit Share System" below, there are no limitations on the rights of non-residents or foreign shareholders to hold or exercise voting rights on the Company's shares imposed by the laws of Japan or the Company's Articles of Incorporation or other constituent documents.

Rights of Shareholders

Set forth below is information relating to the Company's common stock, including brief summaries of the relevant provisions of its Articles of Incorporation and Regulations for Handling of Shares, as currently in effect, and of the Corporation Law of Japan and related legislation.

General

The Company's authorized share capital is 3,000,000,000 shares, of which 1,333,763,464 shares were issued, including the Company's treasury stock, as of December 31, 2011. On January 5, 2009, a new central clearing system for shares of Japanese listed companies was established pursuant to the Law Concerning Book-Entry Transfer of Corporate Bonds, Shares, etc. (including regulations promulgated thereunder; the "Book-Entry Law"), and the shares of all Japanese companies listed on any Japanese stock exchange, including the Company's shares, became subject to this new system. On the same day, all existing share certificates for such

Table of Contents

shares became null and void. At present, the Japan Securities Depository Center, Inc. (JASDEC) is the only institution that is designated by the relevant authorities as a clearing house which is permitted to engage in the clearing operations of shares of Japanese listed companies under the Book-Entry Law. Under the new clearing system, in order for any person to hold, sell or otherwise dispose of shares of Japanese listed companies, it must have an account at an account management institution unless such person has an account at JASDEC. Account management institutions are financial instruments traders (i.e., securities companies), banks, trust companies and certain other financial institutions which meet the requirements prescribed by the Book-Entry Law.

Under the Book-Entry Law, any transfer of shares is effected through book entry, and title to the shares passes to the transferee at the time when the transferred number of the shares is recorded at the transferee's account at an account management institution. The holder of an account at an account management institution is presumed to be the legal owner of the shares held in such account.

Under the Corporation Law of Japan and the Book-Entry Law, in order to assert shareholders' rights against the Company, a shareholder must have its name and address registered in the register of shareholders of the Company, except in limited circumstances.

The registered beneficial holder of deposited shares underlying the ADSs is the depository for the ADSs. Accordingly, holders of ADSs will not be able to directly assert shareholders' rights.

Distributions of Surplus

Under the Corporation Law of Japan, distributions of cash or other assets by joint stock corporations to their shareholders, so called dividends, are referred to as distributions of Surplus (Surplus is defined in Restriction on Distributions of Surplus below). The Company may make distributions of Surplus to the shareholders any number of times per fiscal year, subject to certain limitations described in Restriction on Distributions of Surplus. Under the Corporation Law of Japan, distributions of Surplus are required to be authorized by a resolution of a general meeting of shareholders.

Under the Articles of Incorporation of the Company, year-end dividends and interim dividends, if any, may be distributed to shareholders (or pledgees) appearing in the register of shareholders as of December 31 and June 30 of each year, respectively.

Distributions of Surplus may be made in cash or in kind in proportion to the number of shares held by each shareholder. A resolution of a shareholders' meeting must specify the kind and aggregate book value of the assets to be distributed, the manner of allocation of such assets to shareholders, and the effective date of the distribution. If a distribution of Surplus is to be made in kind, the Company may, pursuant to a resolution of shareholders' meeting, grant a right to its shareholders to require the Company to make such distribution in cash instead of in kind. If no such right is granted to shareholders, the relevant distribution of Surplus must be approved by a special resolution of a general meeting of shareholders.

Restriction on Distributions of Surplus

When the Company makes a distribution of Surplus, the Company must, until the aggregate amount of its additional paid-in capital and legal reserve reaches one-quarter of its stated capital, set aside in its additional paid-in capital and/or legal reserve an amount equal to one-tenth of the amount of Surplus so distributed.

The amount of Surplus at any given time must be calculated in accordance with the following formula:

$$A + B + C + D - (E + F + G)$$

In the above formula, the letters from A to G are defined as follows:

A = the total amount of other capital surplus and other retained earnings, each such amount that is appearing on its non-consolidated balance sheet as of the end of the last fiscal year;

Table of Contents

B = (if the Company has disposed of its treasury stock after the end of the last fiscal year) the amount of the consideration for such treasury stock received by the Company less the book value thereof;

C = (if the Company has reduced its stated capital after the end of the last fiscal year) the amount of such reduction less the portion thereof that has been transferred to additional paid-in capital or legal reserve (if any);

D = (if the Company has reduced its additional paid-in capital or legal reserve after the end of the last fiscal year) the amount of such reduction less the portion thereof that has been transferred to stated capital (if any);

E = (if the Company has cancelled its treasury stock after the end of the last fiscal year) the book value of such treasury stock;

F = (if the Company has distributed Surplus to its shareholders after the end of the last fiscal year) the total book value of the Surplus so distributed;

G = certain other amounts set forth in the ordinances of the Ministry of Justice, including (if the Company has reduced Surplus and increased its stated capital, additional paid-in capital or legal reserve after the end of the last fiscal year) the amount of such reduction and (if the Company has distributed Surplus to the shareholders after the end of the last fiscal year) the amount set aside in the additional paid-in capital or legal reserve (if any) as required by the ordinances of the Ministry of Justice.

The aggregate book value of Surplus distributed by the Company may not exceed a prescribed distributable amount (the Distributable Amount), as calculated on the effective date of such distribution. The Distributable Amount at any given time shall be equal to the amount of Surplus less the aggregate of the following:

(a) the book value of the Company's treasury stock;

(b) the amount of consideration for the treasury stock disposed of by the Company after the end of the last fiscal year; and

(c) certain other amounts set forth in the ordinances of the Ministry of Justice, including (if the sum of one-half of goodwill and the deferred assets exceeds the total of stated capital, additional paid-in capital and legal reserve, each such amount that is appearing on the non-consolidated balance sheet as of the end of the last fiscal year) all or certain part of such exceeding amount as calculated in accordance with the ordinances of the Ministry of Justice.

If the Company has become at its option a company with respect to which consolidated balance sheets should also be taken into consideration in the calculation of the Distributable Amount (*renketsu haito kisei tekiyo kaisha*), it will be required to further deduct from the amount of Surplus the excess amount (if the amount is zero or below zero) of (x) the total amount of shareholders' equity appearing on its non-consolidated balance sheet as of the end of the last fiscal year and certain other amounts set forth in the ordinances of the Ministry of Justice over (y) the total amount of shareholders' equity and certain amounts set forth in the ordinances of the Ministry of Justice appearing on its consolidated balance sheets as of the end of the last fiscal year.

If the Company has prepared interim financial statements as described below, and if such interim financial statements have been approved (unless exempted by the Corporation Law of Japan) by a general meeting of shareholders, the Distributable Amount must be adjusted to take into account the amount of profit or loss, and the amount of consideration for the treasury stock disposed of by the Company, during the period in respect of which such interim financial statements have been prepared. The Company may prepare non-consolidated interim financial statements consisting of a balance sheet as of any date subsequent to the end of the last fiscal year and an income statement for the period from the first day of the current fiscal year to the date of such balance sheet. Interim financial statements so prepared by the Company must be approved by the board of directors and audited by its independent auditors, as required by the ordinances of the Ministry of Justice.

Table of Contents

Stock Splits

The Corporation Law of Japan permits the Company, by resolution of its Board of Directors, to make stock splits, regardless of the value of net assets (as appearing in its latest non-consolidated balance sheet) per share. In addition, by resolution of the Company's Board of Directors, the Company may increase the authorized shares up to the number reflecting the rate of stock splits and amend its Articles of Incorporation to this effect without the approval of a shareholders' meeting. For example, if each share became three shares by way of a stock split, the Company may increase the authorized shares from the current 3,000,000,000 shares to 9,000,000,000 shares.

Japanese Unit Share System

The Company's Articles of Incorporation provided that 100 shares of common stock constitute one unit. The Corporation Law of Japan permits the Company, by resolution of its Board of Directors, to reduce the number of shares which constitutes one unit or abolish the unit share system, and amend its Articles of Incorporation to this effect without the approval of a shareholders' meeting.

Under the Book-Entry Law, the Company must give notice to JASDEC regarding a stock split at least two weeks prior to the relevant record date. On the effective date of the stock split, the numbers of shares recorded in all accounts held by the Company's shareholders at account management institutions or JASDEC will be increased in accordance with the applicable ratio.

Transferability of Shares Representing Less than One Unit

Under the new clearing system, shares constituting less than one unit are transferable. However, because shares constituting less than one unit do not comprise a trading unit, such shares may not be sold on the Japanese stock exchanges under the rules of the Japanese stock exchanges.

Right of a Holder of Shares Representing Less than One Unit to Require the Company to Purchase Its Shares

A holder of shares representing less than one unit may at any time require the Company to purchase its shares through the account management institutions and JASDEC; provided, however, that the Company is not obliged to do so if the Company does not own its own shares in the number which it is requested to sell. These shares will be purchased at (a) the closing price of the shares reported by the TSE on the day when the request to purchase is made or (b) if no sale takes place on the TSE on that day, then the price at which sale of shares is effected on such stock exchange immediately thereafter.

Right of a Holder of Shares Representing Less than One Unit to Purchase from the Company its Shares up to a Whole Unit

The Articles of Incorporation of the Company provide that a holder of shares representing less than one unit may require the Company to sell its shares to such holder so that the holder can raise its fractional ownership to a whole unit. Such a request shall be made through the account management institutions and JASDEC. These shares will be sold at (a) the closing price of the shares reported by the TSE on the day when the request to sell becomes effective or (b) if no sale has taken place on the TSE on that day, then the price at which sale of shares is effected on such stock exchange immediately thereafter.

Voting Rights of a Holder of Shares Representing Less than One Unit

A holder of shares representing less than one unit cannot exercise any voting rights pertaining to those shares. In calculating the quorum for various voting purposes, the aggregate number of shares representing less than one unit will be excluded from the number of outstanding shares. A holder of shares representing one or more whole units will have one vote for each whole unit represented.

Table of Contents

A holder of shares representing less than one unit does not have any rights relating to voting, such as the right to participate in a demand for the resignation of a director, the right to participate in a demand for the convocation of a general meeting of shareholders and the right to join with other shareholders to propose an agenda item to be addressed at a general meeting of shareholders.

However, a holder of shares constituting less than one unit has all other rights of a shareholder in respect of those shares, including the following rights:

- to receive annual and interim dividends,
- to receive cash or other assets in case of consolidation or split of shares, exchange or transfer of shares or corporate merger,
- to be allotted rights to subscribe for free for new shares when such rights are granted to shareholders, and
- to participate in any distribution of surplus assets upon liquidation.

Ordinary and Extraordinary General Meeting of Shareholders

The Company normally holds its ordinary general meeting of shareholders in March of each year in Ohta-ku, Tokyo or in a neighboring area. In addition, the Company may hold an extraordinary general meeting of shareholders whenever necessary by giving at least two weeks advance notice. Under the Corporation Law of Japan, notice of any shareholders' meeting must be given to each shareholder having voting rights or, in the case of a non-resident shareholder, to his resident proxy or mailing address in Japan in accordance with the Company's Regulations for Handling of Shares, at least two weeks prior to the date of the meeting.

Voting Rights

A shareholder is generally entitled to one vote per one unit of shares as described in this paragraph and under Japanese Unit Share System above. In general, under the Corporation Law of Japan, a resolution can be adopted at a general meeting of shareholders by a majority of the shares having voting rights represented at the meeting. The Corporation Law of Japan and the Company's Articles of Incorporation require a quorum for the election of directors and corporate auditors of not less than one-third of the total number of outstanding shares having voting rights. The Company's shareholders are not entitled to cumulative voting in the election of Directors. A corporate shareholder whose outstanding shares are in turn more than one-quarter directly or indirectly owned by the Company does not have voting rights. Shareholders may exercise their voting rights through proxies, provided that those proxies are also shareholders who have voting rights.

Pursuant to the Corporation Law of Japan and the Company's Articles of Incorporation, a quorum of not less than one-third of the outstanding shares with voting rights must be present at a shareholders' meeting to approve any material corporate actions such as:

- a reduction of stated capital,
- amendment of the Articles of Incorporation (except amendments which the Board of Directors are authorized to make under the Corporation Law of Japan as described in "Stock Splits" and "Japanese Unit Share System" above),
- the removal of a director or corporate auditor,
- establishment of a 100% parent-subsidiary relationship by way of share exchange or share transfer,
- a dissolution, merger or consolidation,
- a corporate separation,
- the transfer of the whole or an important part of the Company's business,
- the taking over of the whole of the business of any other corporation,
- any issuance of new shares at a specially favorable price, stock acquisition rights (*shinkabu yoyakuken*) with specially favorable conditions or bonds with stock acquisition rights (*shinkabu yoyakuken-tsuki shasai*) with specially favorable conditions to persons other than shareholders,

Table of Contents

release of part of Directors or Corporate Auditors liabilities to the Company,
distribution of Surplus in kind with respect to which shareholders are not granted the right to require the Company to make such distribution in cash instead of in kind,
purchase of shares by the Company from a specific shareholder other than its subsidiaries,
consolidation of shares, and
discharge of a portion of liabilities of Directors, Corporate Auditors or independent auditors that are owed to the Company.

At least two-thirds of the outstanding shares having voting rights present at the meeting is required to approve these actions.

The voting rights of holders of ADSs are exercised by the depositary based on instructions from those holders.

Subscription Rights

Holders of shares have no pre-emptive rights. Authorized but unissued shares may be issued at such times and upon such terms as the board of directors determines, subject to the limitations as to the issue of new shares at a specially favorable price mentioned in Voting Rights above. The board of directors may, however, determine that shareholders be given subscription rights to new shares, in which case they must be given on uniform terms to all shareholders as of a record date with not less than two weeks prior public notice. Each of the shareholders to whom such rights are given must also be given at least two weeks prior notice of the date on which such rights will expire.

Stock Acquisition Rights

The Company may issue stock acquisition rights or bonds with stock acquisition rights (in relation to which the stock acquisition rights are undetachable). Except where the issue would be on specially favorable conditions mentioned in Voting Rights above, the issue of stock acquisition rights or bonds with stock acquisition rights may be authorized by a resolution of the board of directors. Subject to the terms and conditions thereof, holders of stock acquisition rights may acquire a prescribed number of shares by exercising their stock acquisition rights and paying the exercise price at any time during the exercise period thereof. Upon exercise of stock acquisition rights, the Company will be obliged to either issue the relevant number of new shares or transfer the necessary number of existing shares held by it as treasury stock to the holder. The entitlements accorded to stock acquisition rights attached to bonds are substantially similar to those accorded to stock acquisition rights issued without being attached to bonds, provided that, if so determined by the board of directors at the time of its resolution authorizing the issue of the relevant bonds with stock acquisition rights, then, upon exercise of the stock acquisition rights, their exercise price will be deemed to have been paid by the holder thereof to the Company in lieu of the Company redeeming the relevant bonds.

Liquidation Rights

In the event of liquidation, the assets remaining after payment of all debts, liquidation expenses and taxes will be distributed among the shareholders in proportion to the number of shares they own.

Liability to Further Calls or Assessments

All of the Company's currently outstanding shares, including shares represented by the ADSs, are fully paid and nonassessable.

Table of Contents

Share Registrar

Mizuho Trust & Banking Co., Ltd. (Mizuho Trust) is the share registrar for the Company's shares. Mizuho Trust's office is located at 2-1, Yaesu 1-chome, Chuo-ku, Tokyo, Japan. Under the clearing system, Mizuho Trust maintains the Company's register of shareholders and records transfers of record ownership upon the Company's receipt of necessary information from JASDEC and other information in the register of shareholders, as described under *Record Date* below.

Record Date

The close of business on December 31 is the record date for the Company's year-end dividends, if paid. June 30 is the record date for interim dividends, if paid. A holder of shares constituting one or more whole units who is registered as a holder on the Company's register of shareholders at the close of business as of December 31 is also entitled to exercise shareholders' voting rights at the ordinary general meeting of shareholders with respect to the fiscal year ending on December 31. In addition, the Company may set a record date for determining the shareholders entitled to other rights and for other purposes by giving at least two weeks prior public notice.

Under the Book-Entry Law, the Company is required to give notice of each record date to JASDEC at least two weeks prior to such record date. JASDEC is required to promptly give the Company notice of the names and addresses of the Company's shareholders, the numbers of shares held by them and other relevant information as of such record date.

The shares generally trade ex-dividend or ex-rights in the Japanese stock exchanges on the third business day before a record date (or if the record date is not a business day, the fourth business day prior thereto), for the purpose of dividends or rights offerings.

Repurchase by the Company of Shares

Under the Corporation Law of Japan, the Company may acquire its shares (i) by soliciting all shareholders to offer to sell its shares held by them (in this case, the certain terms of such acquisition, such as the total number of the shares to be purchased and the total amount of the consideration, shall be set by an ordinary resolution of a general meeting of shareholders in advance, and acquisition shall be effected pursuant to a resolution of the board of directors), (ii) from a specific shareholder other than any of the Company's subsidiaries (pursuant to a special resolution of a general meeting of shareholders), (iii) from any of the Company's subsidiaries (pursuant to a resolution of the board of directors), or (iv) by way of purchase on any Japanese stock exchange on which the Company's shares are listed by way of tender offer (in either case pursuant to a resolution of the board of directors). In the case of (ii) above, if the purchase price or any other consideration to be received by the relevant specific shareholder exceeds the then market price of the Company's shares calculated in a manner set forth in the ordinances of the Ministry of Justice, any other shareholder may make a request to a representative director to be included as a seller in the proposed acquisition by the Company.

The total amount of the purchase price of the Company's shares may not exceed the Distributable Amount, as described in *Restriction on Distributions of Surplus* above.

In addition, the Company may acquire its shares by means of repurchase of any number of shares constituting less than one unit upon the request of the holder of those shares, as described under *Japanese Unit Share System* above.

C. Material contracts

All contracts entered into by Canon during the two years preceding the date of this annual report were entered into in the ordinary course of business.

Table of Contents

D. Exchange controls

(a) Information with respect to Japanese exchange regulations affecting the Company's security holders is as follows:

The Foreign Exchange and Foreign Trade Law of Japan and the cabinet orders and ministerial ordinances thereunder (the Foreign Exchange Regulations) govern certain aspects relating to the issuance of securities by the Company and the acquisition and holding of such securities by non-residents of Japan and by foreign investors, as hereinafter defined.

Non-residents of Japan are defined as individuals who are not resident in Japan and corporations whose principal offices are located outside Japan. Generally, branches and other offices of Japanese corporations located outside Japan are regarded as non-residents of Japan, while branches and other offices located within Japan of non-resident corporations are regarded as residents of Japan. Foreign investors are defined to be (i) individuals not resident in Japan, (ii) corporations which are organized under the laws of foreign countries or whose principal offices are located outside Japan, (iii) corporations of which 50% or more of the shares are held by (i) and / or (ii) above and (iv) corporations in respect of which (a) a majority of the officers are non-resident individuals or (b) a majority of the officers having the power to represent the corporation are non-resident individuals.

Issuance of Securities by the Company

Under the Foreign Exchange Regulations, the issue of securities outside Japan by the Company is, in principle, not subject to a prior notification requirement, but subject to a post reporting requirement of the Minister of Finance. Under the Foreign Exchange Regulations as currently in effect, payments of principal, premium and interest in respect of securities and any additional amounts payable pursuant to the terms thereof may in general be paid when made without any restrictions under the Foreign Exchange Regulations.

Acquisition of Shares

In general, the acquisition of shares of stock of a Japanese company listed on any Japanese stock exchange by a non-resident of Japan from a resident of Japan is not subject to a prior notification requirement, but subject to a post reporting requirement of the Minister of Finance by such resident.

In the case where a foreign investor intends to acquire listed shares (whether from a resident or a non-resident of Japan, from another foreign investor or from or through a designated securities company) and as a result of such acquisition the number of shares held, directly or indirectly, by such foreign investor (if there are other foreign investors with whom the foreign investor has a special relationship, the shares held by such other foreign investors will be included in the number) would become 10% or more of the total outstanding shares of the company, the foreign investor must generally report such acquisition to the Minister of Finance and other Ministers having jurisdiction over the business of the subject company within fifteen days from and including the date of such acquisition. In certain exceptional cases, a prior notification is required in respect of such acquisition.

Acquisition of Shares upon Exercise of Rights for Subscription of Shares

The acquisition by a non-resident of Japan of shares upon exercise of his rights for subscription of shares is exempted from the notification and reporting requirements described under Acquisition of Shares above.

Dividends and Proceeds of Sales

Under the Foreign Exchange Regulations currently in effect, dividends paid on, and the proceeds of sale in Japan of, the shares held by non-residents of Japan may be converted into any foreign currency and repatriated abroad. The acquisition of shares by non-resident shareholders by way of stock splits is not subject to any of the aforesaid notification requirements.

Table of Contents

(b) Reporting of Substantial Shareholdings:

The Financial Instruments and Exchange Law of Japan requires any person who has become, beneficially and solely or jointly, a holder of more than 5% of the total outstanding voting shares of capital stock of a company listed on any Japanese stock exchange to file with the relevant Local Finance Bureau of the Minister of Finance within five business days a report concerning such share ownership. A similar report must also be made in respect of any subsequent change of 1% or more in any such holding. Copies of any such report must also be furnished to the issuer of such shares and all Japanese stock exchanges on which the shares are listed. For this purpose, shares with exercisable rights for subscription of shares held by such holder are taken into account in determining both the size of a holding and a company's total outstanding share capital.

E. Taxation

1. Taxation in Japan

Generally, a non-resident of Japan or non-Japanese corporation (a Non-Resident Holder) is subject to Japanese withholding tax on dividends paid by Japanese corporations. Stock splits are not subject to Japanese income tax. A conversion of retained earnings or legal reserve (but, not additional paid-in capital, in general) into stated capital (whether made in connection with a stock split or otherwise) is not treated as a deemed dividend payment to shareholders for Japanese tax purposes. Thus, such a conversion does not trigger Japanese withholding taxation. (Article 2 (16) of the Japanese Corporation Tax Law and Article 8 (1) (xiii) of the Japanese Corporation Tax Law Enforcement Order).

Pursuant to the Convention Between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Treaty), dividend payments made by a Japanese corporation to a U.S. resident or corporation, unless the recipient of the dividend has a permanent establishment in Japan and the shares or ADSs with respect to which such dividends are paid are effectively connected with such permanent establishment, will be subject to a withholding tax at rate of: (1) 10% for portfolio investors who are qualified U.S. residents eligible for benefits of the Treaty; and (2) 0% (*i.e.*, no withholding) for pension funds which are qualified U.S. residents eligible for benefits of the Treaty, provided that the dividends are not derived from the carrying on of a business, directly or indirectly, by such pension funds. Japan is a party to a number of income tax treaties, conventions and agreements, (collectively Tax Treaties), whereby the maximum withholding tax rate for dividend payments is set at, in most cases, 15% for portfolio investors who are Non-Resident Holders. Specific countries with which such Tax Treaties have been entered into include Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, Luxembourg, New Zealand, Norway, Singapore, Spain, and Sweden. Japan's income tax treaties with Australia, France, The Netherlands, Switzerland and the United Kingdom have been amended to generally reduce the maximum withholding tax rate to 10%. On the other hand, under the Japanese Income Tax Law, the temporary rate of Japanese withholding tax (Temporary Rate) applicable to dividends paid with respect to listed shares, such as those paid by the Company on shares or ADSs, to Non-Resident Holders is 7%, a temporary withholding tax rate which is applicable until December 31, 2013 (the applicable period of the Temporary Rate has been extended pursuant to 2011 Japanese tax legislation). Taking this Temporary Rate into account, the treaty rates such as the 15% rate (or 10% for eligible U.S. residents subject to the Treaty and/or eligible residents subject to other similarly renewed treaties mentioned above) will apply only after the expiration of the Temporary Rate, in general, except for dividends paid to any individual holder who holds 3% or more of the total issued shares for which the applicable rate is 20%. While the treaty rate normally overrides the domestic rate, due to the so-called preservation doctrine under Article 1(2) of the Treaty, and/or due to Article 3-2 of the Special Measures Law for the Income Tax Law, Corporation Tax Law and Local Taxes Law with respect to the Implementation of Tax Treaties, if the tax rate under the domestic tax law is lower than that promulgated under the applicable income tax treaty, then the domestic tax rate is still applicable. If the domestic tax rate applies, as will generally be the case until December 31, 2013 for most holders of shares or ADSs who are U.S. residents or corporations, no treaty application is required to be filed. Gains derived from the sale outside Japan of Japanese corporations' shares or ADSs by Non-Resident Holders, or from the sale of Japanese corporations' shares or ADSs within

Table of Contents

Japan by a non-resident of Japan as an occasional transaction or by a non-Japanese corporation not having a permanent establishment in Japan, are generally not subject to Japanese income or corporation taxes, provided that the seller is a portfolio investor. Japanese inheritance and gift taxes at progressive rates may apply to an individual who has acquired Japanese corporations' shares or ADSs as a distributee, legatee or donee.

2. Taxation in the United States

The following is a discussion of the material U.S. federal income tax consequences of owning and disposing of Canon shares or ADSs to the U.S. holders described below, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular person's decision to acquire, hold or dispose of such securities. The discussion applies only if a U.S. holder holds Canon shares or ADSs as capital assets for U.S. federal income tax purposes and it does not address special classes of holders, such as:

- certain financial institutions;
- insurance companies;
- dealers and traders in securities or foreign currencies;
- persons holding Canon shares or ADSs as part of a hedge, straddle, conversion, other integrated transaction or other similar transaction;
- persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;
- persons liable for the alternative minimum tax;
- tax-exempt entities;
- persons holding Canon shares or ADSs that own or are deemed to own 10% or more of any class of Canon stock;
- persons who acquired Canon shares or ADSs pursuant to the exercise of any employee stock option or otherwise as compensation; or
- persons holding shares in connection with trade or business conducted outside of the United States.

This discussion is based on the Internal Revenue Code of 1986, as amended, administrative pronouncements, judicial decisions, final, temporary and proposed Treasury regulations and the Treaty, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. It is also based in part on representations by the depository and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. An investor should consult its own tax advisers concerning the U.S. federal, state, local and foreign tax consequences of purchasing, owning and disposing of Canon shares or ADSs in its particular circumstances.

As used herein, a U.S. holder is a beneficial owner of Canon shares or ADSs who is eligible for the benefits of the Treaty and is, for U.S. federal tax purposes:

- a citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds Canon shares or ADSs, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. Partnerships holding Canon shares or ADSs and partners in such partnerships should consult their tax advisers as to the particular U.S. federal income tax consequences of holding and disposing of Canon shares or ADSs.

In general, if a U.S. holder owns ADSs, it will be treated for U.S. federal income tax purposes as the owner of the underlying shares represented by those ADSs. Accordingly, no gain or loss will be recognized if a U.S. holder exchanges ADSs for the underlying shares represented by those ADSs.

Table of Contents

The U.S. Treasury has expressed concerns that parties to whom American depositary shares are released before shares are delivered to the depositary (pre-released), or intermediaries in the chain of ownership between the holder and the issuer of the security underlying the American depositary shares, may be taking actions that are inconsistent with the claiming of foreign tax credits for U.S. holders of American depositary shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate U.S. holders. Accordingly, the analysis of the creditability of Japanese taxes and the reduced rates of taxation applicable to dividends received by certain non-corporate U.S. holders, both as described below, could be affected by actions that may be taken by parties to whom ADSs are pre-released or by intermediaries.

This discussion assumes that Canon was not a passive foreign investment company for 2011, as described below.

Taxation of Distributions

Distributions paid on Canon shares or ADSs, other than certain pro rata distributions of common shares, to the extent paid out of Canon's current or accumulated earnings and profits (as determined under U.S. federal income tax principles) will be treated as dividends. Because Canon does not maintain calculations of its earnings and profits under U.S. federal income tax principles, it is expected that distributions will be reported to U.S. holders as dividends. The amount of a dividend will include any amounts withheld by Canon or its paying agent in respect of Japanese taxes. The amount of the dividend will be treated as foreign-source dividend income and will not be eligible for the dividends-received deduction generally allowed to U.S. corporations. Subject to applicable limitations that may vary depending upon a U.S. holder's individual circumstances and the concerns expressed by the U.S. Treasury, dividends paid to certain non-corporate U.S. holders in taxable years beginning before January 1, 2013 will be taxable at a maximum rate of 15%. Non-corporate U.S. holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Dividends paid in Japanese yen will be included in a U.S. holder's income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt of the dividend by the U.S. holder, in the case of Canon shares, or by the depositary, in the case of ADSs, regardless of whether the payment is in fact converted into U.S. dollars at that time. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. holder generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. holder may have foreign currency gain or loss if the dividend is not converted into U.S. dollars on the date of receipt.

Japanese income taxes withheld from cash dividends on Canon shares or ADSs at a rate not exceeding the rate provided by the Treaty will be creditable against a U.S. holder's U.S. federal income tax liability, subject to applicable limitations that may vary depending upon a U.S. holder's circumstances and the concerns expressed by the U.S. Treasury. The rules governing foreign tax credits are complex, and a U.S. holder should consult its own tax adviser regarding the availability of foreign tax credits in its particular circumstances. Instead of claiming a credit, a U.S. holder may, at its election, deduct such Japanese taxes in computing its income, subject to generally applicable limitations under U.S. federal income tax law.

Sale and Other Disposition of Canon Shares or ADSs

For U.S. federal income tax purposes, gain or loss a U.S. holder realizes on the sale or other disposition of Canon shares or ADSs will be capital gain or loss, and will be long-term capital gain or loss if such holder held the Canon shares or ADSs for more than one year. The amount of a U.S. holder's gain or loss will be equal to the difference between the U.S. dollar amount realized on the disposition and the U.S. holder's U.S. dollar tax basis in the Canon shares or ADSs that were disposed of. Such gain or loss will generally be U.S. source gain or loss for foreign tax credit purposes. The deductibility of capital losses is subject to limitation.

Table of Contents

Passive Foreign Investment Company Rules

Canon believes that it was not a passive foreign investment company (PFIC) for U.S. federal income tax purposes for its 2011 fiscal year. However, since PFIC status depends upon the composition of Canon's income and assets and the market value of its assets (including, among others, goodwill and equity investments in less than 25% owned entities) from time to time, there can be no assurance that Canon will not be considered a PFIC for any taxable year. If Canon were treated as a PFIC for any taxable year during which a U.S. holder held Canon shares or ADSs, certain adverse tax consequences could apply to such U.S. holder.

If Canon were treated as a PFIC for any taxable year during which a U.S. holder held Canon shares or ADSs, gain recognized by a U.S. holder on the sale or other disposition of Canon shares or ADSs would be allocated ratably over its holding period for such securities. The amounts allocated to the taxable year of the sale or other disposition and to any year before Canon became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect in such taxable year for individuals or corporations, as appropriate, and an interest charge would be imposed on the tax liability attributable to such allocated amounts. Further, any distribution in respect of Canon shares or ADSs in excess of 125% of the average of the annual distributions on such securities received by a U.S. holder during the preceding three years or its holding period, whichever is shorter, would be subject to taxation as described immediately above. Certain elections (including a mark-to-market election) may be available to a U.S. holder that may mitigate the adverse tax consequences resulting from PFIC status.

In addition, if Canon were treated as a PFIC in a taxable year in which it pays a dividend or the prior taxable year, the 15% tax rate discussed above with respect to dividends paid to certain non-corporate U.S. holders would not apply.

Information Reporting and Backup Withholding

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and to backup withholding unless the U.S. holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. holder provides a correct taxpayer identification number and certifies that it is not subject to backup withholding.

Backup withholding is not an additional tax. The amount of any backup withholding from a payment to a U.S. holder will be allowed as a credit against such holder's U.S. federal income tax liability and may entitle it to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

Certain U.S. holders who are individuals may be required to report information relating to stock of a non-U.S. person, generally on IRS Form 8938, subject to certain exceptions (including an exception for stock held in custodial accounts maintained by a U.S. financial institution). U.S. holders are urged to consult their tax advisers regarding the effect, if any, of this requirement on their tax reporting obligations.

F. Dividends and paying agents

Not applicable.

G. Statement by experts

Not applicable.

Table of Contents**H. Documents on display**

Under the Securities Exchange Act of 1934, as amended (the Exchange Act), the Company is subject to requirements information disclosure. The Company files various reports and other information, including Form 20-F and Annual Reports, with the Securities Exchange Commission and the NYSE. These reports may be inspected at the following sites.

Securities Exchange Commission (Public Reference Room):

100 F Street, N.E., Washington D.C. 20549

New York Stock Exchange, Inc.:

20 Broad Street, New York, New York 10005

Form 20-F is also available at the Electronic Data Gathering, Analysis, Retrieval system (EDGAR) website which is maintained by the Securities Exchange Commission.

Securities Exchange Commission Home Page:

<http://www.sec.gov>

I. Subsidiary information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk**Market risk exposures**

Canon is exposed to market risks, including changes in foreign currency exchange rates, interest rates and prices of marketable securities and investments. In order to hedge the risks of changes in foreign currency exchange rates, Canon uses derivative financial instruments.

Equity price risk

Canon holds marketable securities included in current assets, which consist generally of highly-liquid and low-risk instruments. Investments included in noncurrent assets are held as long-term investments. Canon does not hold marketable securities and investments for trading purposes.

Maturities and fair values of such marketable securities and investments with original maturities of more than three months, all of which were classified as available-for-sale securities, were as follows at December 31, 2011 and 2010.

Available-for-sale securities

	2011		2010	
	Cost	Fair value	Cost	Fair value
	(Millions of yen)			
Due within one year	¥ 20	¥ 20	¥ 1,001	¥ 1,001
Due after one year through five years	962	926	952	972
Due after five years through ten years	1,646	1,608	2,026	1,981
Equity securities	15,911	17,724	18,288	23,402
	¥ 18,539	¥ 20,278	¥ 22,267	¥ 27,356

Foreign currency exchange rate and interest rate risk

Canon operates internationally, exposing it to the risk of changes in foreign currency exchange rates. Derivative financial instruments are comprised principally of foreign currency exchange contracts utilized by the Company and certain of its subsidiaries to reduce the risk. Canon assesses foreign currency exchange rate risk by

Table of Contents

continually monitoring changes in the exposures and by evaluating hedging opportunities. Canon does not hold or issue derivative financial instruments for trading purposes. Canon is also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations. Most of the counterparties are internationally recognized financial institutions and selected by Canon taking into account their financial condition, and contracts are diversified across a number of major financial institutions.

Canon's international operations expose Canon to the risk of changes in foreign currency exchange rates. Canon uses foreign exchange contracts to manage certain foreign currency exchange exposures principally from the exchange of U.S. dollars and euros into Japanese yen. These contracts are primarily used to hedge the foreign currency exposure of forecasted intercompany sales and intercompany trade receivables which are denominated in foreign currencies. In accordance with Canon's policy, a specific portion of foreign currency exposure resulting from forecasted intercompany sales are hedged using foreign exchange contracts which principally mature within three months.

The following table provides information about Canon's major derivative financial instruments related to foreign currency exchange transactions existing at December 31, 2011. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2012.

	U.S.\$	Euro	Others	Total
	(Millions of yen)			
Forwards to sell foreign currencies:				
Contract amounts	¥ 217,566	¥ 148,478	¥ 25,411	¥ 391,455
Estimated fair value	(1,033)	4,796	(80)	3,683
Forwards to buy foreign currencies:				
Contract amounts	¥ 33,081	¥ 41,935	¥	¥ 75,016
Estimated fair value	175	(1,750)		(1,575)

All of Canon's long-term debt is fixed rate debt. Canon expects that fair value changes and cash flows resulting from reasonable near-term changes in interest rates will be immaterial. Accordingly, Canon believes interest rate risk is insignificant. See also Note 9 of the Notes to Consolidated Financial Statements.

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings through other income (deductions) in the same period as the hedged items affect earnings. Substantially all such amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next twelve months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2011, 2010 and 2009. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥457 million, ¥302 million and ¥462 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Canon has entered into certain foreign currency exchange contracts to manage its foreign currency exposures. These foreign currency exchange contracts have not been designated as hedges. Accordingly, the changes in fair values of these contracts are recorded in earnings immediately.

Table of Contents

Item 12. Description of Securities Other than Equity Securities

A. Debt securities

Not applicable.

B. Warrants and rights

Not applicable.

C. Other securities

Not applicable.

D. American Depositary Shares

3. (a) Depositing or substituting the underlying shares
Not applicable.

(b) Receiving or distributing dividends
Not applicable.

(c) Selling or exercising rights
Upon the distribution or sale of Canon's ADSs, a holder of American Depositary Receipts is required to pay a commission fee of \$5.00 to the depositary for each 100 ADSs (or part of the 100 ADSs) for this transaction.

(d) Withdrawing an underlying security
Not applicable.

(e) Transferring, splitting or grouping receipts
Not applicable.

(f) General depositary services, particularly those charged on an annual basis
Not applicable.

(g) Expenses of the depositary
Not applicable.

Table of Contents

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Canon's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and Canon's chief executive officer and chief financial officer concluded that Canon's disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act are effective at the reasonable assurance level as of December 31, 2011.

Management's Report on Internal Control over Financial Reporting

The management of Canon is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Exchange Act, as amended, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Canon's management assessed the effectiveness of internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (the COSO criteria).

Based on its assessment, management concluded that, as of December 31, 2011, Canon's internal control over financial reporting was effective based on the COSO criteria.

Canon's independent registered public accounting firm, Ernst & Young ShinNihon LLC, has issued an audit report on the effectiveness of Canon's internal control over financial reporting. This report appears in Item 18.

Changes in Internal Control over Financial Reporting

There has been no change in Canon's internal control over financial reporting that occurred during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

Table of Contents**Item 16A. Audit Committee Financial Expert**

Canon's Board of Corporate Auditors has determined that Shunji Onda and Kazunori Watanabe each qualify as an audit committee financial expert as defined by the rules of the SEC. Mr. Onda began his career at Canon in 1972, and since that time has worked in the field of finance and accounting for more than thirty years. From 2006 to 2007, Mr. Onda served as a Deputy Group Executive of Finance & Accounting HQ, the division responsible for Canon's consolidated reporting. Mr. Watanabe registered as a Certified Public Accountant in Japan in 1978, and since that time has worked in the field of audit as independent auditor of several companies such as electric industry areas for more than thirty years. Mr. Onda and Mr. Watanabe were elected as one of Canon's corporate auditors at an ordinary general meeting of shareholders held in March 2010. Mr. Onda and Mr. Watanabe met the independence requirements imposed on corporate auditors as set forth by Japanese legal provisions.

Item 16B. Code of Ethics

Canon maintains a Canon Group Code of Conduct, or Code of Conduct, applicable to all executives and employees. The Code of Conduct sets forth provisions relating to honest and ethical conduct (including the handling of conflicts of interest), compliance with applicable laws, rules and regulations and accountability for adherence to the provisions of the Code of Conduct. The Board of Directors maintains a Code of Ethics as a supplement to the Code of Conduct. This Code of Ethics applies to Canon's President and Chief Executive Officer, each member of the Board of Directors (which includes the Chief Financial Officer) and general managers belonging to Canon's accounting headquarters. The Code of Ethics requires full, fair, accurate, timely and understandable disclosure in reports and documents that Canon files with or submits to the SEC and in Canon's other communications with the public, prompt internal reporting of violations of the Code of Conduct or Code of Ethics, and accountability for adherence to their provisions. Both the Code of Conduct and the Code of Ethics have been filed as exhibits.

Item 16C. Principal Accountant Fees and Services*Policy on Pre-Approval of Audit and Non-Audit Services of Independent Auditors*

Canon's board of corporate auditors consisting of five members, including three outside auditors, is responsible for the oversight of the services of its independent registered public accounting firm. The board of corporate auditors has established Pre-Approval Policies and Procedures for Audit and Non-Audit Services. These policies and procedures govern the board of corporate auditors' review and approval of the board of director's engagement of Canon's independent registered public accounting firm to render audit or non-audit services. Non-audit services include audit-related services, tax services and other services, as described in greater detail below under Fees and Services. Canon and any affiliate controlled by Canon directly, indirectly or through one or more intermediaries must follow these policies and procedures before any engagement of Canon's independent registered public accounting firm for U.S. securities law reporting purposes.

The policies and procedures stipulate three means by which audit and non-audit services may be pre-approved, depending on the content of and the fee for the services.

All services provided to Canon necessary to perform an annual audit or review to comply with the standards of the Public Company Accounting Oversight Board (United States), in any jurisdiction, including tax services and accounting consultation necessary to comply with the standards of the Public Company Accounting Oversight Board (United States) in those jurisdictions, and any engagement of an Independent Registered Public Accounting Firm for any audit or non-audit service involving estimated fees exceeding ¥10,000,000 per single engagement must be pre-approved by the majority of board of corporate auditors. Certain other services may be pre-approved under detailed categories of audit and non-audit services established annually by the board of corporate auditors, as long as those services do not exceed

Table of Contents

specified maximum yen limits for aggregate fees relating to each of those categories. Any engagement of an Independent Registered Public Accounting Firm by this means must be reported to the board of corporate auditors at its next regularly scheduled meeting. For services that are not covered by the above two means of pre-approval, the board of corporate auditors has delegated pre-approval authority to any of the standing corporate auditors of the board. Any engagement of an Independent Registered Public Accounting Firm pre-approved by one of the standing corporate auditors is required to be reported to the board of corporate auditors at its next regularly scheduled meeting.

Additional services may be pre-approved by the board of corporate auditors on an individual basis.

No services were provided for which pre-approval was waived pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

Fees and services

The following table discloses the aggregate fees accrued or paid to Canon's principal accountant and member firms of Ernst & Young for each of the last two fiscal years and briefly describes the services performed:

	Year ended December 31, 2011	Year ended December 31, 2010
	(Millions of yen)	
Audit fees	¥ 2,176	¥ 2,291
Audit-related fees	59	80
Tax fees	134	89
All other fees	420	305
Total	¥ 2,789	¥ 2,765

Audit fees include fees billed for professional services rendered for audits of Canon's annual consolidated financial statements, reviews of consolidated quarterly financial information and statutory audits of the Company and its subsidiaries.

Audit-related fees include fees billed for assurance and related services such as due diligence, accounting consultations and audits in connection with mergers and acquisitions, employee benefit plan audits, internal control reviews, and consultations concerning financial accounting and reporting standards.

Tax fees include fees billed for services related to tax compliance, including the preparation of tax returns and claims for refund, tax planning and tax advice, including assistance with tax audits and appeals, advice related to mergers and acquisitions, tax services for employee benefit plans and assistance with respect to requests for rulings from tax authorities.

All other fees include fees billed primarily for services rendered with respect to advisory and educational services.

Ernst & Young ShinNihon LLC served as Canon's principal accountant for 2011 and 2010.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Canon is relying on the general exemption contained in Rule 10A-3(c)(3) under the Exchange Act. Because of such reliance, Canon does not have an audit committee which can act independently and satisfy the other requirements of Rule 10A-3 under the Exchange Act.

Table of Contents

According to Rule 10A-3 under the Exchange Act and NYSE listing standards, Canon's board of corporate auditors has been identified to act in place of an audit committee. The board of corporate auditors meets the following requirements of the general exemption contained in Rule 10A-3(c)(3):

the board of corporate auditors is established pursuant to applicable Japanese law and Canon's Articles of Incorporation; under Japanese legal requirements, the board of corporate auditors is separate from the board of directors; the board of corporate auditors is not elected by the management of Canon and no executive officer of Canon is a member of the board of corporate auditors; all of the members of the board of corporate auditors meet specific independence requirements from the Company and Canon, the management and the auditing firm, as set forth by Japanese legal provisions; the board of corporate auditors, in accordance with and to the extent permitted by Japanese law, is responsible for the appointment, retention and oversight of the work of Canon's external auditors engaged for the purpose of issuing audit reports on Canon's annual financial statements; the board of corporate auditors maintains a complaints procedure in accordance with Rule 10A-3(b)(3) of the Exchange Act; the board of corporate auditors is authorized to engage independent counsel and other advisers, as it deems appropriate; and the board of corporate auditors is provided with appropriate funding for payment of (i) compensation to Canon's independent registered public accounting firm engaged for the purpose of issuing audit reports on Canon's annual financial statements, (ii) compensation to independent counsel and other advisers engaged by the board of corporate auditors, and (iii) ordinary administrative expenses of the board of corporate auditors in carrying out its duties.

Canon's reliance on Rule 10A-3(c)(3) does not, in its opinion, materially adversely affect the ability of its board of corporate auditors to act independently and to satisfy the other requirements of Rule 10A-3.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table sets forth, for each of the months indicated, the total number of shares purchased by Canon, or on Canon's behalf or by any affiliated purchaser, the average price paid per share, the number of shares purchased pursuant to the applicable shareholder resolution or board resolution, which are publicly announced, and the maximum number of shares that may yet be purchased pursuant to these shareholder resolutions or board resolutions.

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum number of shares that may yet be purchased under the plans or programs
2011	(Shares)	(Yen)		
January 1 - January 31	1,317	4,179		
February 1 - February 28	695	4,004		
March 1 - March 31	619	3,763		
April 1 - April 30	1,389	3,591		
May 1 - May 31	3,710,789	3,838	3,709,500	
June 1 - June 30	9,238,786	3,871	9,238,400	
July 1 - July 31	501	3,808		
August 1 - August 31	14,059,730	3,556	14,058,800	
September 1 - September 30	1,299	3,450		
October 1 - October 31	901	3,489		
November 1 - November 30	438	3,425		
December 1 - December 31	485	3,421		

Table of Contents

Notes:

- (1) On May 25, a resolution by documents instead of resolution by board meetings authorized the Company to acquire to up to 15 million shares with an aggregate purchase price of ¥50 billion during the period from May 26, 2011 through July 28, 2011.
- (2) On August 11, a resolution by documents instead of resolution by board meetings authorized the Company to acquire to up to 15 million shares with an aggregate purchase price of ¥50 billion during the period from August 12, 2011 through September 16, 2011.
- (3) The Company has completed all of its share repurchase plans or programs listed above by December 31, 2011.

Column (a) represents the total number of shares purchased as fractional shares from fractional shareowners in accordance with the Corporation Law of Japan, and the purchase of shares from publicly announced plans which is shown in column (c). During 2011, the Company purchased 10,249 shares for a total purchase price of 37,930,900 yen upon requests from holders of shares consisting less than one full unit.

Item 16F. Change in Registrant's Certifying Accountant

Not applicable.

Item 16G. Corporate Governance

1. Directors

Currently, the Company's board of directors does not have any director who could be regarded as an independent director under the NYSE Corporate Governance Rules for U.S. listed companies. Unlike the NYSE Corporate Governance Rules, the Corporation Law of Japan (the Corporation Law) does not require Japanese companies with a board of corporate auditors such as the Company, to appoint independent directors as members of the board of directors. The NYSE Corporate Governance Rules require non-management directors of U.S. listed companies to meet at regularly scheduled executive sessions without the presence of management. Unlike the NYSE Corporate Governance Rules, however, the Corporation Law does not require companies to implement an internal corporate organ or committee comprised solely of independent directors. Thus, the Company's board of directors currently does not include any non-management directors.

2. Committees

Under the Corporation Law, the Company may choose to: (i) have an audit committee, nomination committee and compensation committee and abolish the post of corporate auditors; or (ii) have a board of corporate auditors. The Company has elected to have a board of corporate auditors, whose duties include monitoring and reviewing the management and reporting the results of these activities to the shareholders or board of directors of the Company. While the NYSE Corporate Governance Rules provide that U.S. listed companies must have an audit committee, nominating committee and compensation committee, each composed entirely of independent directors, the Corporation Law does not require companies to have specified committees, including those that are responsible for director nomination, corporate governance and executive compensation.

The Company's board of directors nominates candidates for directorships and submits a proposal at the general meeting of shareholders for shareholder approval. Pursuant to the Corporation Law, the shareholders then vote to elect directors at the meeting. The Corporation Law requires that the total amount or calculation method of compensation for directors and corporate auditors be determined by a resolution of the general meeting of shareholders respectively, unless the amount or calculation method is provided under the Articles of Incorporation. As the Articles of Incorporation of the Company do not provide an amount or calculation method, the amount of compensation for the directors and corporate auditors of the Company is determined by a resolution of the general meeting of shareholders. The allotment of compensation for each director from the total

Table of Contents

amount of compensation is determined by the Company's board of directors, and the allotment of compensation to each corporate auditor is determined by consultation among the Company's corporate auditors.

3. Audit Committee

The Company avails itself of paragraph (c)(3) of Rule 10A-3 of the Security Exchange Act, which provides that a foreign private issuer which has established a board of corporate auditors shall be exempt from the audit committee requirements, subject to certain requirements which continue to be applicable under Rule 10A-3. Pursuant to the requirements of the Corporation Law, the shareholders elect the corporate auditors by resolution of a general meeting of shareholders. The Company currently has five corporate auditors, although the minimum number of corporate auditors required pursuant to the Corporation Law is three. Unlike the NYSE Corporate Governance Rules, Japanese laws and regulations, including the Corporation Law, do not require corporate auditors to be experts in accounting or to have any other area of expertise. Under the Corporation Law, a board of corporate auditors may determine the auditing policies and methods for investigating the business and assets of a Company, and may resolve other matters concerning the execution of the corporate auditor's duties. The board of corporate auditors prepares auditors' reports and may veto a proposal for the nomination of corporate auditors, accounting auditors and the determination of the amount of compensation for the accounting auditors put forward by the board of directors. Under the Corporation Law, the half or more of a company's corporate auditors must be outside corporate auditors. These are individuals who are prohibited to have ever been a director, executive officer, manager, or employee of the Company or its subsidiaries. The Company's current corporate auditor system meets these requirements. In addition, pursuant to the regulations of the Japanese stock exchanges, the Company is required to have one or more independent director(s) or independent corporate auditor(s) which terms are defined under the relevant regulations of the Japanese stock exchanges as outside directors or outside corporate auditors (each of which terms is defined under the Corporation Law) who are unlikely to have any conflict of interests with shareholders of the Company. Among the five members on the Company's board of auditors, three are outside corporate auditors. In addition, all such three outside corporate auditors are also qualified as independent corporate auditors under the regulations of the Japanese stock exchanges. The qualifications for an outside or independent corporate auditor under the Corporation Law or the regulations of the Japanese stock exchanges are different from the audit committee independence requirement under the NYSE Corporate Governance Rules.

4. Shareholder Approval of Equity Compensation Plans

The NYSE Corporate Governance Rules require that shareholders be given the opportunity to vote on all equity compensation plans and any material revisions of such plans, with certain limited exceptions. Under the Corporation Law, a Company is required to obtain shareholder approval regarding the details of an equity-compensation plan. Stock acquisition rights to be issued to directors and corporate auditors are recognized as part of remuneration of directors and corporate auditors, and the issuance of stock acquisition rights must be approved by shareholders as part of their approval regarding remuneration of directors and corporate auditors.

Table of Contents

PART III

Item 17. Financial Statements

Not applicable.

Item 18. Financial Statements

	Page number
Consolidated financial statements of Canon Inc. and Subsidiaries: <u>Reports of Ernst & Young ShinNihon LLC, Independent Registered Public Accounting Firm</u>	102
<u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>	104
<u>Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009</u>	105
<u>Consolidated Statements of Equity for the years ended December 31, 2011, 2010 and 2009</u>	106
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009</u>	108
<u>Notes to Consolidated Financial Statements</u>	109
Schedule:	
<u>Schedule II Valuation and Qualifying Accounts for the years ended December 31, 2011, 2010 and 2009</u>	153
All other schedules are omitted as permitted by the rules and regulations of the Securities and Exchange Commission as not applicable.	

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Canon Inc.

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 18. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 29, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan

March 29, 2012

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Canon Inc.

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2011, and our report dated March 29, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan

March 29, 2012

Table of Contents

Canon Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2011	2010
	(Millions of yen)	
Assets		
Current assets:		
Cash and cash equivalents <i>(Note 1)</i>	¥ 773,227	¥ 840,579
Short-term investments <i>(Note 2)</i>	125,517	96,815
Trade receivables, net <i>(Note 3)</i>	533,208	557,504
Inventories <i>(Note 4)</i>	476,704	384,777
Prepaid expenses and other current assets <i>(Notes 6, 12 and 17)</i>	244,649	250,754
Total current assets	2,153,305	2,130,429
Noncurrent receivables <i>(Note 18)</i>	16,772	16,771
Investments <i>(Note 2)</i>	51,790	81,529
Property, plant and equipment, net <i>(Notes 5, 6 and 9)</i>	1,190,836	1,201,968
Intangible assets, net <i>(Note 8)</i>	138,030	153,021
Other assets <i>(Notes 6, 8, 11 and 12)</i>	379,994	400,102
Total assets	¥ 3,930,727	¥ 3,983,820
Liabilities and equity		
Current liabilities:		
Short-term loans and current portion of long-term debt <i>(Note 9)</i>	¥ 8,343	¥ 7,200
Trade payables <i>(Note 10)</i>	380,532	383,251
Accrued income taxes <i>(Note 12)</i>	45,900	72,482
Accrued expenses <i>(Notes 11 and 18)</i>	299,422	299,710
Other current liabilities <i>(Notes 5, 12 and 17)</i>	159,651	134,298
Total current liabilities	893,848	896,941
Long-term debt, excluding current installments <i>(Note 9)</i>	3,368	4,131
Accrued pension and severance cost <i>(Note 11)</i>	249,604	197,609
Other noncurrent liabilities <i>(Note 12)</i>	70,240	75,502
Total liabilities	1,217,060	1,174,183
Commitments and contingent liabilities <i>(Note 18)</i>		
Equity:		
Canon Inc. stockholders' equity:		
Common stock		
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2011 and 2010	174,762	174,762
Additional paid-in capital	401,572	400,425
Legal reserve <i>(Note 13)</i>	59,004	57,930
Retained earnings <i>(Note 13)</i>	3,059,298	2,965,237
Accumulated other comprehensive income (loss) <i>(Note 14)</i>	(481,773)	(390,459)
Treasury stock, at cost; 132,231,296 shares in 2011 and 105,295,975 shares in 2010	(661,731)	(562,113)
Total Canon Inc. stockholders' equity	2,551,132	2,645,782
Noncontrolling interests	162,535	163,855
Total equity	2,713,667	2,809,637

Total liabilities and equity

¥ 3,930,727

¥ 3,983,820

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Canon Inc. and Subsidiaries

Consolidated Statements of Income

	Years ended December 31		
	2011	2010	2009
	(Millions of yen)		
Net sales	¥ 3,557,433	¥ 3,706,901	¥ 3,209,201
Cost of sales (<i>Notes 5, 8, 11 and 18</i>)	1,820,670	1,923,813	1,781,808
Gross profit	1,736,763	1,783,088	1,427,393
Operating expenses (<i>Notes 1, 5, 8, 11, 15 and 18</i>):			
Selling, general and administrative expenses	1,050,892	1,079,719	905,738
Research and development expenses	307,800	315,817	304,600
	1,358,692	1,395,536	1,210,338
Operating profit	378,071	387,552	217,055
Other income (deductions):			
Interest and dividend income	8,432	6,022	5,202
Interest expense	(988)	(1,931)	(336)
Other, net (<i>Notes 1, 2, 17 and 20</i>)	(10,991)	1,220	(2,566)
	(3,547)	5,311	2,300
Income before income taxes	374,524	392,863	219,355
Income taxes (<i>Note 12</i>)	120,415	140,160	84,122
Consolidated net income	254,109	252,703	135,233
Less: Net income attributable to noncontrolling interests	5,479	6,100	3,586
Net income attributable to Canon Inc.	¥ 248,630	¥ 246,603	¥ 131,647
		(Yen)	
Net income attributable to Canon Inc. stockholders per share (<i>Note 16</i>):			
Basic	¥ 204.49	¥ 199.71	¥ 106.64
Diluted	204.48	199.70	106.64
Cash dividends per share	120.00	120.00	110.00

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Canon Inc. and Subsidiaries

Consolidated Statements of Equity

	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss) (Millions of yen)	Treasury stock	Total Canon Inc. stockholders equity	Non- controlling interests	Total equity
Balance at December 31, 2008	¥ 174,762	¥ 403,790	¥ 53,706	¥ 2,876,576	¥ (292,820)	¥ (556,222)	¥ 2,659,792	¥ 191,190	¥ 2,850,982
Equity transactions with noncontrolling interests and other		503					503	(1,376)	(873)
Dividends paid to Canon Inc. stockholders				(135,793)			(135,793)		(135,793)
Dividends paid to noncontrolling interests								(3,326)	(3,326)
Transfer to legal reserve			981	(981)					
Comprehensive income:									
Net income				131,647			131,647	3,586	135,233
Other comprehensive income (loss), net of tax (<i>Note 14</i>):									
Foreign currency translation adjustments					33,340		33,340	30	33,370
Net unrealized gains and losses on securities					2,150		2,150	67	2,217
Net gains and losses on derivative instruments					(1,422)		(1,422)	(1)	(1,423)
Pension liability adjustments					(2,066)		(2,066)	1,121	(945)
Total comprehensive income							163,649	4,803	168,452
Repurchase of treasury stock, net				(12)		(30)	(42)		(42)
Balance at December 31, 2009	174,762	404,293	54,687	2,871,437	(260,818)	(556,252)	2,688,109	191,291	2,879,400
Acquisition of subsidiaries								19,168	19,168
Equity transactions with noncontrolling interests and other		(3,787)		(13,453)	(680)	55,250	37,330	(43,214)	(5,884)
Dividends paid to Canon Inc. stockholders				(136,103)			(136,103)		(136,103)
Dividends paid to noncontrolling interests								(2,827)	(2,827)
Transfer to legal reserve			3,243	(3,243)					
Comprehensive income (loss):									
Net income				246,603			246,603	6,100	252,703
Other comprehensive income (loss), net of tax (<i>Note 14</i>):									
Foreign currency translation adjustments					(122,667)		(122,667)	(4,251)	(126,918)
Net unrealized gains and losses on securities					(222)		(222)	76	(146)
Net gains and losses on derivative instruments					833		833	(66)	767
Pension liability adjustments					(6,905)		(6,905)	(2,422)	(9,327)
							117,642	(563)	117,079

Edgar Filing: CANON INC - Form 20-F

Total comprehensive income
(loss)

Repurchase of treasury stock, net	(81)	(4)	(61,111)	(61,196)	(61,196)
--------------------------------------	------	-----	----------	----------	----------

**Balance at December 31,
2010**

¥ 174,762	¥ 400,425	¥ 57,930	¥ 2,965,237	¥ (390,459)	¥ (562,113)	¥ 2,645,782	¥ 163,855	¥ 2,809,637
-----------	-----------	----------	-------------	-------------	-------------	-------------	-----------	-------------

Table of Contents

Canon Inc. and Subsidiaries

Consolidated Statements of Equity (continued)

	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss) (Millions of yen)	Treasury stock	Total Canon Inc. stockholders equity	Non- controlling interests	Total equity
Balance at December 31, 2010	¥ 174,762	¥ 400,425	¥ 57,930	¥ 2,965,237	¥ (390,459)	¥ (562,113)	¥ 2,645,782	¥ 163,855	¥ 2,809,637
Equity transactions with noncontrolling interests and other		1,193		(609)			584	(247)	337
Dividends paid to Canon Inc. stockholders				(152,784)			(152,784)		(152,784)
Dividends paid to noncontrolling interests								(2,838)	(2,838)
Transfer to legal reserve			1,074	(1,074)					
Comprehensive income:									
Net income				248,630			248,630	5,479	254,109
Other comprehensive income (loss), net of tax (<i>Note 14</i>):									
Foreign currency translation adjustments					(53,251)		(53,251)	(835)	(54,086)
Net unrealized gains and losses on securities					(2,017)		(2,017)	(99)	(2,116)
Net gains and losses on derivative instruments					(462)		(462)	13	(449)
Pension liability adjustments					(35,584)		(35,584)	(2,793)	(38,377)
Total comprehensive income							157,316	1,765	159,081
Repurchase of treasury stock, net		(46)		(102)		(99,618)	(99,766)		(99,766)
Balance at December 31, 2011	¥ 174,762	¥ 401,572	¥ 59,004	¥ 3,059,298	¥ (481,773)	¥ (661,731)	¥ 2,551,132	¥ 162,535	¥ 2,713,667

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Canon Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	Years ended December 31		
	2011	2010	2009
	(Millions of yen)		
Cash flows from operating activities:			
Consolidated net income	¥ 254,109	¥ 252,703	¥ 135,233
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	261,343	276,193	315,393
Loss on disposal of fixed assets	8,937	21,120	8,215
Impairment loss of fixed assets (Note 5)	598	1,288	15,466
Impairment loss of investments	8,130	23,330	2,398
Equity in (earnings) losses of affiliated companies	7,368	(10,471)	12,649
Deferred income taxes	29,129	29,381	20,712
(Increase) decrease in trade receivables	9,991	(6,671)	48,244
(Increase) decrease in inventories	(109,983)	(17,532)	143,580
Increase (decrease) in trade payables	35,766	115,726	(76,843)
Increase (decrease) in accrued income taxes	(25,653)	25,228	(21,023)
Increase (decrease) in accrued expenses	8,938	77	(9,827)
Increase (decrease) in accrued (prepaid) pension and severance cost	(2,315)	4,147	4,765
Other, net	(16,796)	29,894	12,273
Net cash provided by operating activities	469,562	744,413	611,235
Cash flows from investing activities:			
Purchases of fixed assets (Note 5)	(238,129)	(199,152)	(327,983)
Proceeds from sale of fixed assets (Note 5)	3,273	3,303	8,893
Purchases of available-for-sale securities	(2,160)	(10,891)	(3,253)
Proceeds from sale and maturity of available-for-sale securities	1,934	3,910	2,460
Increase in time deposits, net	(34,111)	(80,904)	(11,345)
Acquisitions of subsidiaries, net of cash acquired	29	(55,686)	(2,979)
Purchases of other investments	(373)	(1,955)	(37,981)
Other, net	12,994	(758)	1,944
Net cash used in investing activities	(256,543)	(342,133)	(370,244)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	725	5,902	3,361
Repayments of long-term debt	(4,670)	(5,739)	(6,282)
Increase (decrease) in short-term loans, net	2,466	(74,933)	(280)
Dividends paid	(152,784)	(136,103)	(135,793)
Repurchases of treasury stock, net	(99,766)	(61,196)	(42)
Other, net	(3,484)	(7,828)	(3,343)
Net cash used in financing activities	(257,513)	(279,897)	(142,379)
Effect of exchange rate changes on cash and cash equivalents	(22,858)	(76,838)	17,226
Net change in cash and cash equivalents	(67,352)	45,545	115,838
Cash and cash equivalents at beginning of year	840,579	795,034	679,196
Cash and cash equivalents at end of year	¥ 773,227	¥ 840,579	¥ 795,034

Edgar Filing: CANON INC - Form 20-F

Supplemental disclosure for cash flow information (Note 21):

Cash paid during the year for:

Interest	¥	914	¥	1,924	¥	384
Income taxes		120,696		80,212		82,906

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

(a) Description of Business

Canon Inc. (the Company) and subsidiaries (collectively Canon) is one of the world's leading manufacturers in such fields as office products, consumer products and industry and other products. Office products consist mainly of network digital multifunction devices (MFDs), copying machines, laser printers, large format inkjet printers and digital production printers. Consumer products consist mainly of digital single-lens reflex (SLR) cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction printers, single function inkjet printers, image scanners and broadcast equipment. Industry and other products consist mainly of semiconductor lithography equipment, lithography equipment for liquid crystal display (LCD) panels, and medical equipment. Canon's consolidated net sales for the years ended December 31, 2011, 2010 and 2009 were distributed as follows: the Office Business Unit 53.9%, 53.6% and 51.3%, the Consumer Business Unit 36.9%, 37.5% and 40.5%, the Industry and Others Business Unit 11.8%, 11.7% and 11.2%, and elimination between segments 2.6%, 2.8% and 3.0%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 22.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. 80.5%, 81.2% and 78.1% of consolidated net sales for the years ended December 31, 2011, 2010 and 2009 were generated outside Japan, with 27.0%, 27.6% and 27.9% in the Americas, 31.3%, 31.6% and 31.0% in Europe, and 22.2%, 22.0% and 19.2% in Asia and Oceania, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted 19.3%, 20.1% and 20.0% of consolidated net sales for the years ended December 31, 2011, 2010 and 2009, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 27 plants in Japan and 17 overseas plants which are located in countries or regions such as the United States, Germany, France, Netherlands, Taiwan, China, Malaysia, Thailand and Vietnam.

(b) Basis of Presentation

The Company and its domestic subsidiaries maintain their books of account in conformity with financial accounting standards of Japan. Foreign subsidiaries maintain their books of account in conformity with financial accounting standards of the countries of their domicile.

Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with U.S. generally accepted accounting principles (GAAP). These adjustments were not recorded in the statutory books of account.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its majority owned subsidiaries and those variable interest entities where the Company or its consolidated subsidiaries are the primary beneficiaries. All significant intercompany balances and transactions have been eliminated.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(d) Use of Estimates (continued)

the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant estimates and assumptions are reflected in valuation and disclosure of revenue recognition, allowance for doubtful receivables, valuation of inventories, impairment of long-lived assets, environmental liabilities, valuation of deferred tax assets, uncertain tax positions and employee retirement and severance benefit obligations. Actual results could differ materially from those estimates.

(e) Translation of Foreign Currencies

Assets and liabilities of the Company's subsidiaries located outside Japan with functional currencies other than Japanese yen are translated into Japanese yen at the rates of exchange in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the year. Gains and losses resulting from translation of financial statements are excluded from earnings and are reported in other comprehensive income (loss).

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses was a net loss of ¥3,287 million for the year ended December 31, 2011, and were net gains of ¥3,089 million and ¥1,842 million for the years ended December 31, 2010 and 2009, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months classified as available-for-sale securities of ¥204,307 million and ¥249,907 million at December 31, 2011 and 2010, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Additionally, certain debt securities with original maturities of less than three months classified as held-to-maturity securities of ¥1,000 million at December 31, 2010 were also included in cash and cash equivalents. Fair value for these securities approximates their costs.

(g) Investments

Investments consist primarily of time deposits with original maturities of more than three months, debt and marketable equity securities, investments in affiliated companies and non-marketable equity securities. Canon reports investments with maturities of less than one year as short-term investments.

Canon classifies investments in debt and marketable equity securities as available-for-sale or held-to-maturity securities. Canon does not hold any trading securities, which are bought and held primarily for the purpose of sale in the near term.

Available-for-sale securities are recorded at fair value. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of other comprehensive income (loss) until realized. Held-to-maturity securities are recorded at amortized cost, adjusted for amortization of premiums and accretion of discounts.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(g) Investments (continued)

Available-for-sale and held-to-maturity securities are regularly reviewed for other-than-temporary declines in the carrying amount based on criteria that include the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and Canon's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. For debt securities for which the declines are deemed to be other-than-temporary and there is no intent to sell, impairments are separated into the amount related to credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income (loss). For debt securities for which the declines are deemed to be other-than-temporary and there is an intent to sell, impairments in their entirety are recognized in earnings. For equity securities for which the declines are deemed to be other-than-temporary, impairments in their entirety are recognized in earnings. Canon recognizes an impairment loss to the extent by which the cost basis of the investment exceeds the fair value of the investment.

Realized gains and losses are determined by the average cost method and reflected in earnings.

Investments in affiliated companies over which Canon has the ability to exercise significant influence, but does not hold a controlling financial interest, are accounted for by the equity method.

Non-marketable equity securities in companies over which Canon does not have the ability to exercise significant influence are stated at cost and reviewed periodically for impairment.

(h) Allowance for Doubtful Receivables

Allowance for doubtful trade and finance receivables is maintained for all customers based on a combination of factors, including aging analysis, macroeconomic conditions and historical experience. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. When all collection options are exhausted including legal recourse, the accounts or portions thereof are deemed to be uncollectable and charged against the allowance.

(i) Inventories

Inventories are stated at the lower of cost or market value. Cost is determined by the average method for domestic inventories and principally by the first-in, first-out method for overseas inventories.

(j) Impairment of Long-Lived Assets

Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset and the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of by sale are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(k) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally by the declining-balance method, except for certain assets which are depreciated by the straight-line method over the estimated useful lives of the assets.

The depreciation period ranges from 3 years to 60 years for buildings and 1 year to 20 years for machinery and equipment.

Assets leased to others under operating leases are stated at cost and depreciated to the estimated residual value of the assets by the straight-line method over the lease term, generally from 2 years to 5 years.

(l) Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful life of 3 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years. Certain costs incurred in connection with developing or obtaining internal use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(m) Environmental Liabilities

Liabilities for environmental remediation and other environmental costs are accrued when environmental assessments or remedial efforts are probable and the costs can be reasonably estimated. Such liabilities are adjusted as further information develops or circumstances change. Costs of future obligations are not discounted to their present values.

(n) Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Canon records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not realizable.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(n) Income Taxes (continued)

Canon recognizes the financial statement effects of tax positions when it is more likely than not, based on the technical merits, that the tax positions will be sustained upon examination by the tax authorities. Benefits from tax positions that meet the more-likely-than-not recognition threshold are measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties accrued related to unrecognized tax benefits are included in income taxes in the consolidated statements of income.

(o) Stock-Based Compensation

Canon measures stock-based compensation cost at the grant date, based on the fair value of the award, and recognizes the cost on a straight-line basis over the requisite service period, which is the vesting period.

(p) Net Income Attributable to Canon Inc. Stockholders per Share

Basic net income attributable to Canon Inc. stockholders per share is computed by dividing net income attributable to Canon Inc. by the weighted-average number of common shares outstanding during each year. Diluted net income attributable to Canon Inc. stockholders per share includes the effect from potential issuances of common stock based on the assumptions that all stock options were exercised.

(q) Revenue Recognition

Canon generates revenue principally through the sale of office and consumer products, equipment, supplies, and related services under separate contractual arrangements. Canon recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have been transferred to the customer or services have been rendered, the sales price is fixed or determinable, and collectibility is probable.

Revenue from sales of office products, such as office network digital MFDs and laser printers, and consumer products, such as digital cameras and inkjet multifunction printers, is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

Revenue from sales of optical equipment, such as semiconductor lithography equipment and LCD lithography equipment that are sold with customer acceptance provisions related to their functionality, is recognized when the equipment is installed at the customer site and the specific criteria of the equipment functionality are successfully tested and demonstrated by Canon. Service revenue is derived primarily from separately priced product maintenance contracts on equipment sold to customers and is measured at the stated amount of the contract and recognized as services are provided.

Canon also offers separately priced product maintenance contracts for most office products, for which the customer typically pays a stated base service fee plus a variable amount based on usage. Revenue from these service maintenance contracts is measured at the stated amount of the contract and recognized as services are provided and variable amounts are earned.

Revenue from the sale of equipment under sales-type leases is recognized at the inception of the lease. Income on sales-type leases and direct-financing leases is recognized over the life of each respective lease using the interest method. Leases not qualifying as sales-type leases or direct-financing leases are accounted

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(q) Revenue Recognition (continued)

for as operating leases and related revenue is recognized ratably over the lease term. When equipment leases are bundled with product maintenance contracts, revenue is first allocated considering the relative fair value of the lease and non-lease deliverables based upon the estimated relative fair values of each element. Lease deliverables generally include equipment, financing and executory costs, while non-lease deliverables generally consist of product maintenance contracts and supplies.

For all other arrangements with multiple elements, Canon allocates revenue to each element based on its relative selling price if such element meets the criteria for treatment as a separate unit of accounting. Otherwise, revenue is deferred until the undelivered elements are fulfilled and accounted for as a single unit of accounting.

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions in sales are based upon historical trends and other known factors at the time of sale. In addition, Canon provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

Estimated product warranty costs are recorded at the time revenue is recognized and are included in selling, general and administrative expenses in the consolidated statements of income. Estimates for accrued product warranty costs are based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure.

Taxes collected from customers and remitted to governmental authorities are excluded from revenues in the consolidated statements of income.

(r) Research and Development Costs

Research and development costs are expensed as incurred.

(s) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥81,232 million, ¥94,794 million and ¥78,009 million for the years ended December 31, 2011, 2010 and 2009, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥43,308 million, ¥56,306 million and ¥45,966 million for the years ended December 31, 2011, 2010 and 2009, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(u) Derivative Financial Instruments

All derivatives are recognized at fair value and are included in prepaid expenses and other current assets, or other current liabilities in the consolidated balance sheets.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(u) Derivative Financial Instruments (continued)

Canon uses and designates certain derivatives as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). Canon formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. Canon also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Canon discontinues hedge accounting prospectively. Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability in cash flows of the hedged item. Gains and losses from hedging ineffectiveness are included in other income (deductions). Gains and losses related to the components of hedging instruments excluded from the assessment of hedge effectiveness are included in other income (deductions).

Canon also uses certain derivative financial instruments which are not designated as hedges. The changes in fair values of these derivative financial instruments are immediately recorded in earnings.

Canon classifies cash flows from derivatives as cash flows from operating activities in the consolidated statements of cash flows.

(v) Guarantees

Canon recognizes, at the inception of a guarantee, a liability for the fair value of the obligation it has undertaken in issuing guarantees.

(w) Recently Issued Accounting Guidance

In October 2009, the Financial Accounting Standards Board (FASB) issued new accounting guidance for revenue recognition under multiple-deliverable arrangements. This guidance modifies the criteria for separating consideration under multiple-deliverable arrangements and requires allocation of the overall consideration to each deliverable using the estimated selling price in the absence of vendor-specific objective evidence or third-party evidence of selling price for deliverables. As a result, the residual method of allocating arrangement consideration will no longer be permitted. The guidance also requires additional disclosures about how a vendor allocates revenue in its arrangements and about the significant judgments made and their impact on revenue recognition. This guidance is effective for fiscal years beginning on or after June 15, 2010 and was adopted by Canon from the quarter beginning January 1, 2011. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition.

In October 2009, the FASB issued new accounting guidance for software revenue recognition. This guidance modifies the scope of the software revenue recognition guidance to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. This guidance is effective for fiscal years beginning on or after June 15, 2010 and was adopted by Canon from the quarter beginning January 1, 2011. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(w) Recently Issued Accounting Guidance (continued)

In June 2011, the FASB issued an amendment which requires presentation of net income and other comprehensive income in one continuous statement or in two separate but consecutive statements, which will be applied retrospectively for all periods presented. Canon will adopt this amended guidance from the quarter beginning January 1, 2012, and does not expect the adoption of this guidance to have a material impact on Canon's consolidated results of operations and financial condition.

2. Investments

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in short-term investments and investments by major security type at December 31, 2011 and 2010 were as follows:

	Cost	December 31, 2011		Fair value
		Gross unrealized holding gains	Gross unrealized holding losses	
(Millions of yen)				
Current:				
Corporate bonds	¥ 20	¥	¥	¥ 20
Noncurrent:				
Government bonds	¥ 172	¥	¥ 22	¥ 150
Corporate bonds	569	73	84	558
Fund trusts	1,867	2	43	1,826
Equity securities	15,911	3,200	1,387	17,724
	¥ 18,519	¥ 3,275	¥ 1,536	¥ 20,258

	Cost	December 31, 2010		Fair value
		Gross unrealized holding gains	Gross unrealized holding losses	
(Millions of yen)				
Current:				
Government bonds	¥ 1	¥	¥	¥ 1
Corporate bonds	1,000			1,000
	¥ 1,001	¥	¥	¥ 1,001

Noncurrent:

Edgar Filing: CANON INC - Form 20-F

Government bonds	¥ 183	¥	¥ 22	¥ 161
Corporate bonds	1,017	42	65	994
Fund trusts	1,778	20		1,798
Equity securities	18,288	5,768	654	23,402
	¥ 21,266	¥ 5,830	¥ 741	¥ 26,355

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments (continued)

Maturities of available-for-sale debt securities and fund trusts included in short-term investments and investments in the accompanying consolidated balance sheets were as follows at December 31, 2011:

	Cost	Fair value
	(Millions of yen)	
Due within one year	¥ 20	¥ 20
Due after one year through five years	962	926
Due after five years through ten years	1,646	1,608
	¥ 2,628	¥ 2,554

Gross realized gains were ¥204 million, ¥641 million and ¥277 million for the years ended December 31, 2011, 2010 and 2009, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥4,281 million, ¥1,961 million and ¥2,482 million for the years ended December 31, 2011, 2010 and 2009, respectively.

At December 31, 2011, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months are ¥125,497 million and ¥95,814 million at December 31, 2011 and 2010, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥14,583 million and ¥26,475 million at December 31, 2011 and 2010, respectively. Investments with an aggregate cost of ¥14,583 million and ¥24,053 million were not evaluated for impairment at December 31, 2011 and 2010, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥15,776 million and ¥26,817 million at December 31, 2011 and 2010, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), were losses of ¥7,368 million, earnings of ¥10,471 million and losses of ¥12,649 million for the years ended December 31, 2011, 2010 and 2009, respectively.

3. Trade Receivables

Trade receivables are summarized as follows:

	2011	December 31 2010
	(Millions of yen)	
Notes	¥ 16,739	¥ 15,441

Edgar Filing: CANON INC - Form 20-F

Accounts	528,032	556,983
	544,771	572,424
Less allowance for doubtful receivables	(11,563)	(14,920)
	¥ 533,208	¥ 557,504

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Inventories

Inventories are summarized as follows:

	December 31	
	2011	2010
	(Millions of yen)	
Finished goods	¥ 291,023	¥ 232,584
Work in process	166,076	116,679
Raw materials	19,605	35,514
	¥ 476,704	¥ 384,777

5. Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and are summarized as follows:

	December 31	
	2011	2010
	(Millions of yen)	
Land	¥ 268,493	¥ 266,631
Buildings	1,367,187	1,320,121
Machinery and equipment	1,499,331	1,439,246
Construction in progress	94,507	85,673
	3,229,518	3,111,671
Less accumulated depreciation	(2,038,682)	(1,909,703)
	¥ 1,190,836	¥ 1,201,968

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was ¥210,179 million, ¥232,327 million and ¥277,399 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥47,690 million and ¥23,306 million at December 31, 2011 and 2010, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

As a result of continued sluggish demand in the semiconductor manufacturing industry and diminished profitability of the semiconductor lithography equipment business, Canon recognized impairment losses related primarily to property, plant and equipment of its semiconductor lithography equipment business, which are included in the results of the Industry and Others Business Unit for the year ended December 31, 2009. Long-lived assets with a carrying amount of ¥15,390 million were written down to their fair value of zero, which was estimated using discounted future cash flows expected to be generated over their remaining useful life. The impairment losses were included in selling, general and administrative expenses in the consolidated statement of income.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Finance Receivables and Operating Leases

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the marketing of Canon's and complementary third-party products primarily in foreign countries. These receivables typically have terms ranging from 1 year to 8 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

	2011	December 31	2010
	(Millions of yen)		
Total minimum lease payments receivable	¥ 204,326	¥	215,925
Unguaranteed residual values	8,195		11,120
Executory costs	(2,275)		(2,063)
Unearned income	(24,955)		(27,891)
	185,291		197,091
Less allowance for doubtful receivables	(7,039)		(7,983)
	178,252		189,108
Less current portion	(66,337)		(71,500)
	¥ 111,915	¥	117,608

The activity in the allowance for credit losses is as follows:

	Years ended December 31	
	2011	2010
	(Millions of yen)	
Balance at beginning of year	¥ 7,983	¥ 9,023
Charge-offs	(1,937)	(3,103)
Provision	2,052	1,995
Other	(1,059)	68
Balance at end of year	¥ 7,039	¥ 7,983

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or individually evaluated for impairment at December 31, 2011 and 2010 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2011 and 2010 was ¥75,391 million and ¥63,239 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2011 and 2010 was ¥54,791 million and ¥43,829 million, respectively.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Finance Receivables and Operating Leases (continued)

The following is a schedule by year of the future minimum lease payments to be received under financing leases and non-cancelable operating leases at December 31, 2011.

Year ending December 31:	Financing leases	Operating leases
	(Millions of yen)	
2012	¥ 80,411	¥ 7,610
2013	58,396	2,367
2014	37,177	2,045
2015	19,317	1,632
2016	8,486	1,559
Thereafter	539	248
	¥ 204,326	¥ 15,461

7. Acquisitions

In March 2010, Canon acquired 45.2% of the total outstanding shares of Océ N.V. (Océ), which is listed on NYSE Euronext Amsterdam, principally through a fully self-funded public cash tender offer for consideration of ¥50,374 million, in addition to the 22.9% interest Canon held before the public cash tender offer. In addition, Canon acquired Océ's convertible cumulative financing preference shares representing 19.1% of the total outstanding shares of Océ for consideration of ¥8,027 million. As a result, Canon's aggregate interest represents 87.2% of the total outstanding shares of Océ. The fair value of the 12.8% noncontrolling interest in Océ of ¥18,245 million was measured based on the quoted price of Océ's common stock on the acquisition date.

The acquisition was accounted for using the acquisition method. Prior to the March 2010 acquisition date, Canon accounted for its 22.9% interest in Océ using the equity method. The acquisition-date fair value of the previous equity interest of ¥25,508 million was remeasured using the quoted price of Océ's common stock on the acquisition date and included in the measurement of the total acquisition consideration. In connection with the acquisition, Canon repaid ¥55,378 million of Océ's existing bank debt and ¥22,936 million of Océ's existing United States Private Placement notes, which are included in decrease in short-term loans in the consolidated statement of cash flows.

Océ is engaged in research and development, manufacture and sale of document management systems, printing systems for professionals and high-speed, wide format digital printing systems. Canon and Océ have complementary technologies and products and would benefit from this strong business relationship. Amid the increasingly competitive printing industry, Canon is further strengthening its business foundation in order to solidify its position as one of the global leaders. Canon aims to provide diversified solutions to its customers in the printing industry by making Océ a consolidated subsidiary.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Acquisitions (continued)

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at acquisition date.

	(Millions of yen)
Current assets	¥ 122,248
Property, plant and equipment	51,156
Intangible assets	56,297
Goodwill	77,253
Other noncurrent assets	42,658
Non-current assets	227,364
Total acquired assets	349,612
Total assumed liabilities	247,458
Net assets acquired	¥ 102,154

Intangible assets acquired, which are subject to amortization, consist of customer relationships of ¥32,747 million, patented technologies of ¥11,316 million, and other intangible assets of ¥12,234 million. Canon has estimated the amortization period for the customer relationships and patented technologies to be 5 years and 3 years, respectively. The weighted average amortization period for all intangible assets is approximately 4.4 years.

Goodwill recognized, which is assigned to the Office Business Unit for impairment testing, is attributable primarily to expected synergies from combining operations of Océ and Canon. None of the goodwill is expected to be deductible for income tax purposes.

The amount of net sales of Océ included in Canon's consolidated statement of income from the acquisition date for the year ended December 31, 2010 was ¥246,518 million.

The unaudited pro forma net sales as if Océ had been included in Canon's consolidated statements of income from the beginning of the years ended December 31, 2010 and 2009 were ¥3,772,425 million and ¥3,554,316 million, respectively. Pro forma net income was not disclosed because the impact on Canon's consolidated statements of income was not material.

Canon acquired businesses other than those described above during the years ended December 31, 2011, 2010, and 2009 that were not material to its consolidated financial statements.

8. Goodwill and Other Intangible Assets

Intangible assets developed or acquired during the year ended December 31, 2011 totaled ¥35,994 million, which are subject to amortization and primarily consist of software of ¥33,217 million, which is mainly for internal use. The weighted average amortization period for software and intangible assets in total is approximately 4 years and 5 years, respectively.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Goodwill and Other Intangible Assets (continued)

The components of intangible assets subject to amortization at December 31, 2011 and 2010 were as follows:

	December 31, 2011		December 31, 2010	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
	(Millions of yen)			
Software	¥ 205,235	¥ 115,131	¥ 200,245	¥ 109,200
Customer relationships	34,957	18,724	37,637	12,107
Patented technologies	24,342	13,317	25,425	9,377
License fees	20,425	12,867	22,108	14,436
Other	19,235	6,857	16,686	4,641
	¥ 304,194	¥ 166,896	¥ 302,101	¥ 149,761

Aggregate amortization expense for the years ended December 31, 2011, 2010 and 2009 was ¥51,164 million, ¥43,866 million and ¥37,994 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥44,931 million in 2012, ¥33,864 million in 2013, ¥23,759 million in 2014, ¥11,482 million in 2015, and ¥6,134 million in 2016.

Intangible assets not subject to amortization other than goodwill at December 31, 2011 and 2010 were not significant.

For management reporting purposes, goodwill is not allocated to the segments. Goodwill has been allocated to its respective segment for impairment testing.

The changes in the carrying amount of goodwill by segment, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2011 and 2010 were as follows:

	Year ended December 31, 2011			Total
	Office	Consumer	Industry and Others	
	(Millions of yen)			
Balance at beginning of year	¥ 107,301	¥ 12,386	¥ 5,502	¥ 125,189
Translation adjustments and other	(5,241)	(298)	(629)	(6,168)
Balance at end of year	¥ 102,060	¥ 12,088	¥ 4,873	¥ 119,021

	Year ended December 31, 2010			Total
	Office	Consumer	Industry and Others	
	(Millions of yen)			

Edgar Filing: CANON INC - Form 20-F

Balance at beginning of year	¥ 39,845	¥ 13,303	¥ 2,723	¥ 55,871
Goodwill acquired during the year	79,156		3,719	82,875
Translation adjustments and other	(11,700)	(917)	(940)	(13,557)
Balance at end of year	¥ 107,301	¥ 12,386	¥ 5,502	¥ 125,189

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Short-Term Loans and Long-Term Debt

Short-term loans consisting of bank borrowings at December 31, 2011 and 2010 were ¥4,641 million and ¥2,071 million, respectively. The weighted average interest rates on short-term loans outstanding at December 31, 2011 and 2010 were 2.72% and 1.46%, respectively.

Long-term debt consisted of the following:

	December 31	
	2011	2010
	(Millions of yen)	
Loans, principally from banks, maturing in installments through 2020; bearing weighted average interest of 1.68% and 1.83% at December 31, 2011 and 2010, respectively	¥ 1,297	¥ 1,013
0.75% Japanese yen notes, due 2012	1,020	
0.84% Japanese yen notes, due 2013	156	
Capital lease obligations	4,597	8,247
	7,070	9,260
Less current portion	(3,702)	(5,129)
	¥ 3,368	¥ 4,131

The aggregate annual maturities of long-term debt outstanding at December 31, 2011 were as follows:

	(Millions of yen)	
Year ending December 31:		
2012	¥	3,702
2013		1,528
2014		1,132
2015		457
2016		105
Thereafter		146
	¥	7,070

Certain property, plant and equipment with a net book carrying value of ¥2,913 million at December 31, 2011 were mortgaged primarily to secure loans from banks.

Both short-term and long-term bank loans are made under general agreements which provide that security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right to offset cash deposits against obligations that have become due or, in the event of default, against all obligations due to the bank.

10. Trade Payables

Trade payables are summarized as follows:

	December 31	
	2011	2010
	(Millions of yen)	
Notes	¥ 16,519	¥ 13,676
Accounts	364,013	369,575
	¥ 380,532	¥ 383,251

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits

The Company and certain of its subsidiaries have contributory and noncontributory defined benefit pension plans covering substantially all of their employees. Benefits payable under the plans are based on employee earnings and years of service. The Company and certain of its subsidiaries also have defined contribution pension plans covering substantially all of their employees.

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2011, 2010 and 2009 were ¥12,511 million, ¥11,780 million and ¥9,148 million, respectively.

Obligations and funded status

Reconciliations of beginning and ending balances of the benefit obligations and the fair value of the plan assets are as follows:

	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Change in benefit obligations:				
Benefit obligations at beginning of year	¥ 593,274	¥ 551,320	¥ 261,130	¥ 94,170
Service cost	25,875	23,331	5,756	5,660
Interest cost	12,354	12,636	12,748	11,792
Plan participants' contributions			2,680	2,460
Amendments	(1,913)	(423)		(149)
Actuarial (gain) loss	14,845	22,290	3,872	(5,946)
Benefits paid	(17,511)	(15,880)	(8,234)	(7,458)
Acquisition				198,754
Foreign currency exchange rate changes			(15,822)	(38,153)
Benefit obligations at end of year	626,924	593,274	262,130	261,130
Change in plan assets:				
Fair value of plan assets at beginning of year	460,090	457,208	197,835	75,058
Actual return on plan assets	(17,285)	4,533	2,335	19,307
Employer contributions	22,282	13,283	8,228	8,152
Plan participants' contributions			2,680	2,460
Benefits paid	(16,351)	(14,934)	(8,201)	(7,413)
Acquisition				128,043
Foreign currency exchange rate changes			(10,844)	(27,772)
Fair value of plan assets at end of year	448,736	460,090	192,033	197,835
Funded status at end of year	¥ (178,188)	¥ (133,184)	¥ (70,097)	¥ (63,295)

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)
Obligations and funded status (continued)

Amounts recognized in the consolidated balance sheets at December 31, 2011 and 2010 are as follows:

	0(000,000)	0(000,000)	0(000,000)	0(000,000)
	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Other assets	¥ 54	¥ 345	¥ 1,397	¥ 1,318
Accrued expenses			(132)	(533)
Accrued pension and severance cost	(178,242)	(133,529)	(71,362)	(64,080)
	¥ (178,188)	¥ (133,184)	¥ (70,097)	¥ (63,295)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2011 and 2010 before the effect of income taxes are as follows:

	0(000,000)	0(000,000)	0(000,000)	0(000,000)
	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Actuarial loss	¥ 291,778	¥ 257,625	¥ 16,095	¥ 3,538
Prior service credit	(130,712)	(142,473)	(345)	(486)
Net transition obligation		722		
	¥ 161,066	¥ 115,874	¥ 15,750	¥ 3,052

The accumulated benefit obligation for all defined benefit plans was as follows:

	0(000,000)	0(000,000)	0(000,000)	0(000,000)
	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Accumulated benefit obligation	¥ 595,689	¥ 565,406	¥ 238,675	¥ 216,239

The projected benefit obligations and the fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows:

Edgar Filing: CANON INC - Form 20-F

	0(000,000)	0(000,000)	0(000,000)	0(000,000)
	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Plans with projected benefit obligations in excess of plan assets:				
Projected benefit obligations	¥ 622,645	¥ 589,391	¥ 259,517	¥ 258,326
Fair value of plan assets	444,403	455,862	188,023	193,713
Plans with accumulated benefit obligations in excess of plan assets:				
Accumulated benefit obligations	¥ 591,830	¥ 559,468	¥ 160,941	¥ 144,225
Fair value of plan assets	444,403	453,342	111,527	122,590

125

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)*Components of net periodic benefit cost and other amounts recognized in other comprehensive income (loss)*

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2011, 2010 and 2009 consisted of the following components:

	Japanese plans Years ended December 31			Foreign plans Years ended December 31		
	2011	2010	2009	2011	2010	2009
	(Millions of yen)					
Service cost	¥ 25,875	¥ 23,331	¥ 21,759	¥ 5,756	¥ 5,660	¥ 2,426
Interest cost	12,354	12,636	12,535	12,748	11,792	4,251
Expected return on plan assets	(16,485)	(16,591)	(15,808)	(12,112)	(10,540)	(4,211)
Amortization of net transition obligation	722	722	722			
Amortization of prior service credit	(13,674)	(13,878)	(13,650)	(93)	(116)	(98)
Amortization of actuarial loss	14,462	14,545	13,923	621	1,050	1,014
	¥ 23,254	¥ 20,765	¥ 19,481	¥ 6,920	¥ 7,846	¥ 3,382

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2011 and 2010 are summarized as follows:

	Japanese plans Years ended December 31		Foreign plans Years ended December 31	
	2011	2010	2011	2010
	(Millions of yen)			
Current year actuarial (gain) loss	¥ 48,615	¥ 34,348	¥ 13,649	¥ (14,713)
Amortization of actuarial loss	(14,462)	(14,545)	(621)	(1,050)
Prior service credit due to amendments	(1,913)	(423)		(149)
Amortization of prior service credit	13,674	13,878	93	116
Amortization of net transition obligation	(722)	(722)		
	¥ 45,192	¥ 32,536	¥ 13,121	¥ (15,796)

The estimated prior service credit and actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost over the next year are summarized as follows:

	Japanese plans (Millions of yen)	Foreign plans
Prior service credit	¥ (13,137)	¥ (130)
Actuarial loss	16,708	986

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)**Assumptions**

Weighted-average assumptions used to determine benefit obligations are as follows:

	Japanese plans December 31		Foreign plans December 31	
	2011	2010	2011	2010
Discount rate	1.9%	2.1%	4.6%	4.9%
Assumed rate of increase in future compensation levels	3.0%	3.0%	2.4%	2.9%

Weighted-average assumptions used to determine net periodic benefit cost are as follows:

	Japanese plans Years ended December 31			Foreign plans Years ended December 31		
	2011	2010	2009	2011	2010	2009
Discount rate	2.1%	2.3%	2.4%	4.9%	4.9%	5.3%
Assumed rate of increase in future compensation levels	3.0%	3.0%	3.0%	2.9%	2.8%	3.1%
Expected long-term rate of return on plan assets	3.6%	3.6%	3.7%	5.7%	6.1%	6.2%

Canon determines the expected long-term rate of return based on the expected long-term return of the various asset categories in which it invests. Canon considers the current expectations for future returns and the actual historical returns of each plan asset category.

Plan assets

Canon's investment policies are designed to ensure adequate plan assets are available to provide future payments of pension benefits to eligible participants. Taking into account the expected long-term rate of return on plan assets, Canon formulates a model portfolio comprised of the optimal combination of equity securities and debt securities. Plan assets are invested in individual equity and debt securities using the guidelines of the model portfolio in order to produce a total return that will match the expected return on a mid-term to long-term basis. Canon evaluates the gap between expected return and actual return of invested plan assets on an annual basis to determine if such differences necessitate a revision in the formulation of the model portfolio. Canon revises the model portfolio when and to the extent considered necessary to achieve the expected long-term rate of return on plan assets.

Canon's model portfolio for Japanese plans consists of three major components: approximately 30% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 20% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 40% is invested in equity securities, approximately 55% is invested in debt securities, and approximately 5% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)**Plan assets (continued)**

The equity securities are selected primarily from stocks that are listed on the securities exchanges. Prior to investing, Canon has investigated the business condition of the investee companies, and appropriately diversified investments by type of industry and other relevant factors. The debt securities are selected primarily from government bonds, public debt instruments, and corporate bonds. Prior to investing, Canon has investigated the quality of the issue, including rating, interest rate, and repayment dates, and has appropriately diversified the investments. Pooled funds are selected using strategies consistent with the equity and debt securities described above. As for investments in life insurance company general accounts, the contracts with the insurance companies include a guaranteed interest rate and return of capital. With respect to investments in foreign investment vehicles, Canon has investigated the stability of the underlying governments and economies, the market characteristics such as settlement systems and the taxation systems. For each such investment, Canon has selected the appropriate investment country and currency.

The three levels of input used to measure fair value are more fully described in Note 20. The fair values of Canon's pension plan assets at December 31, 2011 and 2010, by asset category, are as follows:

	December 31, 2011							
	Level 1	Japanese plans		Total	Level 1	Foreign plans		Total
		Level 2	Level 3	(Millions of yen)		Level 2	Level 3	
Equity securities:								
Japanese companies (a)	¥ 37,875	¥	¥	¥ 37,875	¥	¥	¥	¥
Foreign companies	4,804			4,804	3,779			3,779
Pooled funds (b)		82,380		82,380		47,779		47,779
Debt securities:								
Government bonds (c)	17,951			17,951	2,326			2,326
Municipal bonds		864		864		19		19
Corporate bonds		8,170		8,170				
Pooled funds (d)		190,832		190,832		92,653		92,653
Mortgage backed securities (and other asset backed securities)		4,842		4,842		2,726		2,726
Life insurance company general accounts		92,700		92,700				
Other assets		7,171	1,147	8,318		42,751		42,751
	¥ 60,630	¥ 386,959	¥ 1,147	¥ 448,736	¥ 6,105	¥ 185,928	¥	¥ 192,033

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)**Plan assets (continued)**

	December 31, 2010							
	Level 1	Japanese plans		Total	Level 1	Foreign plans		Total
		Level 2	Level 3	(Millions of yen)		Level 2	Level 3	
Equity securities:								
Japanese companies (e)	¥ 50,177	¥	¥	¥ 50,177	¥	¥	¥	¥
Foreign companies	5,352			5,352	3,474			3,474
Pooled funds (f)		90,597		90,597		80,666		80,666
Debt securities:								
Government bonds (g)	9,687			9,687	2,074			2,074
Municipal bonds		323		323				
Corporate bonds		6,518		6,518				
Pooled funds (h)		194,286		194,286		104,650		104,650
Mortgage backed securities (and other asset backed securities)		1,980		1,980		232		232
Life insurance company general accounts		91,610		91,610				
Other assets		8,521	1,039	9,560		6,739		6,739
	¥ 65,216	¥ 393,835	¥ 1,039	¥ 460,090	¥ 5,548	¥ 192,287	¥	¥ 197,835

- (a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥1,129 million.
- (b) These funds invest in listed equity securities consisting of approximately 50% Japanese companies and 50% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (c) This class includes approximately 30% Japanese government bonds and 70% foreign government bonds.
- (d) These funds invest in approximately 75% Japanese government bonds, 15% foreign government bonds, 5% Japanese municipal bonds, and 5% corporate bonds for Japanese plans. These funds invest in approximately 40% foreign government bonds and 60% corporate bonds for foreign plans.
- (e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥1,044 million.
- (f) These funds invest in listed equity securities consisting of approximately 50% Japanese companies and 50% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (g) This class includes approximately 50% Japanese government bonds and 50% foreign government bonds.
- (h) These funds invest in approximately 60% Japanese government bonds, 20% foreign government bonds, 10% Japanese municipal bonds, and 10% corporate bonds for Japanese plans. These funds invest in approximately 40% foreign government bonds and 60% corporate bonds for foreign plans.

Each level into which assets are categorized is based on inputs used to measure the fair value of the assets, and does not necessarily indicate the risks or ratings of the assets.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)***Plan assets (continued)***

Level 1 assets are comprised principally of equity securities and government bonds, which are valued using unadjusted quoted market prices in active markets with sufficient volume and frequency of transactions. Level 2 assets are comprised principally of pooled funds that invest in equity and debt securities, corporate bonds and investments in life insurance company general accounts. Pooled funds are valued at their net asset values that are calculated by the sponsor of the fund and have daily liquidity. Corporate bonds are valued using quoted prices for identical assets in markets that are not active. Investments in life insurance company general accounts are valued at conversion value.

The fair value of Level 3 assets, consisting of hedge funds, was ¥1,147 million and ¥1,039 million at December 31, 2011 and 2010, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the years ended December 31, 2011 and 2010 were not significant.

Contributions

Canon expects to contribute ¥21,946 million to its Japanese defined benefit pension plans and ¥8,931 million to its foreign defined benefit pension plans for the year ending December 31, 2012.

Estimated future benefit payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Japanese plans	Foreign plans
	(Millions of yen)	
Year ending December 31:		
2012	¥ 15,100	¥ 8,750
2013	16,137	8,542
2014	17,301	8,763
2015	19,160	9,228
2016	20,893	9,993
2017 2021	130,449	60,255

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes

Domestic and foreign components of income before income taxes and the current and deferred income tax expense (benefit) attributable to such income are summarized as follows:

	Year ended December 31, 2011		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 287,592	¥ 86,932	¥ 374,524
Income taxes:			
Current	¥ 67,671	¥ 23,615	¥ 91,286
Deferred	21,047	8,082	29,129
	¥ 88,718	¥ 31,697	¥ 120,415

	Year ended December 31, 2010		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 302,965	¥ 89,898	¥ 392,863
Income taxes:			
Current	¥ 78,359	¥ 32,420	¥ 110,779
Deferred	35,496	(6,115)	29,381
	¥ 113,855	¥ 26,305	¥ 140,160

	Year ended December 31, 2009		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 130,857	¥ 88,498	¥ 219,355
Income taxes:			
Current	¥ 45,079	¥ 18,331	¥ 63,410
Deferred	15,415	5,297	20,712
	¥ 60,494	¥ 23,628	¥ 84,122

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 40% for the years ended December 31, 2011, 2010 and 2009.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

Amendments to the Japanese tax regulations were enacted into law on November 30, 2011. As a result of these amendments, the statutory income tax rate will be reduced from approximately 40% to 38% effective from the year beginning January 1, 2013, and to approximately 35% effective from the year beginning January 1, 2016 thereafter. Consequently, the statutory income tax rate utilized for deferred tax assets and liabilities expected to be settled or realized in the period from January 1, 2013 to December 31, 2015 is approximately 38% and for periods subsequent to December 31, 2015 the rate is approximately 35%. The adjustments of deferred tax assets and liabilities for this change in the tax rate amounted to ¥6,599 million and have been reflected in income taxes in the consolidated statement of income for the year ended December 31, 2011.

A reconciliation of the Japanese statutory income tax rate and the effective income tax rate as a percentage of income before income taxes is as follows:

	Years ended December 31		
	2011	2010	2009
Japanese statutory income tax rate	40.0%	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	0.6	0.8	0.9
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	(4.3)	(3.5)	(5.4)
Tax credit for research and development expenses	(3.9)	(5.1)	(2.8)
Change in valuation allowance	(0.5)	2.8	5.4
Effect of enacted changes in tax laws and rates on Japanese tax	1.8		
Other	(1.5)	0.7	0.2
Effective income tax rate	32.2%	35.7%	38.3%

Net deferred income tax assets and liabilities are included in the accompanying consolidated balance sheets under the following captions:

	December 31	
	2011	2010
	(Millions of yen)	
Prepaid expenses and other current assets	¥ 61,961	¥ 69,197
Other assets	130,582	136,727
Other current liabilities	(1,735)	(2,149)
Other noncurrent liabilities	(43,542)	(47,827)
	¥ 147,266	¥ 155,948

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2011 and 2010 are presented below:

	December 31	
	2011	2010
	(Millions of yen)	
Deferred tax assets:		
Inventories	¥ 18,885	¥ 23,836
Accrued business tax	3,227	6,200
Accrued pension and severance cost	90,025	78,552
Research and development costs capitalized for tax purposes	12,898	14,740
Property, plant and equipment	31,624	41,737
Accrued expenses	37,992	35,823
Net operating losses carried forward	31,967	28,373
Other	38,220	52,869
	264,838	282,130
Less valuation allowance	(33,788)	(35,307)
Total deferred tax assets	231,050	246,823
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	(6,783)	(8,215)
Net unrealized gains on securities	(1,180)	(2,119)
Tax deductible reserve	(6,385)	(6,038)
Financing lease revenue	(40,878)	(37,353)
Prepaid pension and severance cost	(2,224)	(2,018)
Other	(26,334)	(35,132)
Total deferred tax liabilities	(83,784)	(90,875)
Net deferred tax assets	¥ 147,266	¥ 155,948

The net changes in the total valuation allowance were a decrease of ¥1,519 million for the year ended December 31, 2011, and increases of ¥13,119 million and ¥11,371 million for the years ended December 31, 2010 and 2009, respectively.

Based upon the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the existing valuation allowance, at December 31, 2011.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

At December 31, 2011, Canon had net operating losses which can be carried forward for income tax purposes of ¥116,581 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to twenty years as follows:

	(Millions of yen)	
Within one year	¥	2,588
After one year through five years		5,097
After five years through ten years		37,199
After ten years through twenty years		42,402
Indefinite period		29,295
Total	¥	116,581

Income taxes have not been accrued on undistributed earnings of domestic subsidiaries as the tax law provides a means by which the dividends from a domestic subsidiary can be received tax free.

Canon has not recognized deferred tax liabilities of ¥18,112 million for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2011 and prior years because Canon currently does not expect to have such amounts distributed or paid as dividends to the Company in the foreseeable future. Deferred tax liabilities will be recognized when Canon expects that it will realize those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. At December 31, 2011, such undistributed earnings of these subsidiaries were ¥869,064 million.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Years ended December 31		
	2011	2010	2009
	(Millions of yen)		
Balance at beginning of year	¥ 6,035	¥ 13,235	¥ 12,689
Additions for tax positions of the current year	149	73	
Additions for tax positions of prior years	431	805	1,442
Reductions for tax positions of prior years	(2,139)	(8,354)	(1,106)
Settlements with tax authorities	(1,264)	(2,471)	
Additions from acquisitions		4,066	
Other	(279)	(1,319)	210
Balance at end of year	¥ 2,933	¥ 6,035	¥ 13,235

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥2,809 million and ¥6,035 million at December 31, 2011 and 2010, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in the future period. Based on each of the items

of which Canon is aware at December 31, 2011, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2011 and 2010, and interest and penalties included in income taxes for the years ended December 31, 2011, 2010 and 2009 are not material.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2010. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2003. In other major foreign tax jurisdictions, including the United States and Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2004 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2003 in major foreign tax jurisdictions.

13. Legal Reserve and Retained Earnings

The Corporation Law of Japan provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law of Japan also provides that additional paid-in capital and legal reserve are available for appropriations by the resolution of the stockholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of the respective countries.

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2011, 2010 and 2009 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2011 did not reflect current year-end dividends in the amount of ¥72,092 million which were approved by the stockholders in March 2012.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥1,223,401 million at December 31, 2011.

Retained earnings at December 31, 2011 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥16,217 million.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) are as follows:

	Years ended December 31		
	2011	2010	2009
	(Millions of yen)		
Foreign currency translation adjustments:			
Balance at beginning of year	¥ (325,612)	¥ (202,628)	¥ (235,968)
Adjustments for the year	(53,251)	(122,984)	33,340
Balance at end of year	(378,863)	(325,612)	(202,628)
Net unrealized gains and losses on securities:			
Balance at beginning of year	3,020	3,285	1,135
Adjustments for the year	(2,017)	(265)	2,150
Balance at end of year	1,003	3,020	3,285
Net gains and losses on derivative instruments:			
Balance at beginning of year	917	71	1,493
Adjustments for the year	(462)	846	(1,422)
Balance at end of year	455	917	71
Pension liability adjustments:			
Balance at beginning of year	(68,784)	(61,546)	(59,480)
Adjustments for the year	(35,584)	(7,238)	(2,066)
Balance at end of year	(104,368)	(68,784)	(61,546)
Total accumulated other comprehensive income (loss):			
Balance at beginning of year	(390,459)	(260,818)	(292,820)
Adjustments for the year	(91,314)	(129,641)	32,002
Balance at end of year	¥ (481,773)	¥ (390,459)	¥ (260,818)

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss) (continued)

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments, including amounts attributable to noncontrolling interests, are as follows:

	Years ended December 31		
	Before-tax amount	Tax (expense) or benefit (Millions of yen)	Net-of-tax amount
2011:			
Foreign currency translation adjustments	¥ (53,839)	¥ (247)	¥ (54,086)
Net unrealized gains and losses on securities:			
Amount arising during the year	(7,571)	3,010	(4,561)
Reclassification adjustments for gains and losses realized in net income	4,077	(1,632)	2,445
Net change during the year	(3,494)	1,378	(2,116)
Net gains and losses on derivative instruments:			
Amount arising during the year	4,221	(1,708)	2,513
Reclassification adjustments for gains and losses realized in net income	(5,006)	2,044	(2,962)
Net change during the year	(785)	336	(449)
Pension liability adjustments:			
Amount arising during the year	(59,928)	20,252	(39,676)
Reclassification adjustments for gains and losses realized in net income	2,038	(739)	1,299
Net change during the year	(57,890)	19,513	(38,377)
Other comprehensive income (loss)	¥ (116,008)	¥ 20,980	¥ (95,028)
2010:			
Foreign currency translation adjustments	¥ (128,271)	¥ 1,353	¥ (126,918)
Net unrealized gains and losses on securities:			
Amount arising during the year	(2,179)	671	(1,508)
Reclassification adjustments for gains and losses realized in net income	1,320	42	1,362
Net change during the year	(859)	713	(146)
Net gains and losses on derivative instruments:			
Amount arising during the year	8,409	(3,573)	4,836
Reclassification adjustments for gains and losses realized in net income	(6,990)	2,921	(4,069)
Net change during the year	1,419	(652)	767
Pension liability adjustments:			
Amount arising during the year	(19,170)	8,314	(10,856)
Reclassification adjustments for gains and losses realized in net income	2,323	(794)	1,529

Edgar Filing: CANON INC - Form 20-F

Net change during the year	(16,847)	7,520	(9,327)
Other comprehensive income (loss)	¥ (144,558)	¥ 8,934	¥ (135,624)

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss) (continued)

	Years ended December 31		
	Before-tax amount	Tax (expense) or benefit (Millions of yen)	Net-of-tax amount
2009:			
Foreign currency translation adjustments	¥ 35,459	¥ (2,089)	¥ 33,370
Net unrealized gains and losses on securities:			
Amount arising during the year	2,231	(1,333)	898
Reclassification adjustments for gains and losses realized in net income	2,205	(886)	1,319
Net change during the year	4,436	(2,219)	2,217
Net gains and losses on derivative instruments:			
Amount arising during the year	298	(119)	179
Reclassification adjustments for gains and losses realized in net income	(2,670)	1,068	(1,602)
Net change during the year	(2,372)	949	(1,423)
Pension liability adjustments:			
Amount arising during the year	(4,115)	1,891	(2,224)
Reclassification adjustments for gains and losses realized in net income	1,911	(632)	1,279
Net change during the year	(2,204)	1,259	(945)
Other comprehensive income (loss)	¥ 35,319	¥ (2,100)	¥ 33,219

15. Stock-Based Compensation

On May 1, 2011, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 912,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2011 was ¥772.

On May 1, 2010, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 890,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2010 was ¥988.

On May 1, 2009, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 954,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2009 was ¥699.

On May 1, 2008, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 592,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2008 was ¥1,247.

Edgar Filing: CANON INC - Form 20-F

The compensation cost recognized for these stock options for the years ended December 31, 2011, 2010 and 2009 was ¥748 million, ¥643 million and ¥564 million, respectively, and is included in selling, general and administrative expenses in the consolidated statements of income.

Table of Contents

Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Stock-Based Compensation (continued)

The fair value of each option award was estimated on the date of grant using the Black-Scholes option pricing model that incorporates the assumptions presented below:

	Years ended December 31		
	2011	2010	2009
Expected term of option (in years)	4.0	4.0	4.0
Expected volatility	36.44%	38.00%	40.08%
Dividend yield	3.16%	2.53%	3.51%
Risk-free interest rate	0.44%	0.45%	0.64