CANON ANNUAL REPORT 2009

Fiscal Year Ended December 31, 2009

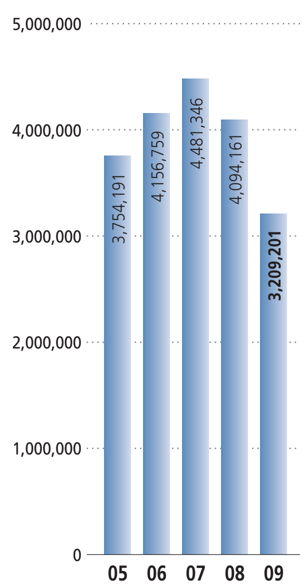
FINANCIAL HIGHLIGHTS

	Millions of yen (except per share amounts)			Thousands of U.S. dollars (except per share amounts)
	2009	2008	Change (%)	**2009**
Net sales	**¥3,209,201**	¥4,094,161	-21.6	**$34,882,620**
Operating profit	**217,055**	496,074	-56.2	**2,359,293**
Income before income taxes	**219,355**	481,147	-54.4	**2,384,293**
Net income attributable to Canon Inc.	**131,647**	309,148	-57.4	**1,430,946**
Net income attributable to Canon Inc. stockholders per share:				
-Basic	**¥ 106.64**	¥ 246.21	-56.7	**$ 1.16**
-Diluted	**106.64**	246.20	-56.7	**1.16**
Total assets	**¥3,847,557**	¥3,969,934	-3.1	**$41,821,272**
Canon Inc. stockholders' equity	**¥2,688,109**	¥2,659,792	1.1	**$29,218,576**

Notes:
1. Canon's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.
2. Canon adopted new guidance for noncontrolling interests in consolidated financial statements in the fiscal year beginning January 1, 2009.
In accordance with the adoption of this guidance, "income before income taxes and minority interests" is now referred to as "income before income taxes" and "net income" is now referred to as "net income attributable to Canon Inc."
3. U.S. dollar amounts are translated from yen at the rate of JPY92=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2009, solely for the convenience of the reader.

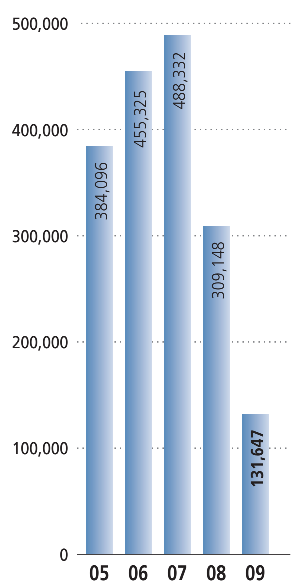
Net Sales

(Millions of yen)



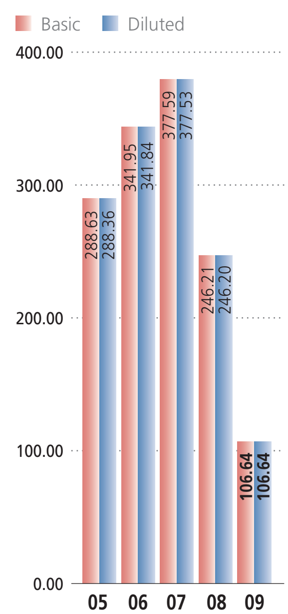
Net Income Attributable to Canon Inc.

(Millions of yen)



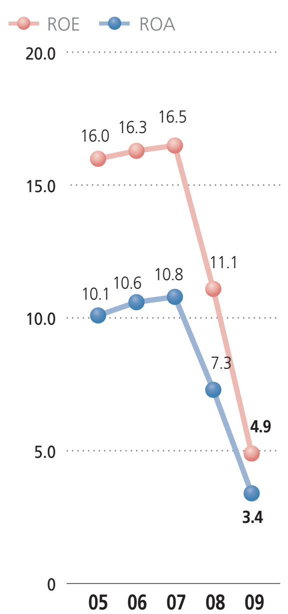
Net Income Attributable to Canon Inc. Stockholders per Share

(Yen)



ROE/ROA

(%)



CORPORATE PROFILE

Canon develops, manufactures and markets a growing lineup of copying machines, printers, cameras, optical and other products that meet a diverse range of customer needs. The Canon brand is well recognized and trusted throughout the world by the individuals, families, offices and industries that use Canon products.

In 1996, Canon launched its Excellent Global Corporation Plan with the aim of becoming a corporation worthy of admiration and respect the world over. To this end, the Company is promoting "cross-media imaging"—wherein a high level of collaboration is realized among input and output devices—and the solutions business—through which it not only develops and markets hardware and software but also proposes ways for users to optimize convenience. In addition, Canon is working to fulfill its duties to investors and society, emphasizing sound corporate governance and stepping up the implementation of activities that contribute to environmental and social sustainability.

CORPORATE PHILOSOPHY: *Kyosei*

The corporate philosophy of Canon is *kyosei*. A concise definition of this word would be "Living and working together for the common good," but Canon's definition is broader: "All people, regardless of race, religion or culture, harmoniously living and working together into the future." Unfortunately, the presence of imbalances in the world in such areas as trade, income levels and the environment hinders the achievement of *kyosei*.

Addressing these imbalances is an ongoing mission, and Canon is doing its part by actively pursuing *kyosei*. True global companies must foster good relations, not only with their customers and the communities in which they operate, but also with nations and the environment. They must also bear the responsibility for the impact of their activities on society. For this reason, Canon's goal is to contribute to global prosperity and people's well-being, which will lead to continuing growth and bring the world closer to achieving *kyosei*.

CORPORATE GOAL

Canon sees itself growing and prospering over the next 100, even 200, years. To realize this goal, the Company is implementing its Excellent Global Corporation Plan. Building on financial strengths that it has continuously reinforced through the implementation of this plan, Canon aims to attain the status of being among the global top 100 companies in terms of key performance indicators.

CONTENTS

Cover Photo:
The imageRUNNER ADVANCE series (above: imageRUNNER ADVANCE C5051) of multifunction devices (MFDs) was developed under a totally new concept with the aim of providing wide-ranging office solutions that meet diverse customer needs.

TO OUR STOCKHOLDERS

Achieving a a New Era

Turnaround in the First Year of of Growth through Improved Management Quality and Global Management

>> In 2009, due to the negative effects of the economic recession, Canon posted declines in sales and profit. We were, however, able to maintain sound balance sheets through various efforts, including reducing inventories.

>> Canon, aiming to become one of the world's top 100 companies, views 2010 as the first year in a new era of growth.

>> In 2010, we will further improve management quality by re-establishing a profit-earning structure through IT reforms and other innovations aimed at further reducing inventories and optimizing management resources.

Achieving a Turnaround in the First Year of Improved Management Quality

Overview of Fiscal 2009

Early in 2009, during what was being called the worst global recession in 100 years, it was difficult to predict the future course of the global economy. Today, looking back at the year, we see that conditions faced by each region were as follows.

In the United States drastic measures taken to stimulate the economy appeared to have had some success from the third quarter of 2009, including positive GDP growth. Nonetheless, new housing starts and new car sales failed to maintain hoped-for momentum targeted by government stimulus measures.

Europe also saw a rise in GDP during the same period. Driving growth were measures taken to stimulate individual consumption, including automobile-buyback programs and public works investment. Delays in resolving bad debt and high unemployment, however, continued to have a negative effect on the real economy.

In Asia, primarily China, measures taken to stimulate consumption in rural areas were successful, kick-starting an early recovery.

Japan, at long last, began showing signs of emerging from a period of intense economic stagnation. This was the result of increased exports and manufacturing owing to growth in China and emerging markets. Economic indicators, however, have yet to regain the levels seen prior to the financial crisis.

Fiscal 2009 Performance Results

In 2009, Canon's consolidated net sales declined 21.6% to ¥3,209.2 billion and the gross profit ratio dipped 2.8 percentage points to 44.5%. Operating profit fell 56.2% to ¥217.1 billion compared with the previous fiscal year. By segment,* in the Office Business Unit, sales declined 26.8% to ¥1,645.1 billion, and operating profit dropped 49.8% to ¥229.4 billion. Within the Consumer Business Unit, sales decreased 10.6% to ¥1,301.2 billion and operating profit declined 17.8% to ¥183.5 billion. In the Industry and Others Business Unit, sales fell 31.5% to ¥358.0 billion and the operating loss deteriorated from ¥47.9 billion to ¥76.0 billion. By geographic area, sales in Europe fell 25.8% to ¥995.2 billion, as was also the case in the Americas, where sales declined 22.6% to ¥894.2 billion. In Japan, sales slipped 19.1% to ¥702.3 billion, and elsewhere in Asia and Oceania sales decreased 15.4% to ¥617.5 billion.

Turning to operating expenses, Canon's selling, general and administrative expenses declined 15.2% year on year to ¥905.7 billion. The Company's R&D expenses decreased 18.6% to ¥304.6 billion, accounting for 9.5% of net sales. Net income attributable to Canon Inc. was down 57.4% to ¥131.6 billion, while net income attributable to Canon Inc. stockholders per share came to ¥106.64, in both basic and diluted terms.

Unfavorable currency exchange rates added to the severity of the business environment in 2009. Although the start of the year saw the yen-dollar rate in the low nineties, and for a time it seemed headed to top ¥100, it instead went in the other direction, appreciating an annual average of ¥10 in 2009. The yen also appreciated against the euro for the year by an average of over ¥21.

As for returning profits to stockholders, Canon emphasizes the stable return of free cash flow to stockholders, and intends to pay a full-year dividend per share of ¥110, the same amount paid in the previous fiscal year.

* Segment sales include intersegment sales.

Accomplishments amid Adversity

As we had set out to do, we improved our management quality to ride out the storm under our own power. Specifically, reductions in inventories and other actions taken enabled the Company to expand cash flows, steer its way toward significantly increased stockholders' equity, and maintain a sound financial condition.

The Office Business Unit positioned itself for action in anticipation of an economic turnaround in the near future. Specific initiatives included the launch of a new office equipment series, the strengthening of our solutions business, and the reinforcement of our direct-sales network in the United States. Also, in March 2010, Canon turned Océ N.V., a major Netherlands-based printing company, into a consolidated subsidiary.

In the Consumer Business Unit, we were able to improve the profitability of our camera business. This upturn was attributable to the launching of attractive new products in a timely manner and the optimizing of inventory management.

Through the Industry and Others Business Unit, Canon restructured its semiconductor equipment business. All these strategic initiatives taken in individual business units empowered Canon to further improve management quality throughout 2009, a year of unprecedented economic turbulence.

Measures for a New Era of Growth

In the course of nurturing new growth in 2010, we will work to further improve management soundness so as to be able to look

a New Era of Growth through and Global Management

back on 2010 as a turning point on the path toward renewed growth. We must make this year one in which we begin transforming from being a company only capable of swiftly adapting to a changing environment to an imaging company that is an overwhelming market leader.

Advancing into a new era of growth, Canon aims to revamp its profit structure, gain a presence in Asian markets, and set up new businesses. To accomplish these goals, the Company is implementing such priority measures as those described below.

In the Office Business Unit, we are constantly strengthening our solutions and service offerings as well as the performance and product lineups of our office equipment. We will bolster the digital production system business by leveraging the capabilities of newly consolidated subsidiary Océ while reinforcing our direct-sales structure and human resources. Moreover, the Company will pursue other M&A opportunities and promote alliances with HP and other companies to expand business. In the Consumer Business Unit, we will also improve our profitability by launching attractive products. The Industry and Others Business Unit will further its restructuring efforts to raise earnings power.

With the aim of gaining a presence in Asian markets, we will accelerate the implementation of region-specific strategies. In accordance with these strategies, the Company will study, establish and execute business models that are exclusively applicable in Asian markets.

In order to set up new businesses that will support sustainable growth, we will speed up the pace at which we cultivate such next-generation domains as equipment and solutions in the medical imaging field and intelligent robots. In support of this, we will actively work with third-party businesses, research institutions, and other personnel resources.

Toward Realizing Sustainable Growth as a Global Corporation

Canon continues to solidify its foundations so as to keep prospering over the next 100 years and beyond. To this end, we are working to establish the global Three Regional Headquarters management system. Under this system, each of our three headquarters will strive to create unique technologies and products developed to meet specific requirements in target markets in each region. Then, they will share each other's technologies and products through import and export to bolster their business. This collaborative framework will underpin activities that lead to sustainable growth.

Furthermore, while steadily pursuing the environmental vision we announced in 2009 and increasing our focus on thorough compliance, we will work to ensure that our corporate DNA continues to be passed on to the next generation of managers throughout the Canon Group.

In closing, I would like to thank everyone for their continued understanding and support.

Fujio Mitarai
Chairman and CEO
Canon Inc.

MESSAGE FROM THE PRESIDENT

As we begin to see light on the horizon for the global economy, we are steadily implementing our "cross-media imaging" strategy and IT reforms toward a new era of growth.

Strategies for the First Year in a New Era of Growth

Viewing 2010 as the first year in a new era of growth, Canon is once again aiming to achieve sound growth, pursuing record sales and profit supported by enhanced management quality.

During 2009, Canon continued to promote "cross-media imaging," a strategy to create new services and business models based on advanced synergies between Canon imaging devices. We believe that cross-media imaging is a key strategy for realizing sound growth. Toward this goal, we will offer solutions and expanded services through cross-divisional collaboration. To reinforce our solutions and services offerings, we are moving ahead with the further strengthening of our infrastructure company-wide, including preparing for the coming age of cloud computing.

Furthermore, as part of our cross-media imaging strategy, we will continue to develop even more advanced input and output devices through color management technology, which enables unified color performance across devices, as well as wireless technologies. Based on such input and output devices, the Company will work to create new products and services for offices, households, production companies, medical institutions and many other customer environments.

Canon will also focus on achieving the overwhelming No. 1 position worldwide in all current core businesses. In the Office Business Unit, promoting attractive new products as core business drivers, we will strengthen our solutions business through alliances with IT industry leaders and Managed Print Services (MPS). In addition, Canon will focus on emerging economies by introducing a large number of products designed exclusively for these markets while establishing and bolstering business bases in each target country. We are also working to expand our commercial printing business through the merger with Océ N.V. as well as the Company's digital production systems and large-format inkjet printers.

In the Consumer Business Unit, Canon is expecting further market growth for digital cameras in view of the rapid evolution of high-value-added products and the growth potential of emerging economies. We will also focus our energies on developing innovative technologies for inkjet printers.

In the Industry and Others Business Unit, we consolidated Canon Marketing Japan Inc.'s semiconductor equipment business into that of Canon Inc., bolstering our business structure in this domain to enable customer needs to be more effectively incorporated into product development as we work to restructure the business toward restoring it to profitability. In addition, we will also reinforce the independent businesses of Group companies.

With regard to new next-generation domains as well, Canon is pursuing medical imaging that contributes to the ultra-early detection of diseases, intelligent production robots that employ super machine vision technology, and display development.

Promoting Total Optimization

Also important are our efforts to realize total optimization. Toward this end, we must continue to implement IT reforms with the aim of realizing not just operational efficiency, but also improving management speed and quality. In 2010, we will standardize 3D-CAD information throughout the Company and put in place an integrated support system for processes ranging from development through material procurement, production, sales and servicing. These changes are expected to lead to major management advancements by making possible the prompt and efficient utilization of information across organizational boundaries. Additionally, we will introduce in our other businesses speedy supply chain management (SCM) systems, that are based on daily sales and inventory information and have led to solid achievements in our digital camera business.

Product quality control is another issue that Canon must decisively tackle company-wide. The occurrence of one serious quality problem could significantly damage the Canon brand and, consequently, place the Company's very existence at risk. Furthermore, product quality-related issues, with a direct impact on profits, are the biggest source of waste. Accordingly, through such initiatives as the introduction of a comprehensive product quality management system covering the entire process from design to mass-production, the Canon Group works as one to continuously strengthen and maintain the structure necessary for preventing product quality problems.

Becoming a Truly Excellent Corporation

The year 2010 marks the final year of Phase III of our Excellent Global Corporation Plan. As we work to solidify our business foundation toward becoming a truly excellent corporation, the Canon Group also strives to further strengthen compliance. In addition to thorough compliance with laws and regulations, each individual in the Canon Group acts in accordance with the norms and rules of society in the course of our daily business operations. We are also concentrating our efforts on the development of human resources, particularly in the areas of management skills and technological capabilities, with the aim of becoming a key player in the global market. Underpinning these efforts will be the further consolidation of our corporate structure to guarantee the Company's success against the competition into the future.

Building on the sound management structure we have established to date, we will pool the resources of the Canon Group as we continue working to switch to a new growth track at the earliest possible opportunity. Along the way, we look forward to your continued understanding and support.

Tsuneji Uchida
President and COO
Canon Inc.

CORPORATE GOVERNANCE

In pursuit of becoming a truly excellent global corporation, Canon continues to bolster corporate governance through its daily operations.

Basic Policy and Corporate Governance Structure

Canon recognizes that strengthening management supervision functions and maintaining management transparency are vital to improving its corporate governance structure and further raising corporate value. Canon's basic governance structure comprises the General Meeting of Shareholders, the Board of Directors and the Board of Corporate Auditors. Furthermore, the Executive Committee and management committees are dedicated to addressing key issues. All of these bodies work together to ensure the appropriate management of the Group through an independent internal auditing structure centered on the Corporate Audit Center and an information disclosure system for management activities.

Board of Directors

Important business matters are discussed and ratified during meetings of the Board of Directors and Executive Committee, which are attended, in principle, by all directors. As of December 31, 2009, the board consisted of 25 directors. In order to facilitate more practical and efficient decision making, the board is entirely composed of internal directors who have well-developed knowledge of the Company's affairs. Also, the board is supported by various management committees that address important management issues in their specific fields. These committees complement the Company's operational structure, facilitate efficient decision making and realize a mutual supervisory function for such matters as compliance and ethics.

Executive Officer System

Canon is endeavoring to realize more flexible and efficient management operations by maintaining an appropriately sized organization of directors and promoting capable human resources with accumulated executive knowledge across specific business areas.

Executive officers are appointed and dismissed by the Board of Directors and have a term of office of one year. The number of executive officers was 11 as of December 31, 2009.

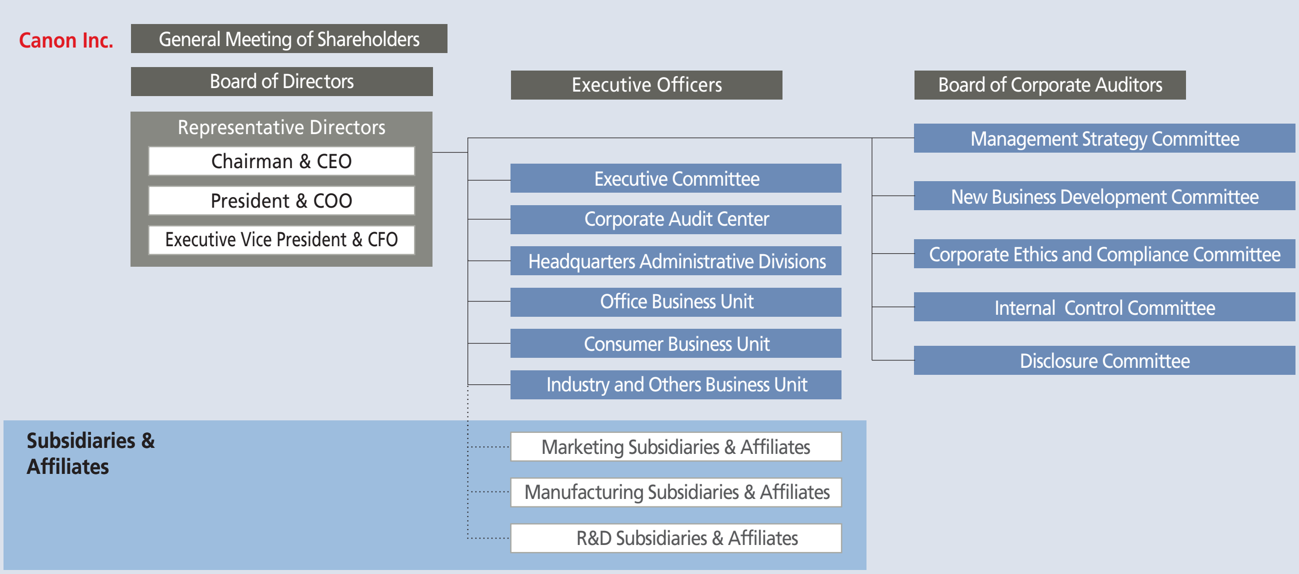
Auditing System

Canon has five corporate auditors, including three outside auditors who have no personal or business affiliations with the Company. Corporate auditors' duties include attending meetings of the Board of Directors, Executive Committee and various management committees, listening to business reports from directors, carefully examining documents related to important decisions and conducting strict audits of the Group's business and assets. Corporate auditors also work closely with accounting auditors and the Corporate Audit Center, which is in charge of monitoring the Company's compliance, risk management and internal control systems in addition to providing assessments and recommendations as required.

Internal Control Committee

In response to the Sarbanes-Oxley Act, including Section 404, which came into force during 2006, Canon continues to reinforce internal control systems and implement appropriate measures. The

Governance Structure (as of December 31, 2009)



Internal Control Committee is responsible for Group-wide internal controls, including those pertaining to financial reporting.

In order to strengthen internal controls, Canon conducts comprehensive evaluations of internal controls across areas that include accounting, management oversight, legal compliance, IT systems and the promotion of corporate ethics. As of December 31, 2009, internal control over financial reporting has been assessed as effective by the management and the independent registered public accounting firm. (Please refer to pages 101 and 103.)

Other Corporate Governance Committees

The Corporate Ethics and Compliance Committee, in addition to the Disclosure Committee, is the key body of Canon's management committees. The Corporate Ethics and Compliance Committee discusses and approves corporate ethics and compliance policies while monitoring the implementation of these policies. The Disclosure Committee works to ensure strict compliance with disclosure regulations as prescribed by stock exchanges.

Compliance

Shortly after its founding, Canon established the *San-Ji*, or "Three Selfs" spirit, namely "self-motivation," or taking the initiative and being proactive in all things; "self-management," or conducting oneself responsibly and being accountable for all one's actions; and

Compliance program at Canon (Suzhou) Inc.

All Canon Group employees carry the Compliance Card.

Directors & Corporate Auditors (as of December 31, 2009)

Chairman & CEO

Fujio Mitarai

President & COO

Tsuneji Uchida

Executive Vice President & CFO

Toshizo Tanaka
Senior General Manager, Policy & Economy Research Center

Executive Vice President & CTO

Toshiaki Ikoma
Group Executive, Corporate R&D Headquarters
Chief Executive, Optical Products Operations

Senior Managing Directors

Nobuyoshi Tanaka
Group Executive, Corporate Intellectual Property & Legal Headquarters

Junji Ichikawa
Chairman & CEO, President & COO, Canon ANELVA Corporation

Akiyoshi Moroe
Group Executive, External Relations Headquarters
Group Executive, Human Resources Management & Organization Headquarters

Kunio Watanabe
Group Executive, Corporate Planning Development Headquarters

Yoroku Adachi
President & CEO, Canon U.S.A., Inc.

Yasuo Mitsuhashi
Chief Executive, Peripheral Products Operations
Chief Executive, Chemical Products Operations

Managing Directors

Tomonori Iwashita
Group Executive, Environment Headquarters
Group Executive, Quality Management Headquarters

Masahiro Osawa
Group Executive, Finance & Accounting Headquarters

Shigeyuki Matsumoto
Group Executive, Device Technology Development Headquarters

Katsuichi Shimizu
Chief Executive, Inkjet Products Operations

Ryoichi Bamba
President & CEO, Canon Europa N.V.
President & CEO, Canon Europe Ltd.

Toshio Homma
Chief Executive, L Printer Products Operations

Masaki Nakaoka
Chief Executive, Office Imaging Products Operations

Haruhisa Honda
Group Executive, Production Engineering Headquarters

Directors

Toshiyuki Komatsu
Deputy Group Executive, Corporate Planning Development Headquarters

Tetsuro Tahara
Group Executive, Global Manufacturing & Logistics Headquarters

Seijiro Sekine

Shunji Onda
Group Executive, Global Procurement Headquarters

Kazunori Fukuma
President & CEO, SED Inc.

Hideki Ozawa
President & CEO, Canon (China) Co., Ltd.

Masaya Maeda
Chief Executive, Image Communication Products Operations

Corporate Auditors

Keijiro Yamazaki
Kunihiro Nagata
(Outside)
Tadashi Ohe
Yoshinobu Shimizu
Minoru Shishikura

"self-awareness," or understanding one's situation and role in it. These principles remain the basis for employee education and provide the platform for the Canon Group Code of Conduct.

Recognizing the importance of safeguarding personal information, Canon does its utmost to protect this valuable form of information asset in the course of fulfilling its social responsibilities. With the aim of keeping its employees informed and aware, the Company conducts e-learning sessions as part of its personal information protection education programs every year.

Disclosure

Canon makes every effort to disclose information on its management and business strategies as well as its performance results to all stakeholders in an accurate, fair and timely manner. To this end, Canon holds regular briefings and posts the latest information on its website together with a broad range of disclosure materials.

Canon has formulated its own Disclosure Guidelines and established the Disclosure Committee, which makes decisions regarding information disclosure, including necessity, content and timing. The Disclosure Committee makes such decisions after receiving reports on information that it might be necessary to disclose from the person in charge of the disclosure working group at each headquarters.

Countering Antisocial Forces

Canon has formulated a basic policy stipulating that no Canon Group companies shall maintain relationships of any kind with antisocial forces that represent a threat to social order and security. To uphold this basic policy, Canon has established a department dedicated to activities aimed at countering such parties while reinforcing cooperative ties with applicable public authorities. In addition, Canon's Employment Regulations include a clause prohibiting such relationships, and the Company continues to step up efforts to ensure strict employee adherence.

Risk Management

As Canon pursues business expansion in various fields on a global scale, the business and other risks to which it may be exposed continue to diversify. With the goal of eliminating such risks altogether while honoring the trust placed in it by its stakeholders, Canon works diligently to avoid or minimize its exposure, to this end assigning specifically designated management committees to address key issues.

In particular, the Executive Committee and other management committees engage in careful discussions regarding significant risk factors. The Corporate Audit Center preemptively identifies risk factors through audit activities. Also, Canon formulates in-house rules to guard against those risks and, in accordance with the policies formulated by the Internal Control Committee, strives to identify and assess relevant risks associated with individual business processes.

Significant Differences in Corporate Governance Practices between Canon and U.S. Companies Listed on the NYSE

Section 303A of the New York Stock Exchange (the "NYSE") Listed Company Manual (the "Manual") provides that companies listed on the NYSE must comply with certain corporate governance standards. However, foreign private issuers whose shares have been listed on the NYSE, such as Canon Inc. (the "Company"), are permitted, with certain exceptions, to follow the laws and practices of their home country in place of the corporate governance practices stipulated under the Manual. In such circumstances, the foreign private issuer is required to disclose the significant differences between the corporate governance practices under Section 303A of the Manual and those required in Japan. A summary of these differences as they apply to the Company is provided below.

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 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. Among the five members on the Company's board of auditors, three are outside corporate auditors. The qualifications for an "outside" corporate auditor under the Corporation Law 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 stock options to be issued to directors and corporate auditors as part of remuneration of directors and corporate auditors.

STRATEGIES AND ACTIVITIES

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Photo:
Canon introduced an extensive range of solutions based on the combination of various input and output devices at the Pro Photo Solutions exhibition held in the United Kingdom.

>> EXCELLENT GLOBAL CORPORATION PLAN

Canon launched the initial phase of its medium- and long-term Excellent Global Corporation Plan in 1996. With this and each subsequent five-year phase of the plan incorporating specific, distinct strategies and targets, fiscal 2009 marked the penultimate year of Phase III.

The Excellent Global Corporation Plan is founded upon a single overarching goal: "In accordance with the philosophy of *kyosei*, Canon will continue contributing to society through technological innovation, aiming to be a corporation worthy of admiration and respect worldwide." Instrumental in keeping this goal firmly in the Company's sights are the five key strategies for Phase III set out below.

Having concentrated on keeping the goal in constant focus in its corporate viewfinder while promoting the key strategies, Canon has tirelessly striven to enter the ranks of world's top 100 companies in terms of key performance indicators. To that end, under Phase I of the Excellent Global Corporation Plan, the Company placed an emphasis on strengthening its financial health with a raft of wide-ranging business reforms. Specifically, all-out efforts were made to entrench such policies as "total optimization" and "focus on profit" in conjunction with a business selection and concentration process.

In Phase II, Canon used the robust financial health secured through the initiatives adopted in Phase I to act as a springboard en route to becoming No.1 in all its major areas of business. Reflecting these efforts, sales and profit grew steadily each year.

5 Key Strategies

>> **1.** Achieving the overwhelming No.1 position worldwide in all current core businesses

>> **2.** Expanding business operations through diversification

>> **3.** Identifying new business domains and accumulating required technologies

>> **4.** Establishing new production systems to sustain international competitiveness

>> **5.** Nurturing truly autonomous individuals and promoting effective corporate reforms

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Digital SLR camera

Laser printer

Océ's headquarters in Venlo, the Netherlands

External Rankings

- **Financial Times Global 500**
  (May 30/31, 2009 issue)
  Market value ranking: 104
  (9th in the Technology Hardware & Equipment sector)
- **FORTUNE Global 500**
  (July 20, 2009 issue)
  Revenues ranking: 190
  (5th in the Computers, Office Equipment category)
  Profits ranking: 131
  (3rd in the Computers, Office Equipment category)
- **BusinessWeek "Best Global Brands" of 2009**
  (September 28, 2009 issue)
  Ranking: 33
  (4th among all Japanese companies)

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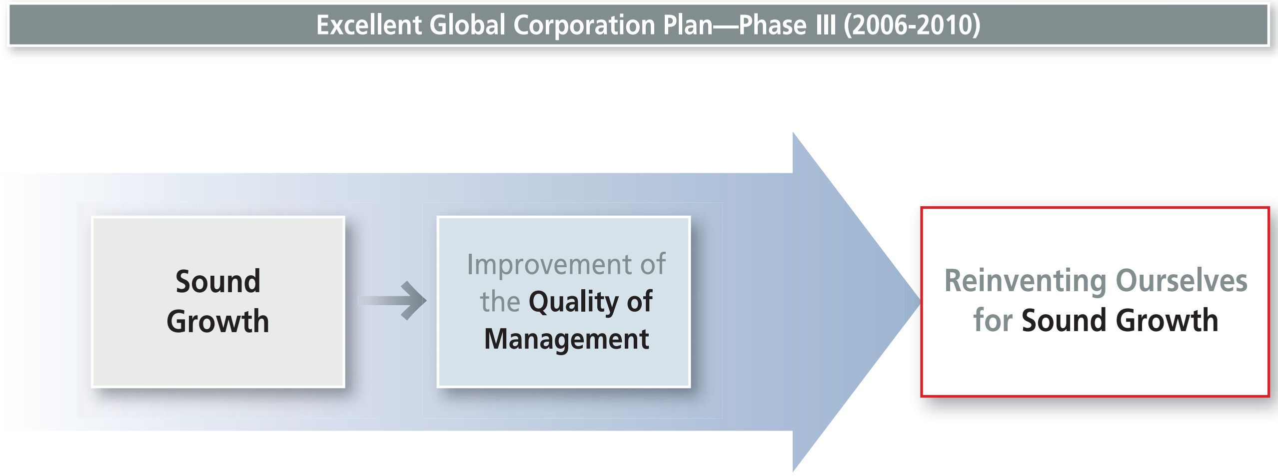
Under Phase III Canon embarked on a course intended to bring about sound growth by reinforcing established businesses and championing new ventures. However, changes in worldwide financial and economic markets dating back to 2008 caused the Company to make a major change in course from the pursuit of sound growth to the securing of improved management quality.

Canon is continuing to make steady progress in improving its management quality. In March 2010, Canon made Netherlands-based Océ N.V. a consolidated subsidiary, aiming to garner the overall No.1 presence in the printing industry. The respective businesses of Canon and Océ effectively complement each other's product portfolio, and this combination will enable both to capitalize on an excellent fit with regard to product range, channel mix and R&D projects not to mention a superior lineup of solutions spanning the entire printing industry. In addition, this move expands Canon's worldwide customer base by giving it access to the large number of outstanding global companies that are Océ clients.

In 2010, the final year of Phase III and one we have defined as the "first year in a new era of growth," we will continue to improve the quality of our management while promoting growth strategies aimed at overcoming the difficulties of the current recession.



>> IMPROVING THE QUALITY OF MANAGEMENT

Canon gained a foothold in 2009 in improving its management quality and will continue to improve it, aiming to achieve renewed sound growth.

Having experienced periods of extremely difficult market conditions in the past, Canon has come to fully understand the necessity of becoming a corporation with a firm structure capable of responding rapidly and flexibly to any changes in external conditions. This understanding acted as a catalyst for our success to date in improving the quality of management.

Improving management quality is synonymous with developing the capability to realize real-time management, that is, reinforcing the Company's comprehensive capabilities to make decisions accurately and agilely and translating those decisions into swift action even amid dynamic fluctuations in market conditions. Through the achievement of sophisticated SCM, IT reforms and an optimal global production structure, Canon aims to realize real-time management.

Establishing Sophisticated SCM

Canon aims to realize sophisticated SCM that considers not only procurement and production processes but also the design process. To remain successful amid major market changes, Canon must continue to expeditiously launch competitive new products in an efficient manner. This cannot be achieved through product planning and development capabilities alone. We will realize more sophisticated SCM in order to facilitate the timely and efficient launch and supply of our products.

Sophisticated SCM will be based on the concept of eliminating intermediate inefficiencies throughout the process, from development to sales and marketing. In other words, if Canon utilizes efficient SCM, it will be able to minimize lead times, prevent stagnation in parts and product distribution and directly connect production and sales activities. The realization of such sophisticated SCM will come through the reinforcement of Canon's purchase order-oriented production system, cell production and logistics capabilities.

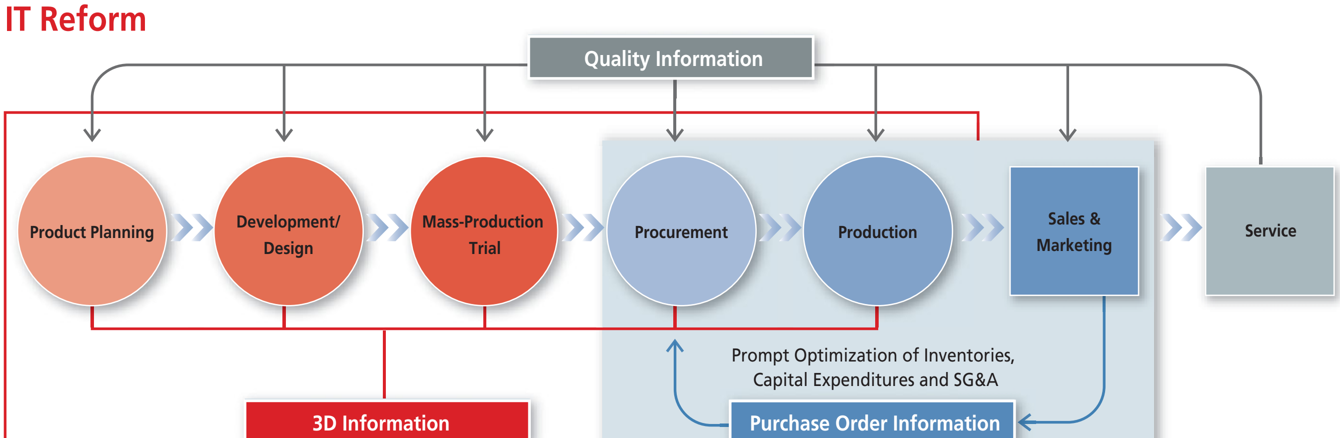
Realizing IT Reforms

Canon is very much aware that IT reforms hold the key to improvements in SCM and, ultimately, management quality. Such IT reforms will enable Canon to centralize the information management of all its business processes, which will, in turn, empower it in the achievement of sophisticated SCM. By effectively using information through IT, the Company aims to integrate the outcomes of the management reforms that it has undertaken to date, thereby enhancing the efficiency of its management and operations. Consequently, SCM will allow us to meet changes in market conditions more efficiently and effectively as well as to strategize our production and marketing activities more flexibly.

From Development to Production

In Canon's upstream IT reforms, the utmost priority has been given to the standardization and integration of the 3D-CAD systems used for

IT Reform

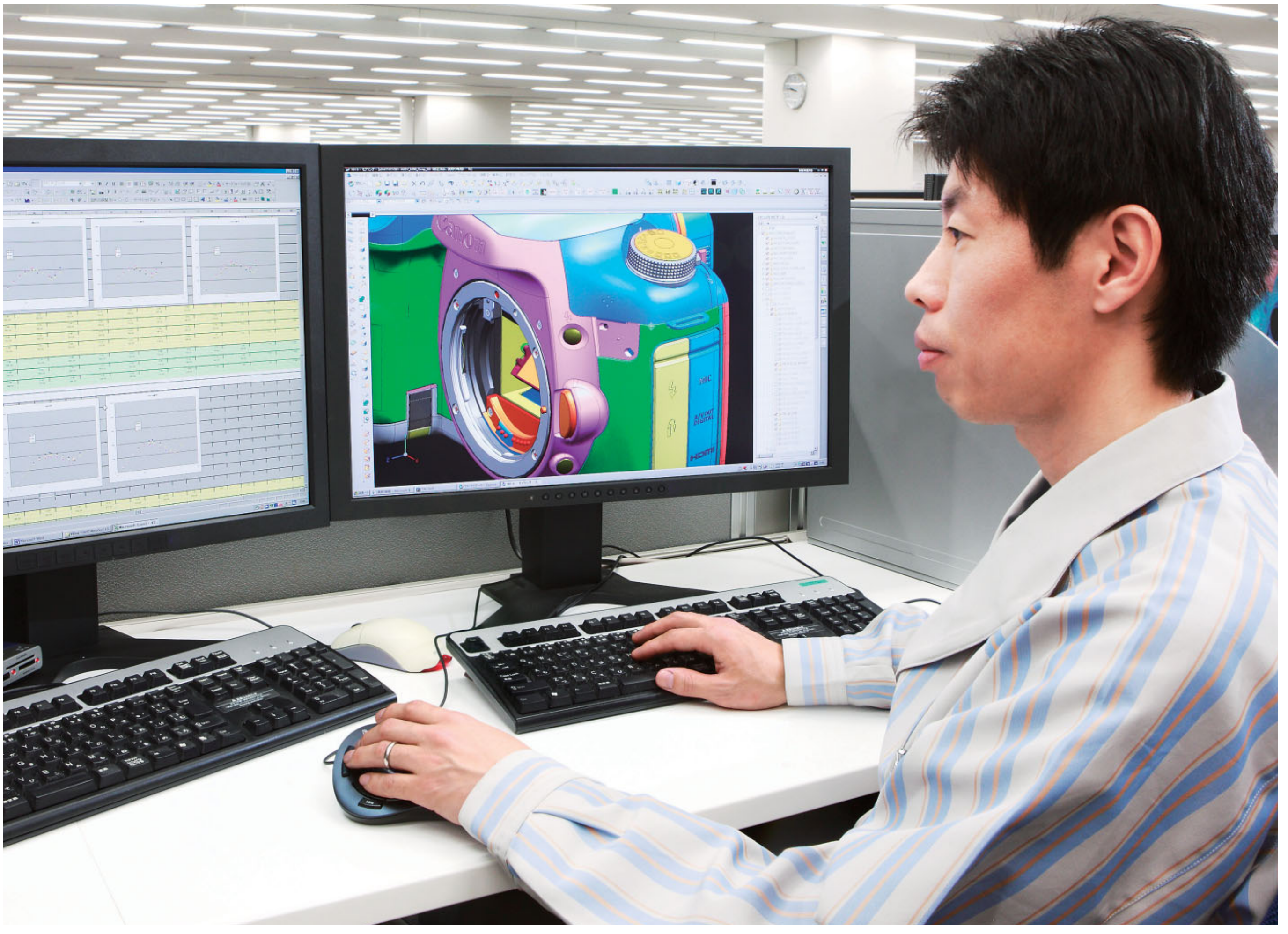


Value Chain

In connection with Group-wide 3D-CAD system standardization and integration, the introduction of a PDM system will enable centralized technical information management throughout the design, procurement, prototyping and production processes, thereby shortening development times.

Supply Chain

With procurement and production operations sharing the purchase-order information managed by sales and marketing, Canon will be able to optimize its control of inventories, facility utilization and costs in sync with market fluctuations. This approach will allow the Company to establish sophisticated SCM.



Through IT reforms, including the Group-wide standardization of 3D-CAD systems, Canon is working to realize sophisticated SCM, thereby bolstering its corporate structure to agilely respond to changes in management conditions.

product development. And, finally, in 2010 Canon expects to complete and launch a Group-wide system based on 3D-CAD systems for centralizing design information management and supporting the entire process from development to procurement and production.

In conjunction with 3D-CAD system standardization and integration, Canon plans to introduce an integrated product data management (PDM) system in 2010. This will enable the centralized management of technical information accumulated throughout the entire process, from design to procurement, prototyping and production. After the unification of 3D-CAD systems and the PDM system introduction, the Company will possess a platform for "prototypeless" product development, which will consequently enable the Company to make development times shorter.

The main advantage offered by IT reforms lies in the resulting ability to make simultaneous progress across all business processes. Fully implemented, this unrivalled system may, for example, enable the scheduled completion of product design to coincide with that of mold and production equipment design.

From Production to Sales and Marketing

By February 2010, Canon completed the introduction of a new production system, which initially had been launched by Oita Canon Inc., at 25 production facilities. This system will not only standardize our production management systems, it will allow us to link production management with the information gathered by our design divisions as well as the sales information collected by our marketing front lines.

More recently, Oita Canon introduced a purchase order-oriented production system. This lean system involves production based on the information provided by sales companies and confirmed by Canon's production divisions. To enable the optimized management of inventories, the Company has to develop a supply chain system that makes full use of information provided by sales companies and implement this system on a Group-wide scale. If these sales companies place purchase orders closely linked with real demand in the market and we manufacture our products strictly based on those purchase orders, our production and sales will be completely synchronized, which will, in turn, eliminate excessive inventories. Canon plans to introduce this system at all its plants within the Group.

Also, Canon is accelerating the establishment of a next-generation logistics system. This logistics system will synchronize production and shipments based on the Company's marketing strategies. More specifically, Canon will be able to ship out its products directly from its plants to sales companies based on their purchase orders and, as a

Cell production at Oita Canon

result, shorten its shipping lead times. This means that we will be able to maintain our inventories at a minimum level. Bringing innovation to global logistics supports reviews of transportation modes and distribution routes. Canon will reduce both its logistics costs and the environmental burden of its logistics operations.

Product Quality

In 2010, Canon plans to begin the practical application of a proprietary product quality management system. This system will allow for the centralized management of Group-wide product quality information. In addition to swift and appropriate responses in matters concerning product quality, the system will enable the Company to preemptively identify the possibility of quality issues and estimate these issues' impact on its production activities in each of the design, prototyping and mass-production stages. Also incorporating servicing information, this system will doubtlessly facilitate total optimization.

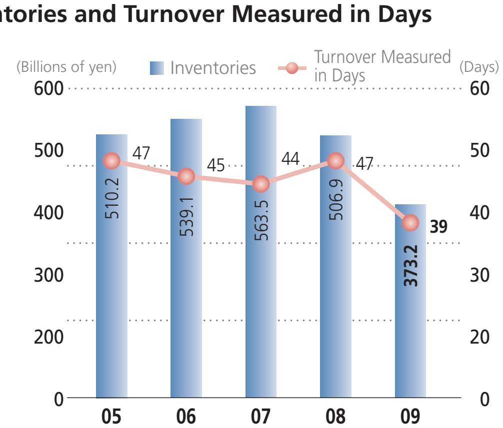
Benefits of IT Reforms

What these IT reforms will do is synchronize the operations of multiple divisions and departments. When successfully synchronized, divisions and departments involved in a business or product will collectively produce significant outcomes, including reduced costs, shortened lead times and improved product quality. As these expectations show, we are working diligently to realize ideal operational conditions through IT reforms and thereby eliminate inefficiencies while putting a great deal of effort into improving the quality of our management.

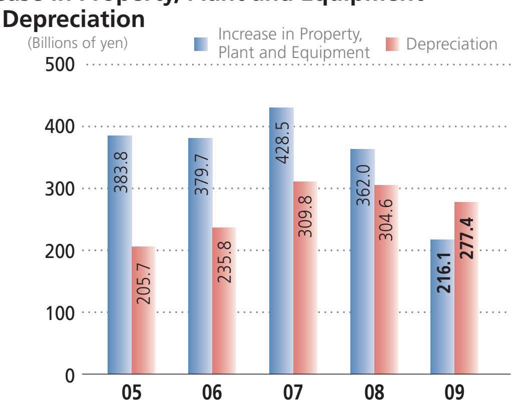
Optimal Global Production Structure

Based on the aforementioned strategies, Canon is promoting the establishment of an optimal global production structure. Canon's optimal global production structure will take into consideration such factors as the environment, product quality, costs, logistics, consumer markets, human resources and parts procurement. One way the

Inventories and Turnover Measured in Days



Increase in Property, Plant and Equipment and Depreciation



Warehouse Management System (WMS) for optimal inventory control

Company is building such a structure is through localized production. For instance, in 2010, our new plant at Canon Virginia, Inc. in the United States will start automated production and establish a supply chain that handles the entirety of toner cartridge processing—from production to recycling—locally within the U.S. market, the very point of consumption for the company's products.

Achievements in Management Quality Improvements

In addition to efforts to establish sophisticated SCM, realize IT reforms and build an optimal global production structure, the entire Canon Group has endeavored to improve its management quality. In 2009, Canon worked to optimize inventory management, the increase in property, plant and equipment and depreciation while reducing such costs as SG&A expenses and R&D expenses. Having already made progress in inventory optimization, Canon was able to reduce its inventories 26.4% compared with December 31, 2008 to ¥373.2 billion.

In 2009, Canon lowered its increase in property, plant and equipment 40.3% year on year to ¥216.1 billion while also lowering its depreciation expenses 8.9% to ¥277.4 billion. Through a selection-and-concentration approach, the Company continued to minimize capital investment while maximizing results. Facing the never-ending challenge of maximizing investment efficiency, we will work to reserve sufficient free cash flows and limit our depreciation expense burden, thereby constructing a profit-focused, resilient corporate structure.

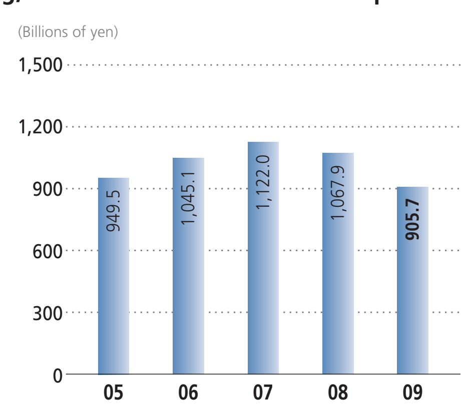
As part of these ongoing efforts, Canon thoroughly examined each expense item to optimize SG&A expenses in 2009. As a result, we were able to decrease SG&A expenses 15.2% year on year to ¥905.7 billion. We aim to establish a structure under which we can lower our cost to sales ratio, even after we have once more returned to a growth path.

Canon similarly reduced its R&D expenses 18.6% year on year to ¥304.6 billion. The ratio of R&D expenses to net sales, however, rose to 9.5% from 9.1% in 2008. The increase in the ratio represents our determination to maintain our technological competitiveness even amid difficult operating conditions.

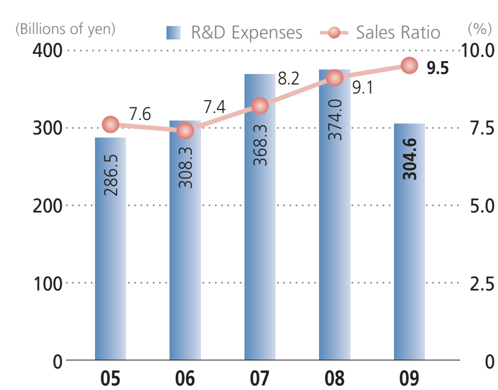
As explained above, Canon has advanced real-time management and steadily improved management quality. The Company will accelerate management quality-focused initiatives in 2010, which it recognizes as the "first year in a new era of growth." At the same time, by implementing growth strategies for 2010 onward aimed at fending off the current recession, Canon aims to return to and remain on the path to sound growth.

New plant at Canon Virginia

Selling, General and Administrative Expenses



R&D Expenses and Sales Ratio



>> RESEARCH & DEVELOPMENT

By prioritizing R&D even in times of extreme economic adversity, Canon is strategically laying out stepping-stones toward renewed, sound growth.

Canon-Kyoto University Joint Research Project (CK Project) in the medical imaging field

R&D Expenses and Patents

Despite harsh market conditions in 2009, Canon continued to make aggressive investments in R&D to better prepare itself for future growth. R&D expenses amounted to ¥304.6 billion, and the ratio to net sales increased from 9.1% in fiscal 2008 to 9.5% in fiscal 2009. By segment, ¥78.9 billion, or 25.9% of the total expenses, was allocated to the Office Business Unit; ¥74.1 billion, or 24.3%, to the Consumer Business Unit; ¥23.3 billion, or 7.7%, to the Industry and Others Business Unit; and ¥128.3 billion, or 42.1%, to Corporate R&D.

Canon's commitment to R&D has also contributed to its leading position in terms of intellectual property rights. In 2009, Canon was granted 2,204* patents in the United States.

Cognizant that R&D is crucial to its renewed, sound growth, Canon will continue to place high priority on R&D expenses.

* Source: U.S. Patent and Trademark Office. Calculated based upon publicly disclosed weekly totals.

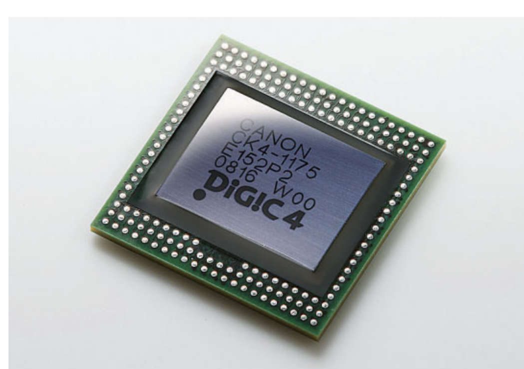
Enhancing Our R&D Structure

Canon is working to bolster its R&D capabilities as part of efforts to improve its management quality. With an eye to achieving renewed, sound growth, the Company has adopted a multifold approach, including the establishment of a new Corporate R&D Headquarters and the strengthening of frontier research through the adoption and encouragement of open innovation.

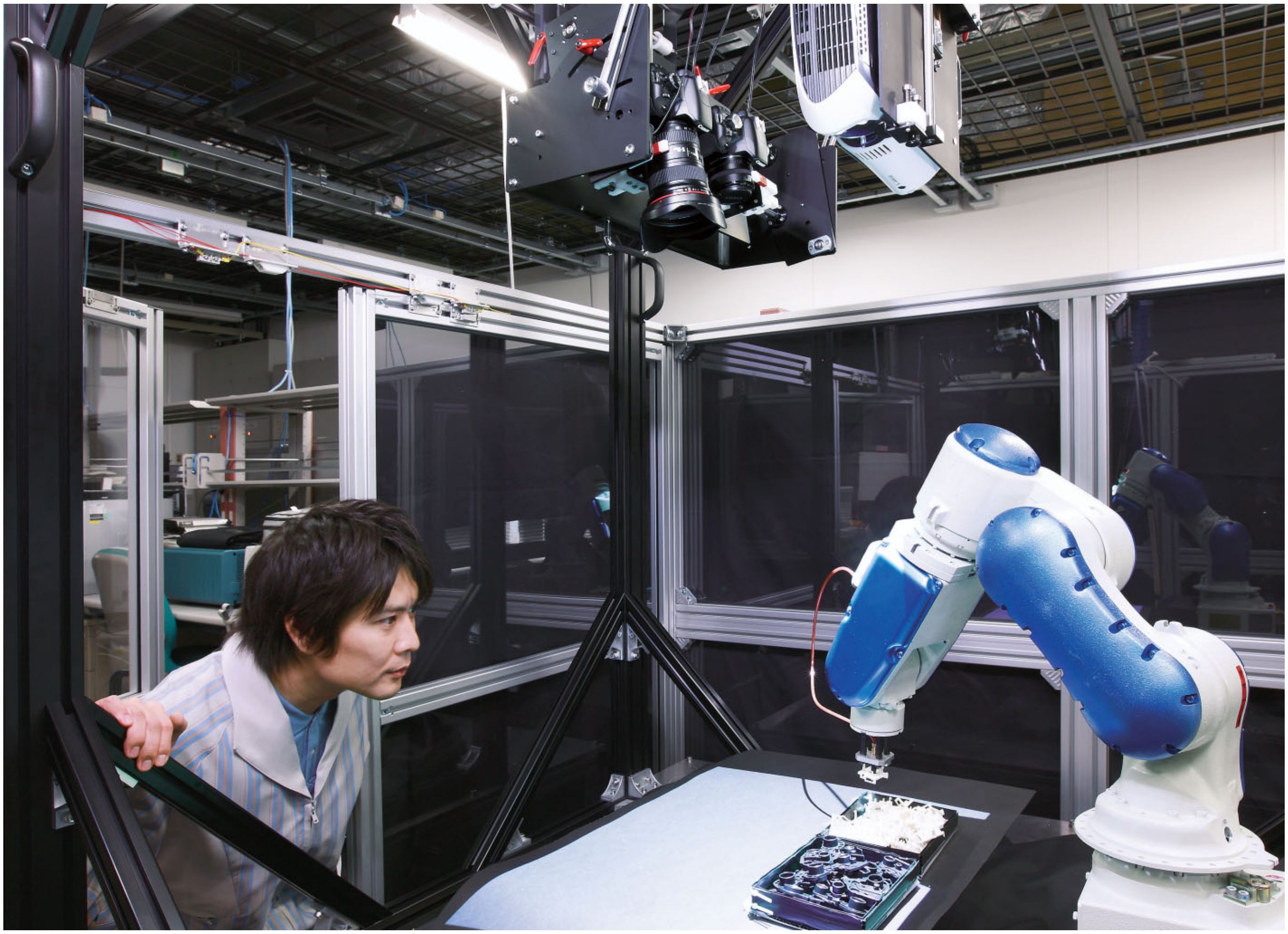
Canon has established the Corporate R&D Headquarters with the aim of bolstering its future-oriented upstream technologies and creating differentiated technologies to be applied in existing and next-generation businesses. The Corporate R&D Headquarters is tasked with vertically integrating Canon's R&D activities to encompass the entire range of fields—from materials to systems and software—and to develop cross-divisional functions. Underpinned by stringent adherence to PDCA cycles in each R&D process, such a structure will empower Canon to facilitate selection and concentration for greater R&D efficiency, reinforce its upstream technological research and, ultimately, nurture new businesses.

The Frontier Research Center, under the Corporate R&D Headquarters, is strengthening upstream technological research. The center focuses on research into optical, precision and other existing core technologies. The Frontier Research Center is committed to contributing to Canon's renewed, sound growth from a long-term perspective.

Canon has adhered to an approach whereby all development is carried out in-house. However, with due consideration given to technological maturity today (a macro-level factor) as well as to a micro-level factor which dictates that it must create breakthrough technologies, Canon has recognized the increasing importance of an open innovation approach—in other words, creating new technologies and products by combining its technologies with those of other companies and research institutions. This approach will enable the Company to keep sharpening its competitiveness even in today's extremely adverse conditions. One example of our open approach is the Canon-Kyoto University Joint Research Project (CK Project), through which Canon is studying medical imaging. More specifically, we are advancing research into optical ultrasound mammography, a safer alternative to conventional X-ray mammography, and optical coherence tomography (OCT) systems.



DIGIC 4 imaging processor, a key component of Canon digital cameras



Canon is advancing the development of Super Machine Vision—an imaging technology that goes beyond the capabilities of human vision.

Bolstering Product Competitiveness

To make its products stand out from those of its competitors, Canon continuously strengthens the development of key components and devices. Underpinning these efforts are the Company's leading-edge technological offerings, including DigitalImagingIC (DIGIC) image processors and Complementary Metal Oxide Semiconductor (CMOS) sensors, both of which are key components of digital cameras, as well as Diffractive Optics (DO) lenses, which help realize smaller and lighter telephoto lenses, and organic photo conductor (OPC) drums employed in electrophotographic processes.

Now, Canon is promoting cross-media imaging, which it defines as achieving advanced synergies between imaging devices. Leveraging the imaging technologies developed from its core technologies, which support various types of "creation," "expression" and "presentation," Canon is working to provide users with an all-new, rewarding and unique communication experience.

Fostering New Core Businesses

Canon is advancing the development of new core businesses. Specific examples include the Company's efforts in the fields of medical imaging and robotics. Long-nurtured imaging and precision technologies—both of which are Canon core technologies—are applied in R&D in these fields.

Specifically, in the medical imaging field, the Company is advancing part of the CK Project to realize the practical applications of imaging technology in the ultra-early detection of diseases.

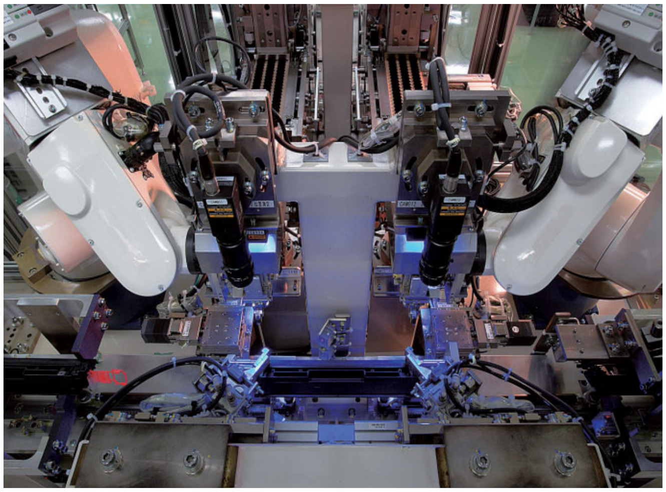
In the robotics field, Canon is currently accumulating tangible results in the development of intelligent robots. Aiming to make a productivity breakthrough that will cross industry boundaries in the future, we will continue to conduct extensive research and testing.

In the displays field, Canon is steadily accumulating technological assets through the development of surface-conduction electron-emitter displays (SEDs). At the same time, it is promoting the development of organic light-emitting diode (OLED) displays and small- and medium-sized liquid crystal displays (LCDs) to improve business profitability and product competitiveness.

These technological stepping-stones are helping to give Canon added impetus toward establishing new business domains. The Company aims to develop its operations in these domains into next-generation core businesses.

>> PRODUCTION

Canon is accelerating toward establishing completely lean SCM through the enhancement of production technologies, production structure and human resources.



Automated production of toner cartridges

Enhancing Production Technologies

Canon is bringing its automated production to a new level. Canon continues to promote the automated production of certain consumables and components, gradually increasing the use of automated machinery. Also, steady efforts are being made in the development of purpose-built intelligent robots, specifically, the Company aims to enhance their manual dexterity and ability to "see" and differentiate between objects.

Canon has also expanded the scope of in-house production. Specifically, Canon further promoted the in-house production of rubber functional components, circuit boards and plastic components, adding to the in-house production of molds as well as electrophotographic and optical key components. Meanwhile, the Kawasaki Office began the in-house production of semiconductor devices, including image sensors for digital SLR cameras, in 2009. Canon is constantly exploring avenues to reinforce in-house production as a means of accumulating know-how and reducing costs.

Developing an Optimal Global Production Structure

Canon is reviewing its global production network to establish an optimal global production structure. The anticipated contraction of the workforce in Japan necessitates the establishment of a high-quality, finely tuned production structure that facilitates the effective use of automated production systems to raise productivity. Faced with this urgent issue, the Company recognizes as indispensable the identification of worldwide locations suitable for manufacturing individual products based on due consideration of all factors, including the environment, product quality, costs, logistics, markets, human resources and materials and parts procurement.

Canon is accelerating the establishment of a production network with built-in flexibility to permit rapid adjustments to changes

Image sensor production in Kawasaki, Japan

In China, Canon (Suzhou) Inc. conducts cell production of imageRUNNER ADVANCE models.

in production volumes. The new plant constructed at Canon Virginia, Inc. in 2009 undertakes the production of toner cartridges as well as the recycling of used cartridges, effectively establishing closed-loop toner cartridge SCM within the United States.

Instilling True Craftsmanship, Group–wide

Canon's success in enhancing production technologies and developing an optimal global production structure hinges on one key factor: the capabilities of its workforce. As a company committed to manufacturing, we have long recognized the value of developing human resources, positioning as a priority management issue the nurturing of expert engineers and technicians.

Canon addresses this aspect of its management on a Group-wide scale. In the United States, Canon Virginia works with a local community college and follows a jointly developed training curriculum to provide new recruits with the education and training needed for high-quality manufacturing.

Also, by dispatching trainers to its production bases, particularly in Asia, Canon is providing training programs of the same quality as those provided by their counterparts in Japan. Furthermore, senior management candidates visit training centers in Japan for the further refinement of their managerial skills.

In Japan, Canon opened its Oita Manufacturing Training Center in 2009. The center employs skilled Canon engineers who pass on the manufacturing expertise that the Company has accumulated over its 70-year history to younger engineers. Canon will continue to do its part in honing the art of manufacturing and bequeathing it to future generations.

Production technology training program

>> SALES & MARKETING

Canon continues to bolster its sales and marketing operations by accelerating the provision of its client needs-oriented solutions.

Canon's new European headquarters in London

General Review

Canon has long delivered to the market an extensive range of imaging products. Against the backdrop of rapid IT advances today, machines are becoming increasingly networked. As a result, calls are heightening for more sophisticated services and productivity-enhancing solutions available in every aspect of both private life and business.

In its office equipment business, Canon aims to expand the contribution that solutions business sales make to total sales. Accordingly, we must set clear goals for product and business development in growth areas.

In 2009, we launched Canon Managed Document Services (Canon MDS). Based on existing region- and market-specific Managed Print Services (MPS), Canon MDS is designed to deliver high-quality, consistent services worldwide, particularly for enterprises with global operations.

Also in 2009, Canon and HP formed an alliance with a view to providing unmatched office workflow solutions. Specifically, the alliance will position the two companies to offer a new class of web-enabled solutions that combine Canon's MFDs with HP's leading-edge device manageability, IT integration and office workflow capabilities. The two companies will collaborate closely to expand their presence in the office solutions field.

Furthermore, in the same year we entered into an alliance with Adobe Systems Incorporated. Based on a global agreement, Adobe digital security technologies are embedded in Canon's imageRUNNER ADVANCE. The integration of both companies' technologies offers various benefits to users, including a reduced risk of unauthorized use of confidential information and enhanced operational productivity.

The Americas

In the year under review, Canon's sales in this region totaled ¥894.2 billion, which accounted for 27.9% of consolidated net sales. Overall results were stagnant due to an economic slowdown in the United States, the Company's core market in the Americas. However, Latin American nations continued to maintain their growth trends.

Under such conditions, Canon bolstered its U.S. direct sales and service network to ensure greater customer satisfaction. Specifically, we continued to expand the business bases of the direct sales and marketing company Canon Business Solutions, Inc. Meanwhile, Canon U.S.A., Inc. acquired Florida-based Virtual Imaging, Inc. to enhance the portfolio of medical imaging solutions and services. In Latin America, we are strengthening our business infrastructure and providing servicing support, training and call center functions.

Europe

Canon's sales in Europe amounted to ¥995.2 billion, which was approximately 31.0% of consolidated net sales. Market conditions varied depending on the country and region. Conditions were relatively steady in Germany and France, as well as in Northern Europe. Meanwhile, markets in the United Kingdom and Italy were weak due to deteriorated economic conditions. Conditions in emerging markets, despite stagnation in the first half, showed mild recovery in the second half.

Call center of Canon Information Technology Services, Inc. in the United States

imagePRESS-based medical imaging solutions have been introduced at University MRI & Medical Imaging Centers in Florida, the United States.

In response to these conditions, Canon has consolidated its European headquarters functions into Canon Europe Ltd. in London, aiming to facilitate more efficient decision making and improve the quality of its regional sales and marketing activities.

In line with ongoing efforts to enhance its solutions business, Canon Europa N.V. acquired a 17% stake in I.R.I.S. Group—a Belgian company boasting an extensive portfolio of scanning technologies.

Asia and Oceania

Remaining relatively stable, the Asian economy is showing potential for further growth. In Japan, sales totaled ¥702.3 billion, which accounted for 21.9% of consolidated net sales. In Asia and Oceania excluding Japan, sales totaled ¥617.6 billion, 19.2% of consolidated net sales.

Market conditions were extremely severe in Japan, particularly for B to B businesses. However, aiming to bolster its solutions business, Canon Marketing Japan Inc. continued to reorganize and reinforce Group operations in 2009.

In such areas as China and India, sales soared despite the global recession. Canon secured profit and achieved growth in these countries by strengthening its brand power through enhanced communication. Canon's business also grew steadily in various other areas in Asia. As a new initiative in China, Canon pioneered new sales channels, including Internet marketing and local distributors for certain products. We plan to expand our sales and servicing bases in China and other Asian markets.

Canon Australia Pty. Ltd. is striving to expand its channel coverage, develop business in uncultivated markets and improve the efficiency of business processes.

Quick Response and Repair Center (QRC) in Shanghai

>> CORPORATE SOCIAL RESPONSIBILITY

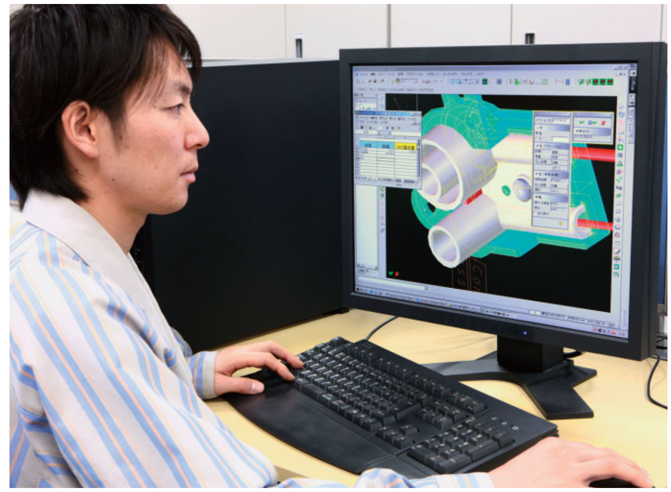
On its way toward becoming an excellent global corporation, Canon continues to contribute to the world's sustainability.

Canon's Basic Approach to CSR

Working to grow into a truly excellent global corporation under its corporate philosophy, *kyosei*, Canon aspires to a society in which all people—regardless of race, religion or culture—live and work together for the common good into the future.

Environmental Activities

Pursuant to "Action for Green," the Canon Environmental Vision announced in 2009, we aim to balance corporate growth with environmental activities. Canon is working to realize technological innovation and, at the same time, improve its management quality, thereby enhancing product performance and functions and minimizing the environmental burden of its products throughout their life cycles. In this way, the Company is contributing to the establishment of a society in which people enjoy affluent lifestyles in a sound global environment.



CO_2 emissions management at the imageRUNNER ADVANCE design stage

Environmental "Top Runner" imageRUNNER ADVANCE

Canon considers environmental aspects throughout the entire life cycle of individual products. The imageRUNNER ADVANCE series of color digital multifunction devices (MFDs) is packed with wide-ranging environmental technologies, including Canon's proprietary on-demand fixing technology, which helps reduce power consumption in toner fixing processes.

In addition to these environmental features, the series is the first family of Canon products for which CO_2 management has been conducted from the product planning stage. Based on assessments made at the development stage, imageRUNNER ADVANCE's life-cycle CO_2 emissions have been reduced significantly. Meanwhile, Canon pioneered the commercial use of a bio-based plastic, co-developed with Toray Industries, Inc., featuring the highest-grade flame retardance. The use of this plastic helps reduce CO_2 emissions.

Also, standards in accordance with the RoHS Directive* have been applied to the imageRUNNER ADVANCE series. In fact, in line with its stricter in-house standards, Canon has refrained from using lead- and cadmium-containing materials that are allowed under

Returnable containers for imageRUNNER ADVANCE models

CANON ENVIRONMENTAL VISION

ACTION for GREEN

Through technological innovation and improved management efficiency throughout all of its corporate activities, Canon aims to achieve sustainable corporate growth while also realizing a society that promotes both enriched lifestyles and the global environment.

To this end, Canon offers greater value using fewer resources throughout the entire product lifecycle—Produce, Use, Recycle—to achieve highly functional products with minimal environmental burden.

Canon continues to expand these activities with its customers and business partners.

Canon will contribute to a future that promotes both enrichment and the environment through technological innovation.

Deleted due to portrait rights.

A reduced maintenance burden was a factor behind the explosive popularity of toner cartridges. Canon fully recycles the used toner cartridges it collects.

RoHS exemption clauses.

In addition, the series uses plastic components created through closed-loop recycling, where plastic materials are semi-permanently recycled and reused. Due to additives used in the melting process, these recycled components boast strength, durability and flame retardance on par with those of brand-new plastic components. This innovative plastic recycling technology enables Canon to improve its MFD's eco-friendliness.

* EU Directive on the restriction of the use of certain hazardous substances in electrical and electronic equipment (2002/95/EC)

Toner Cartridges Recycling Program

2010 marks the 20th anniversary of the Canon Toner Cartridge Recycling Program, a zero-landfill program in which every component of the used cartridges that the Company collects is reused, recycled or recovered. Taking advantage of our toner cartridges' recycling-oriented designs, we have promoted closed-loop recycling, which facilitates the reuse of components and the recycling of plastic without compromising the quality of new cartridges made from used plastic. Today, Canon runs toner cartridge collection operations in 23 countries worldwide and to date has collected approximately 250,000 metric tons of used cartridges.

Environmental Activities at Operational Sites

Canon practices thorough energy management at its operational sites, where it has introduced advanced energy-efficient equipment and devices and makes every effort to cut greenhouse gas emissions. Specific activities during 2009 included the close monitoring of energy-consuming facilities, the optimization of facility utilization and the renewal and upgrading of energy-intensive facilities to facilities with improved energy-saving performance.

Canon continued to reduce or eliminate hazardous chemical substances used in its production processes. For example, the Company promoted the use of advanced technologies for the in-house recycling of waste alcohol solvents.

Contributing to Society

Canon conducts social contribution activities in wide-ranging fields. The following are examples of these activities.

The WWF-Canon Polar Bear Tracker Project

Canon Europe has been a Conservation Partner of the World Wide Fund for Nature (WWF) since 1998 in Europe, the Middle East and Africa by providing the organization with equipment and supplies as well as technical assistance. A relatively recent initiative, the

Through the WWF-Canon Polar Bear Tracker Project and in cooperation with the WWF, Canon has developed educational materials. These materials have been adopted by elementary schools in Vienna, Austria.

WWF-Canon Polar Bear Tracker Project features an environmental education section through which Canon Europe and WWF offer an interesting package of teaching materials on environmental subjects to schools free of charge.

Also, through Canon Austria GmbH's efforts, many Austrian elementary schools offered classes on various project topics during 2009. Students at these schools enjoyed the opportunity to learn about the impact of climate change on polar bears while studying ways of reducing their own impact on the environment.

Making Strides against Breast Cancer—The WALK

For over a decade, Canon U.S.A. has supported the American Cancer Society (ACS), which conducts extensive research, education, advocacy and services for patients and their families aimed at eliminating cancer as a major health concern. The company's support has taken the form of fund and product donations to help the organization continue its research and services.

The ACS organizes an annual "Making Strides against Breast Cancer" fund-raising campaign every October throughout the United States. Canon U.S.A. employees and their families and friends volunteer to participate in a walk that takes place in Jones Beach State Park, Long Island, New York. Canon is a flagship sponsor of this event.

The Tsuzuri Project

Canon and the Kyoto Culture Association (NPO) jointly promote the *Tsuzuri* Project aimed at preserving important Japanese cultural properties. Using Canon's digital SLR cameras, large-format inkjet printers and color management technologies, skilled artisans produce works almost indistinguishable from the originals. Reproduced works are donated to the museums, shrines and temples that own the originals, while the owners use the reproduced works for public and educational events, thus ensuring better storage conditions for the originals. During the three-year period from 2007 to 2010, a total of 15 historic items were reproduced and donated.

The Canon Institute for Global Studies and the Canon Foundation

In areas as diverse as macroeconomics, natural resources and energy, the environment, foreign affairs and national security, the Canon Institute for Global Studies investigates, analyzes and studies political, economic and social issues from a global perspective and disseminates findings, information and policy proposals

2009 Canon Green Volunteer Action

The *Tsuzuri* Project uses Canon technologies to reproduce significant cultural assets. (Above: reproducing Tawaraya Sotatsu's "Waves at Matsushima")

worldwide to further global development. At the same time, to promote sustainable prosperity and human happiness, the Canon Foundation supports researchers, academics, and organizations working in various scientific, technical and cultural fields.

2009 Canon Green Volunteer Action in China

Canon (China) Co., Ltd. undertook an environmental project in China in 2009. Aimed at promoting sustainable bio-diversity in China, the project involved Chinese students from selected universities. At the East Dongting Lake National Nature Reserve in Hunan, selected students working under the project conducted research on current bio-diversity status, photographed animals and plants and, based on the findings, made reports and policy proposals regarding the reserve's future development.

"Canon—For the Next Generation" Program in Vietnam

Canon is working to contribute to educational development in Vietnam under this charity program, which was announced in 2009. Specific activities include the refurbishment of school buildings and facilities, the improvement of peripheral environments by enhancing greenery and the donation of school materials. Canon Group employees volunteer to visit applicable schools to conduct these activities.

Nurturing Diverse Human Resources

Aiming to become a truly excellent global corporation, Canon effectively uses communication and education to motivate each employee to continue growing as an "excellent person."

In 2009, Canon opened new skill training facilities in the city of Oita. Equipment includes board-mounting devices, lathes, milling machines, grinders for lens processing, plastic molding machines, automated control devices and other manufacturing equipment. These facilities and other training venues are used to raise the baseline production capacity and skill levels of employees. At such facilities, we provide courses related to production in addition to training programs for board mounting, processing of all types of parts and practical training using robots. To enhance the role of these facilities as hubs for regional contributions, we also take on trainees from educational institutions and other bodies from outside the Group. One example of this initiative is the offering of internship opportunities to high school students.

In addition, Canon is working to develop the capabilities of executive personnel. Through a dedicated program, executive participants endeavor to strengthen their planning and analytical skills, become well-versed in Canon's management principles and strategies and foster mutual understanding.

BUSINESS UNITS

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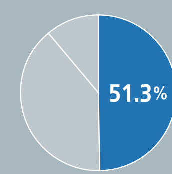
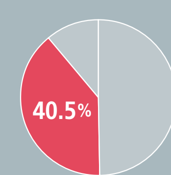
OFFICE BUSINESS UNIT 32

- Office network digital multifunction devices (MFDs)
- Color network digital MFDs
- Office copying machines
- Personal-use copying machines
- Full-color copying machines
- Laser printers
- Large format inkjet printers



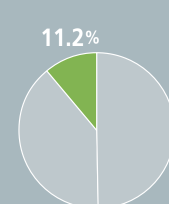
CONSUMER BUSINESS UNIT 36

- Digital SLR cameras
- Compact digital cameras
- Interchangeable lenses
- Digital video camcorders
- Inkjet multifunction peripherals
- Single function inkjet printers
- Image scanners
- Broadcasting equipment



INDUSTRY AND OTHERS BUSINESS UNIT 40

- Semiconductor production equipment
- Mirror projection mask aligners for LCD panels
- Medical equipment
- Components
- Computer information systems
- Document scanners
- Personal information products



Note:
The percentage figures for the three business units presented in the pie charts above do not add up to 100% because "Eliminations," used in consolidated accounting, were not included in calculation considerations.

Photo:
All Canon digital cameras use the common component DIGIC, an innovative technology. The excellence of our digital cameras, digital SLR cameras in particular, has been recognized by camera users worldwide despite the stagnation of the global economy.

BUSINESS UNITS

OFFICE BUSINESS UNIT

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Photo:
The imageRUNNER ADVANCE series (above: imageRUNNER ADVANCE C7065) incorporates the ideas from feedback accumulated by Canon's sales network through the provision of solution proposals. One imageRUNNER ADVANCE feature based on such feedback is the customizable user interface: displays on the control panel can be customized to meet individual user preferences.

"Taking advantage of the imageRUNNER ADVANCE series' rapid rise in popularity since its release, in 2010 Canon will take the offensive and expand this competitive lineup based on a new platform."

Masaki Nakaoka

Chief Executive, Office Imaging Products Operations

Canon's Office Business Unit, like all B to B businesses, faced extremely severe operating conditions in 2009. With yen appreciation exacerbating the conditions, Canon's sales and profits both declined year on year. However, market conditions did show some recovery in the second half. In December, the European market even showed record unit sales for office equipment with color capabilities. In such an environment, Canon released the new imageRUNNER ADVANCE series of office network MFDs, a family of products that have been well-received by the market.

The series boasts powerful IT system networkability, helps strengthen administrative processes and reduce the Total Cost of Ownership (TCO) while supporting the realization of an operational environment optimal for each user. In the lead-up to the development of the imageRUNNER ADVANCE platform, we listened closely to the feedback offered by Canon's sales network. One of the features based on such feedback is the series' server function: models equipped with large hard disk capacity can function as both servers and data storage units—a convenient feature for any type of corporation.

From this point forward, Canon will accelerate the implementation of two-pronged strategies underpinned by devices and solutions. imageRUNNER ADVANCE devices will be roughly divided into two lineup categories: high-value-added and compact. In 2010, Canon plans to expand the imageRUNNER ADVANCE lineup. It is not too much to say that Canon's Office Business Unit will be driven by the imageRUNNER ADVANCE series into the near future.

B to B businesses are increasingly shifting away from hardware-oriented models, and companies are required more than ever before to pursue solutions-oriented business models. With the imageRUNNER ADVANCE series as a core driver, Canon will work to provide printing-related solutions tailored to industry-specific needs, thereby contributing to the evolution of the solutions business sector. Our alliances with HP and Adobe will also play an important role in this regard. From a long-term perspective, we will accelerate preparations for the era of cloud computing, which is expected to arrive shortly.

Meanwhile, the commercial digital printing market is undergoing a transition. Specifically, printing capacity, which formerly had been concentrated among major printers, is being distributed throughout the industry. This shift will bring the expansion of the light/medium production market. Canon will target this promising market with competitive products and services.

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Digital production systems

Laser printer

Fiscal 2009 Review—OFFICE BUSINESS UNIT

In 2009, net sales in the Office Business Unit totaled ¥1,645.1 billion, a decrease of 26.8% year on year. Global demand for office network MFDs—both color and monochrome products—decreased, even in Asia, where previously growth had been rapid. Under such unfavorable conditions, Canon released the imageRUNNER ADVANCE series, which showed strong sales in the fourth quarter. In addition to its environmental features, the series seamlessly accommodates clients' existing IT environments while boasting improved performance and operability.

In line with such new product launches, Canon continued to enhance its business structure in this segment. Moreover, the Company worked to bolster and expand its office solutions business.

By product category, although sales of office network digital MFDs remained low in all regions, A4-models continued to gain popularity and the number of users switching to color models increased. Reflecting the growing need for the optimal management and administration of document input and output, Canon released a range of new, competitive MFDs in 2009. In the color product category, which includes the imageRUNNER ADVANCE series, the Color imageRUNNER C2550 (iR C2380i in some areas) saw sales and market share grow. In the A4-size color multifunction printer (MFP) category, the Color imageRUNNER 1022/1022i (iR C1021i in some areas) performed robustly. Through an alliance with HP announced in 2009, Canon has reinforced proposals for client-specific, optimal office systems that improve productivity and cost efficiency. In addition, Canon initiated Canon MDS, a common global service for effectively managing customers' document input-output environments and processes.

Color imageRUNNER C2550 (iR C2380i in some areas)

Color imageCLASS MF8050Cn (i-SENSYS MF8050Cn in some areas)

Sales of laser printers declined year on year. As a means to improve its management quality, Canon strove to minimize its laser printer inventories. Furthermore, the Company launched new monochrome laser printers in the low-end range for use by individuals and SOHOs as well as new color laser printers, including the Color imageCLASS MF8050Cn/MF8350Cdn (i-SENSYS MF8050Cn/MF8350Cdn in some areas).

The light production market for commercial printers is expanding, particularly in the United States and Europe.

In Focus—Environmentally Conscious imageRUNNER ADVANCE

In addition to its superior functions and performance, the imageRUNNER ADVANCE series boasts eco-friendly features. The application of on-demand fixing technology has realized zero power consumption by the fixing unit when in standby mode. The use of flame-retardant biomass plastics in exterior body parts not only reduces CO_2 emissions over the series' product lifecycles but also promotes environmental awareness among users. Moreover, having adopted the in-house standards stricter than the RoHS Directive,* Canon has minimized the use of lead- and cadmium-containing materials.

Furthermore, Canon began shipping certain models in reusable boxes. Designed in tandem with the series' units, these durable boxes are shaped to minimize dead space in transport containers. The use of the boxes thus helps reduce the environmental burden of shipping.

imageRUNNER ADVANCE C7065

* EU Directive on the restriction of the use of certain hazardous substances in electrical and electronic equipment (2002/95/EC)

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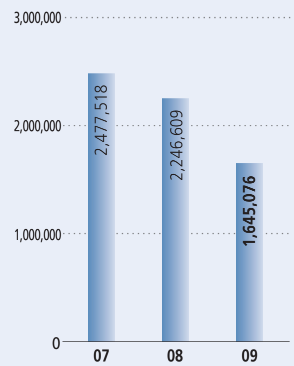
imageRUNNER ADVANCE C5035

imagePROGRAF iPF755

Sales Results

(Millions of yen)



Canon's full-fledged entry into this growing market came with the release of the imageRUNNER ADVANCE C9075/9065 PRO series. Also, the newly launched imagePRESS 1135P/1125P/1110P digital presses (imagePRESS 1135/1125/1110 in some areas) satisfy ever-diversifying customer needs.

Target industries for large-format inkjet printers scaled back capital expenditures. Due to the negative impact of the yen's rapid appreciation and lackluster market conditions, Canon's consolidated sales and unit sales in this business both decreased year on year. However, excluding the effect of yen appreciation, sales in 2009 stayed level with those of 2008. Placing priority on the Chinese market, Canon continued to enhance its business structure and sales activities. Among Canon large-format inkjet printers, the imagePROGRAF iPF700 series, which boasts small footprints and improved operability, was particularly well received by the market, significantly contributing to Canon's business performance in this product category.

imagePRESS 1135P
(imagePRESS 1135 in some areas)

In Focus—Merger with Netherlands-Based Océ N.V.

Océ develops, produces and markets document and industrial-use printing systems and high-speed wide-format digital print systems. Océ has strengths in printers for commercial printing and industrial wide-format printers used for outdoor displays. The combination of these strengths with our own in copying machines and MFPs used by large corporations and SOHOs and in large-format printers aimed at businesses and design firms will help us build a strong complementary fit from a technology and product perspective. Through expanded business and technology portfolios, we will provide printing solutions that are most sophisticated ever offered.

Press conference announcing the merger plan

BUSINESS UNITS

CONSUMER BUSINESS UNIT

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Photo:
Thanks to Canon's built-in Dual DIGIC 4 image processors and 18.0-megapixel image sensor, the EOS 7D digital SLR camera boasts superior capabilities, including high-speed continuous shooting that comes close to that of pro-series EOS models. Satisfying the desire of advanced amateur users, the EOS 7D is leading the way in advances for digital SLR cameras.

"Securing the leading position in global markets, Canon will continue to provide attractive products."

Masaya Maeda

Chief Executive, Image Communication Products Operations

Canon worked diligently to minimize the impact on its digital camera business of the economic downturn that started in 2008. Although sales of compact digital cameras showed a decline from the third quarter of 2008, the digital SLR camera business was affected only slightly. While emerging markets maintained their solid growth throughout the year, developed markets—starting with Europe, including Russia—showed some signs of recovery in the second half of 2009. As a result, during the final quarter of 2009, both sales and profit in Canon's digital camera business exceeded those recorded in the corresponding period of 2008.

Approaching the recession as an opportunity, Canon proactively aimed for the timely launch of strategic products while expanding its digital camera lineups. The Company focused on reinforcing mid-range and high-end products, among which the EOS 5D Mark II, EOS 7D and PowerShot S90 bore fruit. One of Canon's key strategies is to use a single platform packed with innovative technologies, such as DIGIC, and thereby ensure high product quality throughout its lineups.

Taking advantage of its in-house development and production capabilities, Canon will continue to launch innovative products, thereby pursuing greater growth in sales and profit.

It has been only a decade since digital technologies began to take hold in the imaging market. With an eye on its further expansion, Canon commits itself to always being the technological forerunner while improving productivity through the effective use of sophisticated SCM.

Digital SLR camera, EOS-1D Mark IV

"Leveraging its advanced technology, Canon will further introduce 'real-deal' products."

Katsuichi Shimizu

Chief Executive, Inkjet Products Operations

Although the sales volume in the global inkjet printer market largely fell below that of the previous year due to worldwide recession, overall consumer-specific market conditions slowed only slightly. Nevertheless, Canon recorded sales growth in terms of volume in the Americas and Asia due to the high market evaluation of its products.

In 2009, with advanced product technologies and excellent designs, Canon strove to expand sales channels, particularly in the United States, despite severe economic conditions. Furthermore, amid rapid market changes, Canon further improved its SCM to significantly lower the inventory level. This was helped by the Company's promotion of in-house production for product components.

Furthermore, to improve competitiveness Canon became one of the first to adopt the image per minute (IPM) speed measuring method based on ISO global standards. This move is expected to further strengthen Canon's brand recognition among users and dealers.

Also, Canon introduced high-value-added items to attract new high-volume production users. In the first half of 2009, the PIXMA Pro9500 Mark II and PIXMA Pro9000 Mark II, both of which garnered high praise, particularly in the United States, were launched for professional and advanced amateur photographers for use in combination with EOS cameras. In the second half of 2009, Canon renewed the consumer product lineup with models to meet growing demand for wireless LAN printers.

Focusing on speedy, high-quality printing, Canon will continue to pursue the power of innovation and thereby boost its market presence.

Inkjet printer, PIXMA Pro9500 Mark II

Fiscal 2009 Review—CONSUMER BUSINESS UNIT

The Consumer Business Unit's net sales fell 10.6% from the previous fiscal year to ¥1,301.2 billion. This was mainly attributable to the negative impact of the strong yen and the worldwide recession. However, sales of digital SLR cameras remained healthy worldwide. On the other hand, the inkjet printer business faced weak market conditions.

Against this backdrop, Canon strove to adjust its production and shipping operations in order to eliminate uneven inventories.

In digital SLR cameras, sales of the EOS 5D Mark II remained healthy. The EOS 7D, another advanced-amateur model, has earned great recognition since its release. Two low-end models—namely, the EOS Rebel T1i (EOS 500D in some areas) and the EOS Rebel Xsi (EOS 450D in some areas), also contributed to sales in the digital SLR camera business.

EOS 5D Mark II

In lenses for digital SLR cameras, sales of the new EF 100mm F2.8L Macro IS USM, which incorporates the Hybrid IS (Image Stabilizer) to compensate for both angle and shift camera shake, gained popularity.

EF100mm F2.8L Macro IS USM

PowerShot SD980 IS DIGITAL ELPH
(DIGITAL IXUS 200 IS in some areas)

Compact digital cameras saw sales negatively impacted by the stagnant global market, resulting in a sales volume drop. In response, Canon secured its leading position in the global market by introducing attractive products at fair prices in a timely manner. In the United States, Canon released new products, including the PowerShot SD980 IS DIGITAL ELPH (DIGITAL IXUS 200 IS in some areas) and the PowerShot S90. In digital video camcorders, the Company introduced the VIXIA HF21 (LEGRIA HF21 in some areas), which contributed to sales thanks to a good reputation for high-quality images. In LCD projectors, Canon released the WUX10 Mark II and the SX80 Mark II with specifications optimized for photography and medical use. Canon also strengthened its lineups of broadcasting lenses and network cameras. Despite such efforts, Canon marked decreased sales and profit due to currency exchange fluctuations

REALiS WUX10 Mark II
(XEED WUX10 Mark II in some areas)

In Focus—EOS 7D Digital SLR Camera

Made to be the tool of choice for advanced amateur users, EOS 7D debuted in 2009. Providing functions and performance nearing those of pro-series EOS cameras, this new digital SLR camera realizes superior photoshooting versatility.

Featuring an all-new 18.0-megapixel image sensor and Dual DIGIC 4 Image Processors, the EOS 7D achieves extended ISO sensitivity of up to ISO 12800 and captures high-quality images at speeds of up to 8 fps.* The EOS 7D is also capable of capturing full HD video. By reinforcing the lineups of mid-range and high-end digital SLR cameras, Canon aims to stimulate and capture replacement demand among entry-model Canon users.

* frames per second

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EOS 7D

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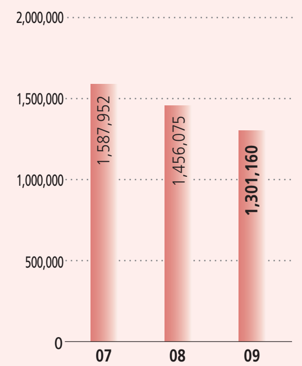
VIXIA HF21 (LEGRIA HF21 in some areas)

PIXMA MP640

Sales Results
(Millions of yen)



and the economic recession.

Amid the severe business environment, Canon's inkjet printer business enhanced its sales volume and reinforced its sales network, building on the high market reputation of its advanced product technologies based on FINE technology* as well as excellent product design.

The Company recorded a sales volume increase in the Americas and Asia. Canon released the PIXMA MX860 for office use as well as the PIXMA Pro9500 Mark II and the PIXMA Pro9000 Mark II for professional and advanced amateur users in the first half of 2009. During the second half of 2009, Canon refreshed the consumer product lineup by introducing the PIXMA MP990, PIXMA MP640 and PIXMA MP560 with various excellent functions, including wireless LAN, which has seen growing market needs.

PIXMA MP990

With regard to scanners, Canon released such new products as the CanoScan LiDE 700F while enhancing its sales and marketing activities. These efforts enabled the Company to accelerate global operations and thereby maintain the No. 1 position worldwide in this product category.

* Full-photolithography Inkjet Nozzle Engineering technology

CanoScan LiDE 700F

In Focus—Inkjet Printer Marketing Strategy in China

To bolster sales and marketing activities and after-sales services related to its inkjet printers in China, Canon moved its Chinese inkjet printer business headquarters functions from Beijing to Shanghai on January 1, 2010. In line with the headquarters transfer, Canon is bolstering its sales and marketing operations in robustly developing coastal areas through the strengthening of operational resources. Specifically, the Company is increasing its sales personnel and accelerating investment in sales promotion.

Also, in an effort to expand its inkjet printer customer base, Canon is strengthening marketing activities targeted at commercial users. At the same time, the Company is working to improve the recognition of Canon-brand inkjet printers in the Chinese market through vigorous advertising and promotion activities.

Canon is reinforcing its sales network in China.

BUSINESS UNITS

INDUSTRY AND OTHERS BUSINESS UNIT

Photo:
Measuring 9.0 m in width, 11.6 m in depth and 5.8 m in height, and weighing approximately 100 tons, Canon's LCD lithography equipment can accommodate eighth-generation glass substrate sizes. Canon is currently undertaking technological development for lithography equipment to support substrate sizes of 10th- and future generations, achieve a higher resolution and realize compatibility with organic light-emitting diode devices and displays.

"Spurred by the progress of its structural reforms in the semiconductor lithography equipment business, Canon will pursue higher customer satisfaction while improving its advanced technologies."

Toshiaki Ikoma

Chief Executive, Optical Products Operations

Market conditions for semiconductor lithography and LCD lithography equipment were harsh in 2009 due to the suspension of investment and manufacturers' postponement of mass production operations. Reflecting this, demand for LCD lithography equipment halved and semiconductor lithography equipment saw sales shrink one-third from 2008 levels.

The semiconductor lithography equipment business was hit heavily and marked a large sales drop. In response, Canon launched drastic structural reforms to optimize the scale of businesses in the face of market contraction. In January 2010, Canon Marketing Japan's semiconductor lithography equipment business was transferred to Canon Inc. as the latter shifted to a style of business operation able to more promptly reflect customers' opinions and requests in its products.

Canon will flexibly meet increasingly diverse market needs through its i-line and KrF lithography equipment. In addition, the Company will continue to pursue the further development of ArF lithography equipment and next-generation lithography technologies.

In LCD lithography equipment, the Company was negatively affected by sluggish market conditions during 2009. However, Canon is expecting market recovery in 2010. Canon has been contributing to customers' operations through high productivity and the speedy launch of its products—efforts that have led to a high rate of repeat orders. The Company is anticipating growth in the Chinese market and therefore will make ongoing efforts to achieve a leading market position. Simultaneously, Canon will strive to secure its competitiveness by developing lithography equipment for 10th- and future generation panels as well as higher definition displays.

Semiconductor lithography and LCD lithography equipment continually require the latest technologies in the optical lens and ultra-precision device design fields. These technologies, along with the results of R&D in these fields, are applicable in developing new optical and precision devices and triggering the creation of new markets. In this sense, R&D efforts made in these businesses are driving technological advances for the entire Group. The Industry and Others Business Unit understands this important role and aims to fulfill it.

Semiconductor lithography systems

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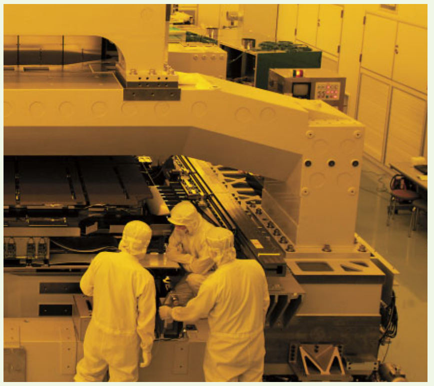
Ophthalmic equipment

Fiscal 2009 Review—INDUSTRY AND OTHERS BUSINESS UNIT

Net sales of the Industry and Others Business Unit fell 31.5% year on year to ¥358.0 billion.

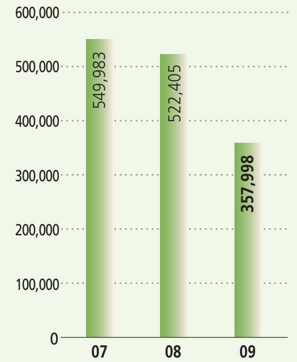
Overall markets for semiconductor and LCD lithography equipment were negatively impacted by sluggish demand.

In LCD lithography equipment, despite weak demand, Canon managed to maintain a strong market presence, backed by the MPAsp-H700 series for eighth-generation mirror projection aligners, while recording significant sales in South Korea.



LCD lithography equipment

Sales Results
(Millions of yen)



However, Canon experienced a significant sales drop for semiconductor lithography equipment during 2009, reflecting the suspension of capital investment and investment plans by device manufacturers.

Despite the economic downturn, Canon's medical equipment business saw sales growth. In mydriatic/non-mydriatic two-in-one digital retinal cameras, Canon released the CX-1, the world's first digital retinal camera to incorporate a dedicated digital camera unit, to positive reviews. In non-mydriatic digital retinal cameras, the Company introduced the CR-1 Mark II and marked relatively favorable results amid stagnant markets.

MPAsp-H700

In digital radiography systems, Canon enjoyed brisk sales in China and other Asian countries due to the introduction of the CXDI-50G/55G/55C, which boasts better operability and easier maintenance. Furthermore, addressing needs in the growing dynamic X-ray imaging market, Canon launched a portable DR system that enables both the viewing of dynamic images and capturing of static images.

CXDI-55G

In Focus—Consolidation of Poland-Based OPTOPOL Technology S.A.

The OPTOPOL Group develops, manufactures and markets such innovative ophthalmic diagnostic equipment as Optical Coherence Tomography (OCT) systems and operates throughout Europe, the United States and Japan.

In line with the aging of the global population, the number of people suffering from ophthalmic diseases is growing, and OCT plays a key role in fundus-examination devices using near-infrared light for retinal disorder diagnosis. To penetrate the promising OCT market, Canon made OPTOPOL a consolidated subsidiary, gaining access to a powerful product portfolio. OPTOPOL's OCT systems, ultrasound scanners, corneal topographers and perimeters will complement Canon's retinal cameras, refractors and tonometers. Also, technological collaboration will facilitate the creation of groundbreaking ophthalmic diagnostic tools. Through such actions, Canon aims for the world's No. 1 position in the ophthalmic diagnostic equipment business.

The OPTOPOL Group's R&D activities

TABLE OF CONTENTS

FINANCIAL OVERVIEW

GENERAL

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

OVERVIEW

Canon is one of the world's leading manufacturers of copying machines, laser printers, inkjet printers, cameras, steppers and aligners. 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 fiscal 2009, although the year began amid an unprecedentedly harsh business climate, economic stimulus measures implemented by different countries have started to yield results, leading to moderate recoveries as the second half of the year approached. Although countries such as China and India, whose economies have rapidly grown in prominence, maintained their stable growth largely owing to increased consumer spending, developed countries such as Japan, the United States and European nations all recorded negative growth for the first time since the end of World War II, leading to negative growth overall around the globe.

Market environment

As for the markets in which Canon operates amid these conditions, within the office equipment market, demand for both color and monochrome models of network digital multifunction devices ("MFDs") decreased in each region. While sales for laser printers also remained weak, dropping below the year-ago level, the rate of decline gradually narrowed toward the second half of the year. As for the consumer products market, while demand for compact digital cameras remained sluggish and prices continued to decline, demand for digital single-lens reflex ("SLR") cameras displayed solid growth especially in overseas markets. With regard to inkjet printers, although demand continued to be slack, which led to a reduction in market size compared with the previous year, conditions started to improve toward the end of the year. In the industry and others market, demand for steppers, utilized in the production of semiconductors, declined significantly while demand for aligners, used to produce liquid crystal display ("LCD") panels, also slowed but showed signs of a recovery heading into the next fiscal year. The average value of the yen during the year was ¥93.21 to the U.S. dollar, a year-on-year appreciation of approximately ¥10 or 10%, and ¥130.46 to the euro, a year-on-year appreciation of approximately ¥21 or 14%.

Summary of operations

Although the markets for consumer products such as cameras and inkjet printers are clearly bottoming out amid the significantly stronger yen, which has had an impact on all of the Company's businesses, net sales for the year totaled ¥3,209.2 billion (U.S.$34,883 million), a year-on-year decline of 21.6%, mainly due to the effects of reduced sales volumes of office products throughout the year. Income before income taxes totaled ¥219.4 billion (U.S.$2,384 million), a year-on-year decline of 54.4%, while net income attributable to Canon Inc. also decreased by 57.4% to ¥131.6 billion (U.S.$1,431 million).

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 on page 45.

Revenues

As Canon pursues 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 less 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, product reputation 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 product group to be important for the purpose of assessing Canon's sales performance in various product groups, taking into account recent market trends.

Gross profit ratio (ratio of gross profit to net sales) is another KPI for Canon. Through its reforms in 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 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 strives 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 high level of spending in core technology to sustain Canon's leading position in its current fields of business 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 ruined 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 collect 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 good status or further improved the constitution 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 research and development 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.

KEY PERFORMANCE INDICATORS

	2009	2008	2007	2006	2005
Net sales (Millions of yen)	**¥3,209,201**	¥4,094,161	¥4,481,346	¥4,156,759	¥3,754,191
Gross profit to net sales ratio	**44.5%**	47.3%	50.1%	49.6%	48.5%
R&D expense to net sales ratio	**9.5%**	9.1%	8.2%	7.4%	7.6%
Operating profit to net sales ratio	**6.8%**	12.1%	16.9%	17.0%	15.5%
Inventory turnover measured in days	**39 days**	47 days	44 days	45 days	47 days
Debt to total assets ratio	**0.3%**	0.4%	0.6%	0.7%	0.8%
Canon Inc. stockholders' equity to total assets ratio	**69.9%**	67.0%	64.8%	66.0%	64.4%

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

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 peripherals, 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 steppers and aligners 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 fair value 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.

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. Canon maintains an allowance for doubtful receivables for all customers based on a variety of factors, including the length of time receivables are past due, trends in the overall weighted average risk rating of the total portfolio, macroeconomic conditions, significant one-time events 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.

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 2009, Canon estimated a weighted-average discount rate of 2.4% for Japanese plans and 5.3% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.7% for Japanese plans and 6.2% 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 9%. 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 2010, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥2,661 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.

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.

Effective January 1, 2007, the Company and certain of its domestic subsidiaries amended their funded defined benefit pension plans. Under these funded defined benefit pension plans, the lifetime pension benefit is based upon amounts payable during an initial period after retirement (the "guarantee period") and the subsequent period lasting for the remainder of the retiree's lifetime (the "post-guarantee period"). The Company and certain of its domestic subsidiaries amended these plans to increase the duration of this guarantee period from 15 years to 20 years to reflect an increase in the average lifespan of their employees, resulting in reduced amounts payable during each of the guarantee and post-guarantee periods. As a result of these changes, the projected benefit obligation decreased by ¥101,620 million as of January 1, 2007. In conjunction with these plan changes, the Company and certain of its domestic subsidiaries also have implemented an unfunded retirement and severance plan and a defined contribution pension plan for certain future pension benefits attributable to employees' future services.

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen					Thousands of U.S. dollars
	2009	change	2008	change	2007	**2009**
Net sales	**¥3,209,201**	**–21.6%**	¥4,094,161	–8.6%	¥4,481,346	**$34,882,620**
Operating profit	**217,055**	**–56.2**	496,074	–34.4	756,673	**2,359,293**
Income before income taxes	**219,355**	**–54.4**	481,147	–37.4	768,388	**2,384,293**
Net income attributable to Canon Inc.	**131,647**	**–57.4**	309,148	–36.7	488,332	**1,430,946**

Sales

Canon's consolidated net sales in fiscal 2009 totaled ¥3,209,201 million (U.S.$34,883 million), representing a 21.6% decrease from the previous fiscal year. Although the markets for such consumer products as cameras and inkjet printers are clearly bottoming out amid the significantly stronger yen, which has had an impact on all of the Company's businesses, the decrease in sales mainly reflected the effects of reduced sales volumes of office products throughout the year.

Overseas operations are significant to Canon's operating results and generated approximately 78% of total net sales in fiscal 2009. 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 2009 was ¥93.21 to the U.S. dollar, and ¥130.46 to the euro, representing an appreciation of about ¥10 or 10% to the U.S. dollar, and a significant appreciation of approximately ¥21 or 14% against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively impacted net sales by approximately ¥249,500 million in 2009. This unfavorable impact was comprised of approximately ¥116,800 million for U. S. dollar denominated sales, ¥114,800 million for euro denominated sales and ¥17,900 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 2009 and 2008 was 55.5% and 52.7%, respectively.

Gross profit

Canon's gross profit in fiscal 2009 decreased by 26.3% to ¥1,427,393 million (U.S.$15,515 million) from fiscal 2008. The gross profit ratio deteriorated by 2.8 points year on year to 44.5%. Despite the launch of new products and ongoing cost-reduction efforts aimed at an improved gross profit ratio, the impact of such factors as the substantial appreciation of the yen and the drop in sales value led to the decline in the ratio.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Continued Group-wide efforts to thoroughly cut spending contributed to a decline in total operating expenses of 16.1% for fiscal 2009.

Operating profit

Operating profit in fiscal 2009 dropped 56.2% to a total of ¥217,055 million (U.S.$2,359 million) from fiscal 2008, recording 6.8% to net sales.

Other income (deductions)

Other income (deductions) for fiscal 2009 improved by ¥17,227 million (U.S.$187 million). Although net interest and dividends decreased, foreign currency exchange gains and losses improved by ¥13,054 million (U.S.$142 million).

Income before income taxes

Income before income taxes in fiscal 2009 was ¥219,355 million (U.S.$2,384 million), a decline of 54.4% from fiscal 2008, and constituted 6.8% of net sales.

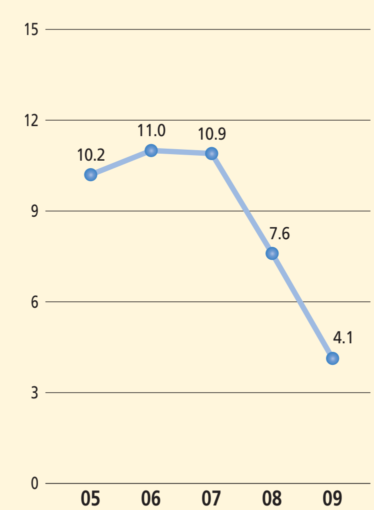
Income taxes

Provision for income taxes in fiscal 2009 decreased by ¥76,666 million (U.S.$833 million) from fiscal 2008, primarily as a result of the decline in income before income taxes. The effective tax rate during fiscal 2009 rose by 4.9% compared with fiscal 2008. This was mainly due to an increase in valuation allowances on deferred tax assets.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in fiscal 2009 decreased by 57.4% to ¥131,647 million (U.S.$1,431 million), which represents a 4.1% return on net sales.

Return on Sales
(%)



Segment information

The Company adopted guidance for segment reporting in accordance with U.S. GAAP in the year ending December 31, 2009. See Note 22 of the Notes to Consolidated Financial Statements for further details.

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 MFDs, color network digital MFDs, office copying machines, personal-use copying machines, full-color copying machines, laser printers and large format inkjet printers.
- **The Consumer Business Unit** mainly includes digital SLR cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction peripherals, single function inkjet printers, image scanners and broadcasting equipment.
- **The Industry and Others Business Unit** mainly includes semiconductor production equipment, mirror projection mask aligners for LCD panels, medical equipment, components, computer information systems, document scanners and personal information products.

Sales by segment

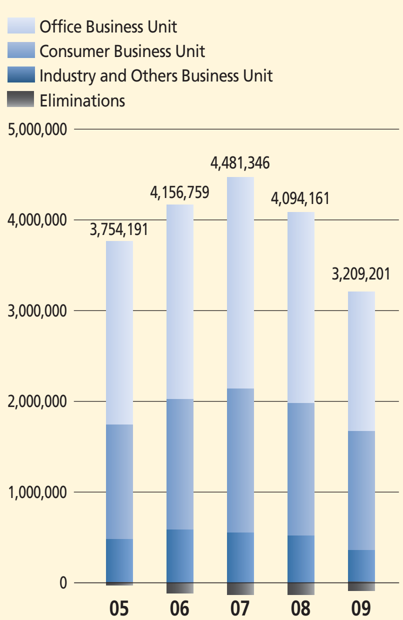
Please refer to the table of sales by segment in Note 22 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

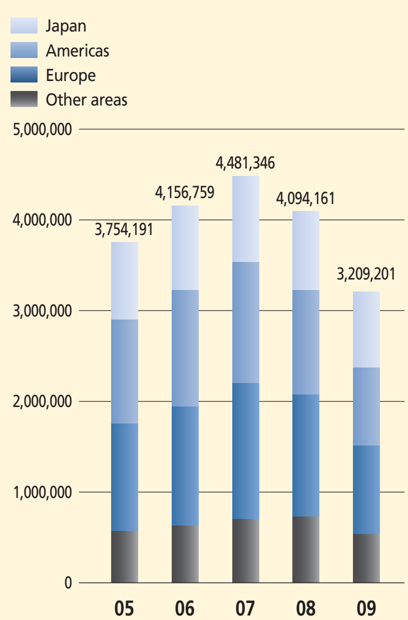
SALES BY SEGMENT

	Millions of yen					Thousands of U.S. dollars
	2009	change	2008	change	2007	2009
Office	**¥1,645,076**	**–26.8%**	¥2,246,609	–9.3%	¥2,477,518	**$17,881,261**
Consumer	**1,301,160**	**–10.6**	1,456,075	–8.3	1,587,952	**14,143,043**
Industry and Others	**357,998**	**–31.5**	522,405	–5.0	549,983	**3,891,283**
Eliminations	**(95,033)**	**—**	(130,928)	—	(134,107)	**(1,032,967)**
Total	**¥3,209,201**	**–21.6%**	¥4,094,161	–8.6%	¥4,481,346	**$34,882,620**

Sales by Segment
(Millions of yen)



Sales by Geographic Area
(Millions of yen)



Sales of the Office Business Unit, constituting 51.3% of consolidated net sales, decreased by 26.8% to ¥1,645,076 million (U.S.$17,881 million) in fiscal 2009, due to the decreased demand for office equipment overall amid the deterioration of economic conditions, along with the impact of the strong yen. Sales of network digital MFDs remained low in all regions while demand for laser printers decreased substantially compared with the previous year despite the optimization of inventory levels being in sight.

Sales of the Consumer Business Unit declined by 10.6% in fiscal 2009, totaling ¥1,301,160 million (U.S.$14,143 million), due to the significant impact of the yen's appreciation. Sales volumes, however, of such new products as the competitively priced EOS Rebel T1i (EOS 500D) and advanced-amateur model EOS 7D digital SLR cameras recorded solid growth. As for compact digital cameras, although stagnant market conditions led to a contraction in sales volume, the Company reinforced its product lineup through the launch of six new ELPH (IXUS)-series models and nine new PowerShot-series models. As for inkjet printers, although the market overall remained sluggish, sales in the Americas and Asia displayed healthy growth, contributing to a year-on-year increase in sales volume. Sales of the Consumer Business Unit constituted 40.5% of consolidated net sales in fiscal 2009.

Sales of the Industry and Others Business Unit decreased by 31.5% in fiscal 2009, to ¥357,998 million (U.S.$3,891 million). Within this segment, sales of steppers remained sluggish amid worsening market conditions for memory chips, while sales of aligners dropped due to restrained capital investment by LCD panel manufacturers. Sales of the Industry and Others Business Unit constituted 11.2% of consolidated net sales in fiscal 2009.

Intersegment sales of ¥95,033 million (U.S.$1,033 million), representing 3.0% 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 geographical analysis indicates that net sales in fiscal 2009 decreased in each of the major geographic areas.

In Japan, sales decreased by 19.1% in fiscal 2009 mainly due to weakened sales of monochrome and color models of network digital MFDs within the Office Business Unit, along with steppers.

In the Americas, net sales declined by 14.9% on a local currency basis in fiscal 2009, mainly due to reduced sales of such products as monochrome network MFDs and laser printers. On a yen basis, net sales in the Americas declined by 22.6% in fiscal 2009 as the yen strengthened to the U.S. dollar.

In Europe, net sales fell by 15.4% on a local currency basis in fiscal 2009, mainly due to reduced sales of such products as laser printers and monochrome network MFDs. On a yen basis, net sales in Europe dropped by 25.8% in fiscal 2009 resulting from the impact of the substantial appreciation of the yen to the euro.

Sales in other areas decreased by 15.4% on a yen basis in fiscal 2009, largely due to the stagnant sales of steppers and aligners.

A summary of net sales by geographic area is provided below.

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 2009 decreased by ¥227,950 million (U.S.$2,478 million) to ¥229,396 million (U.S.$2,493 million). This decline resulted primarily from the decrease in gross profit led by the significant reduction in sales.

Operating profit for the Consumer Business Unit in fiscal 2009 declined by ¥39,632 million (U.S.$431 million) to ¥183,492 million (U.S.$1,994 million) as a result of the decrease in gross profit arising from the reduction in sales.

Operating profit for the Industry and Others Business Unit in fiscal 2009 decreased by ¥28,080 million (U.S.$305 million) to an operating loss of ¥75,956 million (U.S.$826 million) as a result of a significant drop in sales along with impairment losses related to semiconductor production equipment, totaling ¥15,390 million (U.S.$167 million), arising from a fundamental reassessment of the business structure for steppers.

SALES BY GEOGRAPHIC AREA

	Millions of yen					Thousands of U.S. dollars
	2009	change	2008	change	2007	2009
Japan	¥ 702,344	−19.1%	¥ 868,280	−8.4%	¥ 947,587	$ 7,634,174
Americas	894,154	−22.6	1,154,571	−13.6	1,336,168	9,719,065
Europe	995,150	−25.8	1,341,400	−10.5	1,499,286	10,816,848
Other areas	617,553	−15.4	729,910	+4.5	698,305	6,712,533
Total	¥3,209,201	−21.6%	¥4,094,161	−8.6%	¥4,481,346	$34,882,620

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customer.

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 are comprised 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.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents in fiscal 2009 increased by ¥115,838 million (U.S.$1,259 million) to ¥795,034 million (U.S.$8,642 million), compared with ¥679,196 million in fiscal 2008 and ¥944,463 million in fiscal 2007. 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 2009 decreased slightly by ¥5,449 million (U.S.$59 million) from the previous year to ¥611,235 million (U.S.$6,644 million), as a result of the substantial progress achieved in inventory-reduction efforts. 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 2009, cash inflow from cash received from customers decreased, due to the decrease in net sales. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials also decreased, as a result of a decrease in net sales and cost reductions. Cost reductions reflect a decline in unit prices of parts and raw materials, as well as a streamlining of the process of using these parts and materials through promoting efficiency in operations. Cash outflow for payments for selling, general and administrative expenses decreased as a result of cost-cutting efforts. Cash outflow for payments of income taxes decreased, due to the decrease in taxable income.

Net cash used in investing activities in fiscal 2009 was ¥370,244 million (U.S.$4,024 million), compared with ¥472,480 million in fiscal 2008 and ¥432,485 million in fiscal 2007, consisting primarily of purchases of fixed assets. The purchases of fixed assets, which totaled ¥327,983 million (U.S.$3,565 million) in fiscal 2009, were focused on items relevant to introducing new products.

Canon defines "free cash flow" by deducting the cash flows from investing activities from the cash flows of operating activities. For fiscal 2009, free cash flow totaled ¥240,991 million (U.S.$2,619 million) as compared with ¥144,204 million for fiscal 2008. 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, therefore, the 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 ¥142,379 million (U.S.$1,548 million) in fiscal 2009, mainly resulting from the dividend payout of ¥135,793 million (U.S.$1,476 million). The Company paid dividends in fiscal 2009 of ¥110.00 (U.S.$1.20) per share, the same dividend amount as the prior year on a local currency basis.

Canon has completed a tender offer for the issued and outstanding ordinary shares of Océ N.V. (listed on the NYSE Euronext in Amsterdam, "Océ") on March 9, 2010 and made Océ a consolidated subsidiary, in order to create the overall No.1 presence in the printing industry. Including this and other investments, Canon seeks to meet its capital requirements principally with cash flow from operations, although Canon expects net cash provided by operating activities in fiscal 2010 to decline. In response to this expectation, Canon is currently endeavoring to optimize the level of capital investments, by further raising the efficiency of its investments and focusing investments on selected material items. This approach is supplemented with groupwide treasury and cash management activities undertaken at the parent company level.

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 current portion of long-term debt) amounted to ¥4,869 million (U.S.$53 million) at December 31, 2009 compared with ¥5,540 million at December 31, 2008. Long-term debt (excluding current portion) amounted to ¥4,912 million (U.S.$53 million) at December 31, 2009 compared with ¥8,423 million at December 31, 2008.

Canon's long-term debt (excluding current portion) generally 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 Rating 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 23, 2010, 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 2009 amounted to ¥216,128 million (U.S.$2,349 million) compared with ¥361,988 million in fiscal 2008 and ¥428,549 million in fiscal 2007. In fiscal 2009, increase in property, plant and equipment was mainly used to introducing new products. For fiscal 2010, Canon projects its increase in property, plant and equipment will be approximately ¥220,000 million (U.S.$2,391 million).

Employer contributions to Canon's worldwide defined benefit pension plans were ¥18,232 million (U.S.$198,174 million) in fiscal 2009, ¥23,033 million in fiscal 2008, ¥21,720 million in fiscal 2007. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥9,148 million (U.S.$99 million) in fiscal 2009, ¥10,840 million in fiscal 2008, and ¥10,262 million in fiscal 2007.

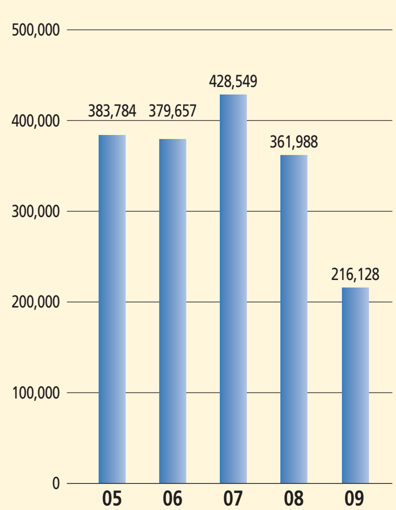
Working capital in fiscal 2009 increased by ¥113,241 million (U.S.$1,231 million), to ¥1,234,089 million (U.S.$13,414 million), compared with ¥1,120,848 million in fiscal 2008 and ¥1,352,082 million in fiscal 2007. This increase was primarily a result of the increase in cash and cash equivalent. Canon 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 2009 was 2.57 compared to 2.19 for fiscal 2008 and to 2.08 for fiscal 2007.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 3.4% in fiscal 2009, compared to 7.3% in fiscal 2008 and 10.8% in fiscal 2007.

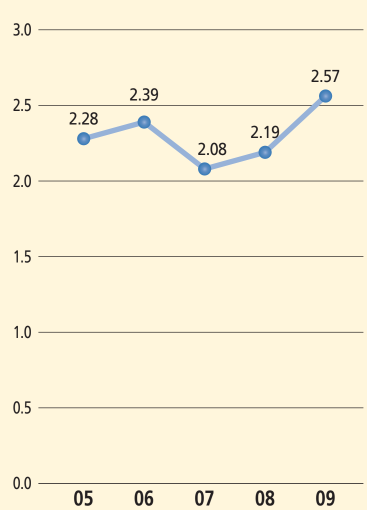
Return on Canon Inc. stockholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. stockholders' equity) was 4.9% in fiscal 2009 compared with 11.1% in fiscal 2008 and 16.5% in fiscal 2007.

Debt to total assets ratio was 0.3%, 0.4% and 0.6% as of December 31, 2009, 2008 and 2007, respectively. Canon had short-term loans and long-term debt of ¥9,781 million (U.S.$106 million) as of December 31, 2009, ¥13,963 million as of December 31, 2008 and ¥26,997 million as of December 31, 2007.

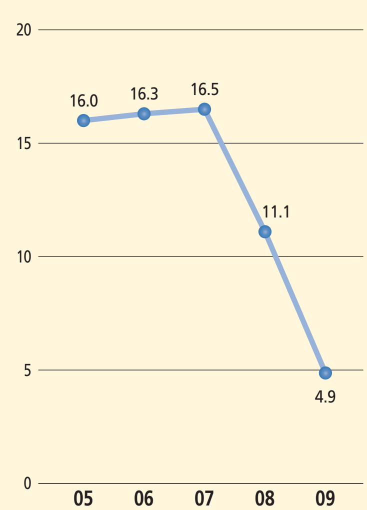
Increase in Property, Plant and Equipment
(Millions of yen)



Working Capital Ratio



Return on Canon Inc. Stockholders' Eqiuty
(%)



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 30 years in the case of employees with housing loans, and of 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 ¥18,526 million (U.S.$201 million) at December 31, 2009. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees were insignificant.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2009.

		Payments due by period			
Millions of yen	**Total**	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**¥ 9,761**	¥ 4,869	¥ 4,405	¥ 450	¥ 37
Other long-term debt	**20**	—	20	—	—
Operating lease obligations	**58,964**	16,259	22,972	11,553	8,180
Purchase commitments for:					
Property, plant and equipment	**21,839**	21,839	—	—	—
Parts and raw materials	**64,226**	64,226	—	—	—
Total	**¥154,810**	¥107,193	¥27,397	¥12,003	¥8,217

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.

		Payments due by period			
Thousands of U.S. dollars	**Total**	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**$ 106,098**	$ 52,924	$ 47,881	$ 4,891	$ 402
Other long-term debt	**217**	—	217	—	—
Operating lease obligations	**640,913**	176,728	249,695	125,577	88,913
Purchase commitments for:					
Property, plant and equipment	**237,380**	237,380	—	—	—
Parts and raw materials	**698,109**	698,109	—	—	—
Total	**$1,682,717**	$1,165,141	$297,793	$130,468	$89,315

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 is recognized and is included in selling, general and administrative expenses. Estimates for accrued product warranty cost 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, 2009, accrued product warranty costs amounted to ¥13,944 million (U.S.$152 million).

At December 31, 2009, commitments outstanding for the purchase of property, plant and equipment were approximately ¥21,839 million (U.S.$237 million), and commitments outstanding for the purchase of parts and raw materials were approximately ¥64,226 million (U.S.$698 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 2010, Canon expects to contribute ¥14,116 million (U.S.$153 million) to its Japanese defined benefit pension plans and ¥3,650 million (U.S.$40 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.

RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Canon is in the fourth year of the Excellent Global Corporation Plan, its 5-year (2006–2010) management plan. The slogan of the third phase ("Phase III") is "Innovation & Sound Growth" and there are four core strategies:

- Realize an overwhelming No.1 position worldwide in all current core businesses;
- Expand operations through diversification;
- Identify new business domains and accumulate necessary technological capabilities; and
- Establish new production system to sustain global competitiveness.

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

- Realize an overwhelming No.1 position worldwide in all current core businesses: Pursue development of new products which enable "cross-media imaging" by sophisticated functional synergy among the variety of Canon's image handling products, benefiting from the proliferation of broad band communication environment.
- Expand operations through diversification: Focus on developing various types of display, including Surface-conduction Electron-emitter Display ("SED") and Organic Light-Emitting Diode displays ("OLED").
- Identify new business domains and accumulate necessary technological capabilities: Accumulate technological capability in each of the medical imaging sector, intelligent robot industry and safety technology domain.

Canon is developing and strengthening relationships with universities and other research institutes, such as Kyoto University, Tokyo Institute of Technology, Stanford University and the New Energy and Industrial Technology Development Organization, to assist with fundamental research and to develop cutting-edge technologies.

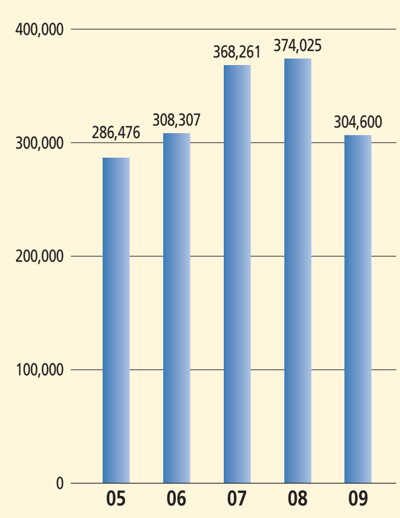
Canon has fully introduced 3D-CAD systems across the Canon group, boosting R&D efficiency to curtail product development times and costs. Moreover, Canon enhanced and evolved its simulation, measurement, and analysis technologies by establishing leading-edge facilities, including one of Japan's highest-performance 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 ¥304,600 million (U.S.$3,311 million) in fiscal 2009, ¥374,025 million in fiscal 2008 and ¥368,261 million in fiscal 2007. The ratios of R&D expenses to the consolidated total net sales for fiscal 2009, 2008 and 2007 were 9.5%, 9.1% and 8.2%, respectively.

Canon believes that new products protected by patents will not easily allow competitors to compete with it, and will give it an advantage in establishing standards in the market and industry.

R&D Expenses
(Millions of yen)



RECENT DEVELOPMENTS

Canon transferred responsibility for sales, service and support functions for semiconductor production equipment and mirror projection mask aligners for LCD panels from Canon Marketing Japan Inc. (“Canon Marketing Japan”) to the Company on January 1, 2010. This was in an effort to fortify the industry equipment business by establishing a completely integrated system from development to production, sales and servicing.

Asia Pacific System Research Co., Ltd. (“Asia Pacific System Research”) entered into a share exchange with Canon Electronics Inc. (“Canon Electronics”) and became a wholly owned subsidiary of Canon Electronics on February 1, 2010. This was in an effort to further accelerate business decision-making by integrating the two companies. Prior to the share exchange, Asia Pacific System Research was delisted from the JASDAQ Securities Exchange.

Canon Marketing Japan concluded a share exchange agreement with Canon Software Inc. (“Canon Software”) on January 26, 2010, making Canon Software a wholly owned subsidiary effective May 1, 2010. This was in an effort to further fortify and streamline our consolidated business base and accelerate the making of the IT solutions business of Canon Marketing Japan Group into a core business.

Canon concluded a share exchange agreement with Canon Finetech Inc. (“Canon Finetech”) on February 8, 2010, making Canon Finetech a wholly owned subsidiary effective May 1, 2010. This was in an effort to facilitate the organic integration of management resources between both companies and further enhance the synergies throughout the Canon Group to promote speed of management and solidify our position in the office equipment segment.

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

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

MARKET RISK EXPOSURE

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, 2009.

	Millions of yen		Thousands of U.S. dollars	
Available-for-sale securities	Cost	Fair value	Cost	Fair value
Due within one year	¥ 222	¥ 222	$ 2,413	$ 2,413
Due after one year through five years	3,274	3,568	35,587	38,783
Due after five years through ten years	623	573	6,772	6,227
Equity securities	11,932	17,726	129,696	192,674
	¥16,051	¥22,089	$174,468	$240,097

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 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, 2009. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2010.

Millions of yen	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	¥277,944	¥182,852	¥33,518	¥494,314
Estimated fair value	(6,951)	863	(881)	(6,969)
Forwards to buy foreign currencies:				
Contract amounts	¥ 25,861	¥ 1,244	¥ 3,873	¥ 30,978
Estimated fair value	58	(14)	467	511

Thousands of U.S. dollars	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	$3,021,130	$1,987,522	$364,326	$5,372,978
Estimated fair value	(75,554)	9,380	(9,576)	(75,750)
Forwards to buy foreign currencies:				
Contract amounts	$ 281,098	$ 13,522	$ 42,097	$ 336,717
Estimated fair value	630	(152)	5,076	5,554

All of Canon's long-term debt is fixed rate debt. Canon believes that fair value changes, and cash flows resulting from reasonable near-term changes in interest rates would be immaterial. Accordingly, Canon considers 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 12 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, 2009, 2008 and 2007. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥462 million (U.S.$5 million), ¥3,701 million and ¥6,883 million for the years ended December 31, 2009, 2008 and 2007, 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.

LOOKING FORWARD

Although the global economy has generally entered a recovery trend, there are still various risk factors such as weakened effects of stimulus measures in various countries, worsening employment conditions and consequent weakness in consumer spending, and it is necessary to maintain a close watch on what is a very uncertain future. It is expected that the global economy will continue to be trapped in a slow, L-shaped recovery, with business conditions facing the Canon Group remaining severe for the foreseeable future.

The Canon Group has, however, successfully managed to further strengthen its financial condition, by implementing various management reforms undertaken until this term. Therefore, Canon has designated 2010, the final year of Phase III (2006–2010) of its "Excellent Global Corporation Plan," as "First Year of Growth," a turning point to the growth mode. Canon will make full efforts to improve business performance at a speed that exceeds that of the economic recovery under a new growth strategy.

Canon will begin by focusing on the introduction of innovative products and services that take markets by storm. For example, Canon strives to utilize the most of technologies and personnel resources Canon has developed throughout its history to identify market trends early on and create novel products and services like the "imageRUNNER ADVANCE series" which has the potential to become the core of the promising solutions business.

Next, Canon will also focus on capturing significant portions of markets in China and other parts of Asia, where significant growth beyond that of the industrialized nations can be expected. Canon's approach will be to maximize competitiveness by thoroughly considering the characteristics of individual regions and revising sales strategies from the ground up.

In addition, Canon will make Océ N.V., a Dutch printer manufacturer with strengths in printers for commercial use and large-format printers for business use, into a consolidated subsidiary and by doing so, Canon will enhance its direct-sales and direct-service systems, mainly in Europe and the U.S., and apply its technologies and products to overwhelmingly achieve the No.1 position in the printing industry. With the addition of Océ to the Canon Group serving as a foothold, Canon will also accelerate efforts to achieve its long-held objective of constructing a global tri-polar (Japan, U.S., and Europe) business creation organization.

To nurture the development of new businesses, Canon plans to search for and develop existing businesses and peripheral businesses, enhance Group company sales to non-Group members and swiftly establish positions in next-generation businesses such as medical imaging and industrial robots.

As Canon moves ahead with the measures mentioned above, it will remain steadfast in its efforts to achieve further improvements in management quality. To strengthen its profit structure, Canon will work on restructuring the semiconductor business, strengthening the office equipment business and creating an optimal production system.

Canon will also continue to promote inventory reductions and strive for "supremacy of quality".

Office Business Unit

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 expects that the printing market will expand in the long term as well as the office product market. However, as the impact of the economic downturn has continued to affect the entire industry, sales for fiscal 2009 decreased. In recent years, a new printer-based MFD market has emerged as printer vendors seek to enter the copying machine and MFD market.

Canon has matched its business strategy to market trends by strengthening its lineup of digital color network MFDs and print-on-demand machines. In 2009, Canon launched the imageRUNNER ADVANCE series, a new lineup of digital color MFDs with enhanced network capability. In addition, Canon entered into the monochrome printing market with the introduction of the imagePRESS 1135/1125/1110 series. To maintain and enhance its competitive edge and to meet increasingly sophisticated customer demands, Canon is reinforcing its hardware and software product lineups and solution capability.

Canon's laser printer business has maintained a strong market position and has consistently displayed solid growth. However, the recent global economic downturn has led to a dramatic market decline. Although a recovery is expected in developing countries, particularly in Asia, uncertainty remains. Within the monochrome laser printer market, demand in emerging economies, which had been driving market expansion, declined in fiscal 2009 along with demand in developed countries. This situation has caused the overall market to shrink. As for color laser printers, market growth reversed from expansion to a slight contraction. Under such severe market conditions, Canon is accelerating its development of competitive, strategic products in all segments in preparation for an eventual economic recovery. Canon is also focused on shifting from selling single-function models to multifunction models, where Canon expects continued growth in demand. Canon is concurrently promoting automated production of cartridges and in-house production of components in order to ensure stable procurement.

Although the economic downturn caused the large format printer market to decline dramatically, Canon launched four new models (iPF650/655/750/755) that met commercial success and contributed significantly to sales due to their easy use and new compact design. Accordingly, Canon expanded its market share in fiscal year 2009.

Consumer Business Unit

The digital SLR camera market was affected by the worldwide economic downturn starting in the second half of 2008, resulting in a much lower volume of shipments in the first quarter of 2009 as compared to the same quarter of the previous year. Subsequent quarters, however, rebounded to roughly the same level as 2008. Thus, the full year improved as compared to the previous year. In technology terms, the market is expected to continue improving image sensor performance, with further increases in ISO settings making it increasingly possible to take beautiful photographs even in dark environments. In addition, video functions are now being included in cameras for every class of user from entry-level to professional, as high-quality video capability has come to be considered as a basic function for these products.

Although the Asian market (including China) for compact digital cameras was strong in 2009, the developed market shrank between 10% and 15%, and both the East European and South American markets declined to below the levels for the previous year. Thus, the global market shrank by 8% overall. Nevertheless, Canon has continued to maintain its top market share compared with its market share in 2008. The developed market is expected to remain stable in 2010, and emerging markets other than Russia are expected to remain on a positive growth track, resulting in a projected slight worldwide increase as compared to 2009.

Factors including a fierce price war and the strong yen have been drastically squeezing profit margins. While both the digital SLR camera market and the compact digital camera market as a whole are relying more and more on electronic manufacturing services companies, because cost competition is expected to intensify in the future, Canon plans to take advantage of its economies of scale and maintain profitability thanks to its 100% internal manufacturing system.

Canon expects the interchangeable lens market to grow as a result of its penetration into the digital SLR camera market. Canon aims to expand its sales and market share by introducing products with features such as Canon's Image Stabilizer functionality.

While the global video camera market has diversified with respect to new storage media, including DVDs, hard disks, flash memory and others, the trends toward flash memory as the future mainstream medium and HD became clear in 2009. Despite the worldwide economic downturn that started in the fall of 2008, the flash memory and HD market segments have continued to grow year-on-year. The low-priced Webcam market has proven to be strong, particularly in North America. Webcams appeal to a user segment that wants to enjoy convenient video capabilities, and they have been selling in increasing numbers. Canon is working to expand sales of its powerful lineup of products to meet a wide range of user needs with even greater added value. Canon seeks to differentiate itself from the competition based on its high-quality HD image technology as well as its dual flash memory concept.

The business application projector market experienced the effects of the economic downturn during 2009, resulting in a decline from the predicted unit volume and sales targets. This downturn affected products with a high added value. Nevertheless, system integrators and other video professionals continue to inquire about these products, and Canon plans to continue working to expand sales.

Prior to the economic downturn, the market for network cameras used for surveillance video and monitoring applications showed consistent double-digit growth by sales value. During 2009, however, due to cancellations and postponements of capital expenditures, this segment contracted for the first time. However, due to trends toward larger numbers of pixels and the standardization of operational commands, market research companies are predicting that this segment will rebound once again in the future. In order to avoid missing this trend, Canon is working to expand sales with a lineup ranging from low-priced, mass market models to high value-added models.

In the broadcast television lens market, the demand for HD lenses has been growing smoothly over the past several years, mainly in the United States and Europe. Due to the economic downturn, however, advertising revenues declined in 2009, and broadcast stations, which represent the major market segment for such products, struggled to obtain funds. For this reason, stations began to postpone the purchase of new broadcast equipment, resulting in a temporary decline in demand. In the medium term, growing demand for replacing equipment is projected as the conversion to digital broadcasts continues apace in developed nations. Demand for HD lenses for news applications is also expected to grow in emerging countries, and the market is expected to rebound as a result. Canon already has a high market share worldwide and plans to increase sales and expand its share as the market recovers, further solidifying its position in the industry.

In the inkjet printer market, market growth drastically declined in the first half of 2009, led by the global economic downturn. Beginning in the third quarter, the market started to recover gradually and in the fourth quarter it returned to the levels of the previous year. To manage these trends, Canon has focused on selling mid-range to high-end models which enable large volume printing, including photo printers for professional and experienced amateurs and wireless MFPs. Canon also has strengthened its lineup with respect to entry-level models.

Industry and Others Business Unit

Earnings for semiconductor device manufacturers deteriorated sharply in the wake of the recent financial crisis, and the impact on the market for steppers has been severe. As a result, a drastic reduction in shipments from 2008 to 2009 was unavoidable. Due to this unexpected prolonged sluggish demand, long-lived assets mainly consisting of production equipment for this business with a carrying amount of ¥15,390 million were written down to zero in 2009. The market for semiconductor devices is gradually recovering, but a true recovery for the semiconductor production equipment market is expected to take more time. Cost-cutting measures therefore remain a high priority. In addition, in case the demand decreases drastically from 2009, the impairment of long-lived assets will not affect the operating profit because they have been written down to zero in 2009, but other assets may have a risk of impairment.

Sales of mask aligners for LCD panels declined drastically in 2009 as LCD panel manufacturers, mainly in Taiwan, postponed or froze their equipment investment between the third quarter of 2008 and the first quarter of 2009. Canon continues to prioritize the Chinese market and is carefully monitoring market trends, such as bigger sizes and high-definition LCD panels, in order to quickly respond to customer demands.

The document scanners market has declined due to a reduction of equipment investment during the economic downturn. Despite this decline, Canon will strengthen its lineup of document scanners in order to expand sales.

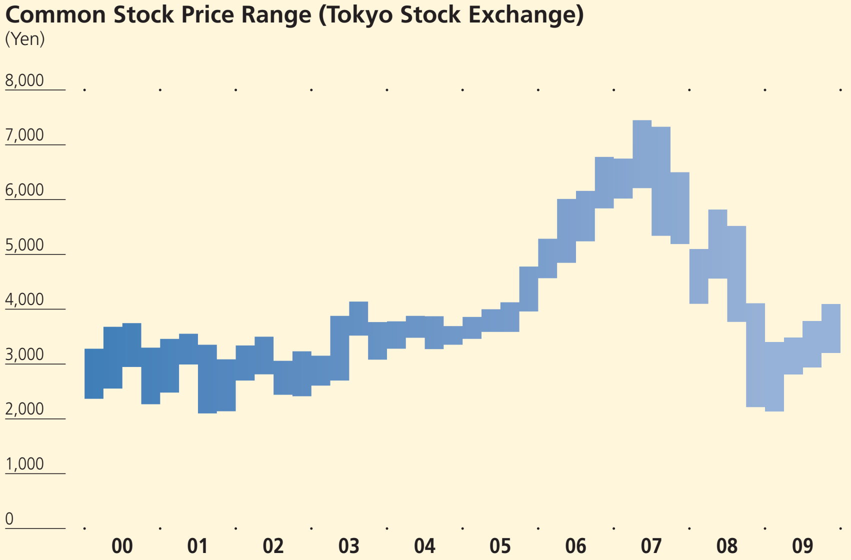
Forward looking statements

The foregoing discussion and other disclosure in this report contains forward-looking statements that reflect management's current views with respect to certain future events and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements. Further, certain forward-looking statements are based upon assumptions of future events that may not prove to be accurate. The following important factors could cause actual results to differ materially from those projected or implied in any forward-looking statements: foreign currency exchange rate fluctuations; the uncertainty of Canon's ability to implement its plans to localize production and other measures to reduce the impact of foreign currency exchange rate fluctuations; uncertainty as to economic conditions in Canon's major markets; uncertainty of continued demand for Canon's high-value-added products; uncertainty as to the recovery of computer and related markets; uncertainty of recovery in demand for Canon's semiconductor production equipment; Canon's ability to continue to develop products and to market products that incorporate new technology on a timely basis, are competitively priced, and achieve market acceptance; the possibility of losses resulting from foreign currency transactions designed to reduce financial risks from changes in foreign currency exchange rates; and inventory risk due to shifts in market demand.

TEN-YEAR FINANCIAL SUMMARY

	Millions of yen (except per share amounts)			
	2009	2008	2007	2006
Net sales:				
Domestic	¥ 702,344	¥ 868,280	¥ 947,587	¥ 932,290
Overseas	2,506,857	3,225,881	3,533,759	3,224,469
Total	3,209,201	4,094,161	4,481,346	4,156,759
Percentage of previous year	78.4%	91.4%	107.8%	110.7%
Net income attributable to Canon Inc.	131,647	309,148	488,332	455,325
Percentage of sales	4.1%	7.6%	10.9%	11.0%
Advertising	78,009	112,810	132,429	116,809
Research and development expenses	304,600	374,025	368,261	308,307
Depreciation of property, plant and equipment	277,399	304,622	309,815	235,804
Increase in property, plant and equipment	216,128	361,988	428,549	379,657
Long-term debt, excluding current installments	¥ 4,912	¥ 8,423	¥ 8,680	¥ 15,789
Canon Inc. stockholders' equity	2,688,109	2,659,792	2,922,336	2,986,606
Total assets	3,847,557	3,969,934	4,512,625	4,521,915
Per share data:				
Income before cumulative effect of change in accounting principle:				
Basic	¥ 106.64	¥ 246.21	¥ 377.59	¥ 341.95
Diluted	106.64	246.20	377.53	341.84
Net income attributable to Canon Inc. stockholders per share:				
Basic	106.64	246.21	377.59	341.95
Diluted	106.64	246.20	377.53	341.84
Dividends per share	110.00	110.00	110.00	83.33
Stock price:				
High	4,070	5,820	7,450	6,780
Low	2,115	2,215	5,190	4,567
Average number of common shares in thousands	1,234,482	1,255,626	1,293,296	1,331,542
Number of employees	168,879	166,980	131,352	118,499

Common Stock Price Range (Tokyo Stock Exchange)



2005	2004	2003	2002	2001	2000	Thousands of U.S. dollars (except per share amounts) 2009
¥ 856,205	¥ 849,734	¥ 801,400	¥ 732,551	¥ 827,288	¥ 779,366	**$ 7,634,174**
2,897,986	2,618,119	2,396,672	2,207,577	2,080,285	1,917,054	**27,248,446**
3,754,191	3,467,853	3,198,072	2,940,128	2,907,573	2,696,420	**34,882,620**
108.3%	108.4%	108.8%	101.1%	107.8%	106.5%	**78.4%**
384,096	343,344	275,730	190,737	167,561	134,088	**1,430,946**
10.2%	9.9%	8.6%	6.5%	5.8%	5.0%	**4.1%**
106,250	111,770	100,278	71,725	66,837	67,840	**847,924**
286,476	275,300	259,140	233,669	218,616	194,552	**3,310,870**
205,727	174,397	168,636	158,469	147,286	144,043	**3,015,207**
383,784	318,730	210,038	198,702	207,674	170,986	**2,349,217**
¥ 27,082	¥ 28,651	¥ 59,260	¥ 81,349	¥ 95,526	¥ 142,925	**$ 53,391**
2,604,682	2,209,896	1,865,545	1,591,950	1,458,476	1,298,914	**29,218,576**
4,043,553	3,587,021	3,182,148	2,942,706	2,844,756	2,832,125	**41,821,272**
¥ 288.63	¥ 258.53	¥ 209.21	¥ 145.04	¥ 124.71	¥ 102.44	**$ 1.16**
288.36	257.85	207.17	143.20	123.03	101.01	**1.16**
288.63	258.53	209.21	145.04	127.53	102.44	**1.16**
288.36	257.85	207.17	143.20	125.80	101.01	**1.16**
66.67	43.33	33.33	20.00	16.67	14.00	**1.20**
4,780	3,880	4,140	3,500	3,553	3,747	**44.24**
3,460	3,273	2,607	2,413	2,100	2,267	**22.99**
1,330,761	1,328,048	1,317,974	1,315,074	1,313,940	1,308,909	
115,583	108,257	102,567	97,802	93,620	86,673	

Notes:

1. Canon adopted new guidance for noncontrolling interests in consolidated financial statements in the fiscal year beginning January 1, 2009. In accordance with the adoption of this guidance, "income before income taxes and minority interests" is now referred to as "income before income taxes" and "net income" is now referred to as "net income attributable to Canon Inc."
2. U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY92, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2009.
3. The Company made a three-for-two stock split on July 1, 2006. The average number of common shares and the per share data for the periods prior to the stock split have been adjusted to reflect the stock split.

CONSOLIDATED BALANCE SHEETS

CANON INC. AND SUBSIDIARIES

December 31, 2009 and 2008

	Millions of yen		Thousands of U.S. dollars (Note 2)
	2009	2008	2009
ASSETS		(As adjusted) (Note 1)	
Current assets:			
Cash and cash equivalents (Note 1)	¥ 795,034	¥ 679,196	$ 8,641,674
Short-term investments (Note 3)	19,089	7,651	207,489
Trade receivables, net (Note 4)	556,572	595,422	6,049,696
Inventories (Note 5)	373,241	506,919	4,056,967
Prepaid expenses and other current assets (Notes 7 and 12)	273,843	275,660	2,976,554
Total current assets	2,017,779	2,064,848	21,932,380
Noncurrent receivables (Note 19)	14,936	14,752	162,348
Investments (Note 3)	114,066	88,825	1,239,848
Property, plant and equipment, net (Notes 6 and 7)	1,269,785	1,357,186	13,802,011
Intangible assets, net (Note 8)	117,396	119,140	1,276,043
Other assets (Notes 7,8,11 and 12)	313,595	325,183	3,408,642
Total assets	¥3,847,557	¥3,969,934	$41,821,272
LIABILITIES AND EQUITY			
Current liabilities:			
Short-term loans and current portion of long-term debt (Note 9)	¥ 4,869	¥ 5,540	$ 52,924
Trade payables (Note 10)	339,113	406,746	3,686,011
Accrued income taxes (Note 12)	50,105	69,961	544,620
Accrued expenses (Notes 11 and 19)	274,300	277,117	2,981,522
Other current liabilities (Notes 6 and 12)	115,303	184,636	1,253,293
Total current liabilities	783,690	944,000	8,518,370
Long-term debt, excluding current installments (Note 9)	4,912	8,423	53,391
Accrued pension and severance cost (Note 11)	115,904	110,784	1,259,826
Other noncurrent liabilities (Note 12)	63,651	55,745	691,859
Total liabilities	968,157	1,118,952	10,523,446
Commitments and contingent liabilities (Note 19)			
Equity:			
Canon Inc. stockholders' equity:			
Common stock			
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2009 and in 2008 (Note 13)	174,762	174,762	1,899,587
Additional paid-in capital (Note 13)	404,293	403,790	4,394,489
Legal reserve (Note 14)	54,687	53,706	594,424
Retained earnings (Note 14)	2,871,437	2,876,576	31,211,272
Accumulated other comprehensive income (loss) (Note 15)	(260,818)	(292,820)	(2,834,978)
Treasury stock, at cost; 99,288,001 shares in 2009 and 99,275,245 shares in 2008	(556,252)	(556,222)	(6,046,218)
Total Canon Inc. stockholders' equity	2,688,109	2,659,792	29,218,576
Noncontrolling interests	191,291	191,190	2,079,250
Total equity	2,879,400	2,850,982	31,297,826
Total liabilities and equity	¥3,847,557	¥3,969,934	$41,821,272

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2009, 2008 and 2007

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2009	2008	2007	2009
		(As adjusted) (Note 1)		
Net sales	¥3,209,201	¥4,094,161	¥4,481,346	$34,882,620
Cost of sales (Notes 6, 8, 11 and 19)	1,781,808	2,156,153	2,234,365	19,367,479
Gross profit	1,427,393	1,938,008	2,246,981	15,515,141
Operating expenses (Notes 1, 6 ,8, 11, 16 and 19):				
Selling, general and administrative expenses	905,738	1,067,909	1,122,047	9,844,978
Research and development expenses	304,600	374,025	368,261	3,310,870
	1,210,338	1,441,934	1,490,308	13,155,848
Operating profit	217,055	496,074	756,673	2,359,293
Other income (deductions):				
Interest and dividend income	5,202	19,442	32,819	56,543
Interest expense	(336)	(837)	(1,471)	(3,652)
Other, net (Notes 1, 3 and 18)	(2,566)	(33,532)	(19,633)	(27,891)
	2,300	(14,927)	11,715	25,000
Income before income taxes	219,355	481,147	768,388	2,384,293
Income taxes (Note 12)	84,122	160,788	264,258	914,369
Consolidated net income	135,233	320,359	504,130	1,469,924
Less: Net income attributable to noncontrolling interests	3,586	11,211	15,798	38,978
Net income attributable to Canon Inc.	¥ 131,647	¥ 309,148	¥ 488,332	$ 1,430,946
	Yen			U.S. dollars (Note 2)
Net income attributable to Canon Inc. stockholders per share (Note 17):				
Basic	¥ 106.64	¥ 246.21	¥ 377.59	$ 1.16
Diluted	106.64	246.20	377.53	1.16
Cash dividends per share	110.00	110.00	110.00	1.20

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EQUITY

CANON INC. AND SUBSIDIARIES

	Millions of yen								
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total Canon Inc. stockholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2006	¥174,603	¥403,510	¥43,600	¥2,368,047	¥ 2,718	¥ (5,872)	¥2,986,606	¥216,801	¥3,203,407
Cumulative effect of a change in accounting principle - adoption of accounting guidance for sabbatical leave and other similar benefits, net of tax				(2,204)			(2,204)		(2,204)
Conversion of convertible debt	95	95					190		190
Equity transactions with noncontrolling interests and other		(617)					(617)	(12,185)	(12,802)
Dividends paid to Canon Inc. stockholders				(131,612)			(131,612)		(131,612)
Dividends paid to noncontrolling interests								(4,612)	(4,612)
Transfer to legal reserve			2,417	(2,417)			—		—
Comprehensive income:									
Net income				488,332			488,332	15,798	504,130
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					(62)		(62)	(26)	(88)
Net unrealized gains and losses on securities					(1,778)		(1,778)	(577)	(2,355)
Net gains and losses on derivative instruments					814		814	7	821
Pension liability adjustments					32,978		32,978	7,664	40,642
Total comprehensive income							520,284	22,866	543,150
Repurchase of treasury stock, net		3				(450,314)	(450,311)		(450,311)
Balance at December 31, 2007	174,698	402,991	46,017	2,720,146	34,670	(456,186)	2,922,336	222,870	3,145,206
Conversion of convertible debt	64	63					127		127
Equity transactions with noncontrolling interests and other		761					761	(26,218)	(25,457)
Dividends paid to Canon Inc. stockholders				(145,024)			(145,024)		(145,024)
Dividends paid to noncontrolling interests								(5,123)	(5,123)
Transfer to legal reserve			7,689	(7,689)			—		—
Comprehensive income (loss):									
Net income				309,148			309,148	11,211	320,359
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					(258,764)		(258,764)	(1,911)	(260,675)
Net unrealized gains and losses on securities					(5,152)		(5,152)	(690)	(5,842)
Net gains and losses on derivative instruments					2,342		2,342	—	2,342
Pension liability adjustments					(65,916)		(65,916)	(8,949)	(74,865)
Total comprehensive income (loss)							(18,342)	(339)	(18,681)
Repurchase of treasury stock, net		(25)		(5)		(100,036)	(100,066)		(100,066)
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 (Note 15):									
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**

	Thousands of U.S. dollars (Note 2)								
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total Canon Inc. stockholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2008	$1,899,587	$4,389,022	$583,761	$31,267,130	$(3,182,825)	$(6,045,892)	$28,910,783	$2,078,152	$30,988,935
Equity transactions with noncontrolling interests and other		5,467					5,467	(14,956)	(9,489)
Dividends paid to Canon Inc. stockholders				(1,476,011)			(1,476,011)		(1,476,011)
Dividends paid to noncontrolling interests								(36,152)	(36,152)
Transfer to legal reserve			10,663	(10,663)			—		—
Comprehensive income:									
Net income				1,430,946			1,430,946	38,978	1,469,924
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					362,391		362,391	326	362,717
Net unrealized gains and losses on securities					23,370		23,370	728	24,098
Net gains and losses on derivative instruments					(15,457)		(15,457)	(11)	(15,468)
Pension liability adjustments					(22,457)		(22,457)	12,185	(10,272)
Total comprehensive income							1,778,793	52,206	1,830,999
Repurchase of treasury stock, net				(130)		(326)	(456)		(456)
Balance at December 31, 2009	$1,899,587	$4,394,489	$594,424	$31,211,272	$(2,834,978)	$(6,046,218)	$29,218,576	$2,079,250	$31,297,826

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2009, 2008 and 2007

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2009	2008	2007	2009
		(As adjusted) (Note 1)		
Cash flows from operating activities:				
Consolidated net income	¥ 135,233	¥ 320,359	¥ 504,130	$ 1,469,924
Adjustments to reconcile consolidated net income to net cash provided by operating activities:				
Depreciation and amortization	315,393	341,337	341,694	3,428,185
Loss on disposal of property, plant and equipment	8,215	11,811	9,985	89,294
Impairment loss of fixed assets (Note 6)	15,466	13,503	15,908	168,109
Deferred income taxes	20,712	(32,497)	(35,021)	225,130
Equity in (earnings) losses of affiliated companies	12,649	20,047	(5,634)	137,490
(Increase) decrease in trade receivables	48,244	83,521	(10,722)	524,391
(Increase) decrease in inventories	143,580	49,547	(26,643)	1,560,652
Increase (decrease) in trade payables	(76,843)	(36,719)	21,136	(835,250)
Increase (decrease) in accrued income taxes	(21,023)	(77,340)	14,988	(228,511)
Increase (decrease) in accrued expenses	(9,827)	(30,694)	43,035	(106,815)
Increase (decrease) in accrued (prepaid) pension and severance cost	4,765	(12,128)	(15,387)	51,793
Other, net	14,671	(34,063)	(18,200)	159,467
Net cash provided by operating activities	611,235	616,684	839,269	6,643,859
Cash flows from investing activities:				
Purchases of fixed assets (Note 6)	(327,983)	(428,168)	(474,285)	(3,565,033)
Proceeds from sale of fixed assets (Note 6)	8,893	7,453	9,635	96,663
Purchases of available-for-sale securities	(3,253)	(7,307)	(2,281)	(35,359)
Proceeds from sale and maturity of available-for-sale securities	2,460	4,320	8,614	26,739
Proceeds from maturity of held-to-maturity securities	—	10,000	10,000	—
(Increase) decrease in time deposits, net	(11,345)	2,892	31,681	(123,315)
Acquisitions of subsidiaries, net of cash acquired	(2,979)	(5,999)	(15,675)	(32,380)
Purchases of other investments	(37,981)	(45,473)	(2,432)	(412,837)
Other, net	1,944	(10,198)	2,258	21,131
Net cash used in investing activities	(370,244)	(472,480)	(432,485)	(4,024,391)
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	3,361	6,841	2,635	36,533
Repayments of long-term debt	(6,282)	(15,397)	(13,046)	(68,283)
Decrease in short-term loans, net	(280)	(2,643)	(358)	(3,043)
Dividends paid	(135,793)	(145,024)	(131,612)	(1,476,011)
Repurchases of treasury stock, net	(42)	(100,066)	(450,311)	(456)
Other, net	(3,343)	(21,276)	(11,691)	(36,338)
Net cash used in financing activities	(142,379)	(277,565)	(604,383)	(1,547,598)
Effect of exchange rate changes on cash and cash equivalents	17,226	(131,906)	(13,564)	187,239
Net change in cash and cash equivalents	115,838	(265,267)	(211,163)	1,259,109
Cash and cash equivalents at beginning of year	679,196	944,463	1,155,626	7,382,565
Cash and cash equivalents at end of year	¥ 795,034	¥ 679,196	¥ 944,463	$ 8,641,674
Supplemental disclosure for cash flow information:				
Cash paid during the year for:				
Interest	¥ 384	¥ 901	¥ 1,476	$ 4,174
Income taxes	82,906	263,392	273,888	901,152

See accompanying 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 multifunction devices ("MFDs"), copying machines, laser printers and large format inkjet printers. Consumer products consist mainly of digital single-lens reflex ("SLR") cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction peripherals, single function inkjet printers, image scanners and broadcasting equipment. Industry and other products consist mainly of semiconductor production equipment, mirror projection mask aligners for liquid crystal display ("LCD") panels, and medical equipment. Canon's consolidated net sales for the years ended December 31, 2009, 2008 and 2007 were distributed as follows: the Office Business Unit 51%, 55% and 55%, the Consumer Business Unit 41%, 35% and 36%, the Industry and Others Business Unit 11%, 13% and 12%, and elimination between segments 3%, 3% and 3%, 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. Approximately 78%, 79% and 79% of consolidated net sales for the years ended December 31, 2009, 2008 and 2007 were generated outside Japan, with 28%, 28% and 30% in the Americas, 31%, 33% and 33% in Europe, and 19%, 18% and 16% in other areas, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted approximately 20%, 23% and 22% of consolidated net sales for the years ended December 31, 2009, 2008 and 2007, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 25 plants in Japan and 16 overseas plants which are located in countries or regions such as the United States, Germany, France, 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 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 plans. 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 gain of ¥1,842 million ($20,022 thousand) for the year ended December 31, 2009, and were net losses of ¥11,212 million and ¥31,943 million for the years ended December 31, 2008 and 2007, 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 ¥184,856 million ($2,009,304 thousand) and ¥194,030 million at December 31, 2009 and 2008, 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 ¥999 million ($10,859 thousand) and ¥997 million at December 31, 2009 and 2008, respectively, are also included in cash and cash equivalents. Fair value for these securities approximates their cost.

(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.

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 on 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, significant one-time events, 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.

(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 period ranging 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 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. Intangible assets with finite useful lives, consisting primarily of 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. 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.

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 convertible debentures were converted into common stock and 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 peripherals, 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 steppers and aligners 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 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 fair value 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 ¥78,009 million ($847,924 thousand), ¥112,810 million and ¥132,429 million for the years ended December 31, 2009, 2008 and 2007, respectively.

(t) Shipping and Handling Costs
Shipping and handling costs totaled ¥45,966 million ($499,630 thousand), ¥62,128 million and ¥63,708 million for the years ended December 31, 2009, 2008 and 2007, 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.

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 June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Codification ("ASC"). The ASC has become the source of authoritative U.S. GAAP. Additionally, rules and interpretive releases of the U.S. Securities and Exchange Commission ("SEC") under authority of the federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. The ASC did not change current U.S GAAP, but was intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. This Codification is effective for fiscal years and interim periods ending after September 15, 2009 and was adopted by Canon beginning from the quarter ended September 30, 2009. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition. However, throughout the notes to the consolidated financial statements, references that were previously made to various former authoritative U.S. GAAP pronouncements have been removed.

In December 2007, the FASB issued new accounting guidance for business combinations. This guidance establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired in a business combination. This guidance also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This guidance is effective for fiscal years beginning on or after December 15, 2008 and was adopted by Canon for any business combinations with an acquisition date on or after January 1, 2009. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition.

In December 2007, the FASB issued new accounting guidance for noncontrolling interests in consolidated financial statements. This guidance establishes accounting and reporting guidance for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. This guidance also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This guidance is effective for fiscal years beginning on or after December 15, 2008 on a prospective basis, except for certain presentation and disclosure requirements, which must be applied retrospectively for all periods presented, and was adopted by Canon in the first quarter beginning January 1, 2009. Upon the adoption of this guidance, noncontrolling interests, which were previously referred to as minority interests and classified between total liabilities and stockholders' equity on the consolidated balance sheets, are now included as a separate component of total equity. In addition, consolidated net income on the consolidated statements of income now includes the net income (loss) attributable to noncontrolling interests. These financial statement presentation requirements have been adopted retrospectively and prior year amounts in the consolidated financial statements have been reclassified or adjusted to conform to this guidance. 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 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 is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted). The provisions are effective prospectively for revenue arrangements entered into or materially modified after the effective date, or retrospectively for all prior periods. Canon is currently evaluating the effect that the adoption of this guidance will have on its 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 is required to be adopted by Canon no later than the first quarter beginning January 1, 2011 (with early adoption permitted) using the same effective date and the same transition method used to adopt the guidance for revenue recognition under multiple-deliverable arrangements. Canon is currently evaluating the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

(x) Reclassifications

Certain reclassifications have been made to the prior years' consolidated statements of cash flows to conform to the current year presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
CANON INC. AND SUBSIDIARIES

2. Basis of Financial Statement Translation

The consolidated financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥92=U.S.$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on December 30, 2009. This translation should not be construed as a representation that the amounts shown could be converted into United States dollars at such rate.

3. 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, 2009 and 2008 were as follows:

December 31 Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2009: Current:				
Government bonds	**¥ 222**	**¥ —**	**¥ —**	**¥ 222**
Noncurrent:				
Government bonds	**¥ 225**	**¥ —**	**¥ 21**	**¥ 204**
Corporate bonds	**1,397**	**27**	**55**	**1,369**
Fund trusts	**2,275**	**300**	**7**	**2,568**
Equity securities	**11,932**	**7,295**	**1,501**	**17,726**
	¥15,829	**¥7,622**	**¥1,584**	**¥21,867**

Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2008: Current:				
Government bonds	¥ 1	¥ —	¥ —	¥ 1
Fund trusts	133	16	—	149
	¥ 134	¥ 16	¥ —	¥ 150
Noncurrent:				
Government bonds	¥ 431	¥ —	¥ 18	¥ 413
Corporate bonds	1,593	27	32	1,588
Fund trusts	2,366	40	170	2,236
Equity securities	10,522	2,532	836	12,218
	¥14,912	¥2,599	¥1,056	¥16,455

Thousands of U.S. dollars		Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2009:	Current:				
	Government bonds	**$ 2,413**	**$ —**	**$ —**	**$ 2,413**
	Noncurrent:				
	Government bonds	**$ 2,446**	**$ —**	**$ 229**	**$ 2,217**
	Corporate bonds	**15,185**	**293**	**598**	**14,880**
	Fund trusts	**24,728**	**3,261**	**76**	**27,913**
	Equity securities	**129,696**	**79,293**	**16,315**	**192,674**
		$172,055	**$82,847**	**$17,218**	**$237,684**

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, 2009:

	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	**¥ 222**	**¥ 222**	**$ 2,413**	**$ 2,413**
Due after one year through five years	**3,274**	**3,568**	**35,587**	**38,783**
Due after five years through ten years	**623**	**573**	**6,772**	**6,227**
	¥4,119	**¥4,363**	**$44,772**	**$47,423**

Gross realized gains were ¥277 million ($3,011 thousand), ¥116 million and ¥1,512 million for the years ended December 31, 2009, 2008 and 2007, respectively. Gross realized losses, including write-downs for impairments that were other than temporary, were ¥2,482 million ($26,978 thousand) and ¥7,868 million for the years ended December 31, 2009 and 2008, respectively, and were not significant for the year ended December 31, 2007.

At December 31, 2009, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Time deposits with original maturities of more than three months are ¥18,852 million ($204,913 thousand) and ¥7,430 million at December 31, 2009 and 2008, 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 ¥28,567 million ($310,511 thousand) and ¥10,684 million at December 31, 2009 and 2008, respectively. Investments with an aggregate cost of ¥28,087 million ($305,293 thousand) were not evaluated for impairment 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 ¥61,595 million ($669,511 thousand) and ¥59,428 million at December 31, 2009 and 2008, 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 ¥12,649 million ($137,490 thousand) and ¥20,047 million for the years ended December 31, 2009 and 2008, respectively, and earnings of ¥5,634 million for the year ended December 31, 2007.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
CANON INC. AND SUBSIDIARIES

4. Trade Receivables

Trade receivables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Notes	¥ 13,037	¥ 20,303	$ 141,707
Accounts	554,878	584,437	6,031,282
	567,915	604,740	6,172,989
Less allowance for doubtful receivables	(11,343)	(9,318)	(123,293)
	¥556,572	¥595,422	$6,049,696

5. Inventories

Inventories are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Finished goods	¥228,161	¥316,533	$2,480,011
Work in process	129,824	171,511	1,411,130
Raw materials	15,256	18,875	165,826
	¥373,241	¥506,919	$4,056,967

6. Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Land	¥ 258,824	¥ 247,602	$ 2,813,304
Buildings	1,299,154	1,268,388	14,121,239
Machinery and equipment	1,422,076	1,395,451	15,457,348
Construction in progress	105,713	81,346	1,149,055
	3,085,767	2,992,787	33,540,946
Less accumulated depreciation	(1,815,982)	(1,635,601)	(19,738,935)
	¥ 1,269,785	¥ 1,357,186	$ 13,802,011

Depreciation expense for the years ended December 31, 2009, 2008 and 2007 was ¥277,399 million ($3,015,207 thousand), ¥304,622 million and ¥309,815 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥29,030 million ($315,543 thousand) and ¥98,398 million at December 31, 2009 and 2008, 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 production equipment business, Canon recognized impairment losses related primarily to property, plant and equipment of its semiconductor production 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 ($167,283 thousand) 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.

Canon also recognized impairment losses of ¥11,164 million related primarily to property, plant and equipment of its semiconductor production equipment business, which are included in the results of the Industry and Others Business Unit for the year ended December 31, 2008, mainly as a result of declining demand in the semiconductor manufacturing industry. The impairment losses were estimated using discounted cash flows and included in selling, general and administrative expenses in the consolidated statement of income.

7. 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. These receivables typically have terms ranging from 1 year to 6 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:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Total minimum lease payments receivable	**¥206,267**	¥198,611	**$ 2,242,033**
Unguaranteed residual values	**14,630**	16,310	**159,022**
Executory costs	**(1,973)**	(1,729)	**(21,446)**
Unearned income	**(26,994)**	(26,658)	**(293,413)**
	191,930	186,534	**2,086,196**
Less allowance for doubtful receivables	**(9,023)**	(8,268)	**(98,076)**
	182,907	178,266	**1,988,120**
Less current portion	**(65,146)**	(59,608)	**(708,109)**
	¥ 117,761	¥118,658	**$ 1,280,011**

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2009 and 2008 was ¥53,807 million ($584,859 thousand) and ¥50,388 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2009 and 2008 was ¥39,992 million ($434,696 thousand) and ¥37,284 million, respectively.

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, 2009.

Year ending December 31:	Millions of yen		Thousands of U.S. dollars	
	Financing leases	Operating leases	Financing leases	Operating leases
2010	¥ 82,058	¥ 4,685	$ 891,935	$ 50,924
2011	59,342	2,304	645,022	25,043
2012	38,834	1,627	422,109	17,685
2013	18,580	814	201,957	8,848
2014	6,396	51	69,522	554
Thereafter	1,057	10	11,488	109
	¥ 206,267	¥ 9,491	$ 2,242,033	$ 103,163

8. Goodwill and Other Intangible Assets

Intangible assets developed or acquired during the year ended December 31, 2009 totaled ¥43,461 million ($472,402 thousand), which are subject to amortization and primarily consist of software of ¥39,303 million ($427,207 thousand), which is mainly for internal use, and license fees of ¥2,797 million ($30,402 thousand), in addition to those recorded from acquired businesses. The weighted average amortization period for software, license fees and intangible assets in total is approximately 4 years, 7 years and 4 years, respectively.

The components of intangible assets subject to amortization at December 31, 2009 and 2008 were as follows:

December 31	2009		2008	
Millions of yen	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Software	**¥198,276**	**¥114,410**	¥187,920	¥103,535
License fees	**23,889**	**13,546**	21,537	11,104
Other	**30,610**	**8,258**	34,341	10,925
	¥252,775	**¥136,214**	¥243,798	¥125,564

	2009	
Thousands of U.S. dollars	Gross carrying amount	Accumulated amortization
Software	**$2,155,174**	**$1,243,587**
License fees	**259,663**	**147,239**
Other	**332,717**	**89,761**
	$2,747,554	**$1,480,587**

Aggregate amortization expense for the years ended December 31, 2009, 2008 and 2007 was ¥37,994 million ($412,978 thousand), ¥36,715 million and ¥31,879 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥36,633 million ($398,185 thousand) in 2010, ¥26,309 million ($285,967 thousand) in 2011, ¥16,959 million ($184,337 thousand) in 2012, ¥10,846 million ($117,891 thousand) in 2013, and ¥6,411 million ($69,685 thousand) in 2014.

Intangible assets not subject to amortization other than goodwill at December 31, 2009 and 2008 were not significant.

The changes in the carrying amount of goodwill, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2009 and 2008 were as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Balance at beginning of year	**¥50,754**	¥ 56,783	**$551,674**
Goodwill acquired during the year	**4,805**	4,975	**52,228**
Translation adjustments and other	**312**	(11,004)	**3,391**
Balance at end of year	**¥55,871**	¥ 50,754	**$607,293**

Almost all of the goodwill has been allocated to the Office Business Unit and the Consumer Business Unit at December 31, 2009 and 2008 for impairment testing.

9. Short-Term Loans and Long-Term Debt

Short-term loans consisting of bank borrowings at December 31, 2008 were ¥220 million. The weighted average interest rate on short-term loans outstanding at December 31, 2008 was 6.21%.

Long-term debt consisted of the following:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Loans, principally from banks, maturing in installments through 2017; bearing weighted average interest of 0.30% and 2.93% at December 31, 2009 and 2008, respectively	¥ 20	¥ 95	$ 217
Capital lease obligations	9,761	13,648	106,098
	9,781	13,743	106,315
Less current portion	(4,869)	(5,320)	(52,924)
	¥ 4,912	¥ 8,423	$ 53,391

The aggregate annual maturities of long-term debt outstanding at December 31, 2009 were as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2010	¥ 4,869	$ 52,924
2011	3,357	36,489
2012	1,068	11,609
2013	352	3,826
2014	98	1,065
Thereafter	37	402
	¥ 9,781	$ 106,315

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	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Notes	¥ 7,608	¥ 14,544	$ 82,696
Accounts	331,505	392,202	3,603,315
	¥339,113	¥406,746	$3,686,011

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, 2009, 2008 and 2007 were ¥9,148 million ($99,435 thousand), ¥10,840 million and ¥10,262 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:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Change in benefit obligations:						
Benefit obligations at beginning of year	¥ 521,985	¥493,478	$ 5,673,750	¥ 78,468	¥113,833	$ 852,913
Service cost	21,759	20,786	236,511	2,426	3,141	26,369
Interest cost	12,535	12,253	136,250	4,251	4,991	46,207
Plan participants' contributions	—	—	—	1,177	1,460	12,793
Amendments	(674)	(204)	(7,326)	—	(86)	—
Actuarial (gain) loss	10,822	10,160	117,631	3,533	(4,521)	38,402
Benefits paid	(15,107)	(14,488)	(164,207)	(1,784)	(2,210)	(19,391)
Foreign currency exchange rate changes	—	—	—	6,099	(38,140)	66,294
Benefit obligations at end of year	551,320	521,985	5,992,609	94,170	78,468	1,023,587
Change in plan assets:						
Fair value of plan assets at beginning of year	429,870	511,450	4,672,500	62,996	92,908	684,739
Actual return on plan assets	26,616	(81,981)	289,304	4,844	(8,453)	52,652
Employer contributions	15,173	14,716	164,924	3,059	8,317	33,250
Plan participants' contributions	—	—	—	1,177	1,460	12,793
Benefits paid	(14,451)	(14,315)	(157,076)	(1,784)	(1,556)	(19,391)
Foreign currency exchange rate changes	—	—	—	4,766	(29,680)	51,805
Fair value of plan assets at end of year	457,208	429,870	4,969,652	75,058	62,996	815,848
Funded status at end of year	¥ (94,112)	¥ (92,115)	$(1,022,957)	¥(19,112)	¥ (15,472)	$ (207,739)

Amounts recognized in the consolidated balance sheets at December 31, 2009 and 2008 are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Other assets	¥ 707	¥ 806	$ 7,685	¥ 2,069	¥ 2,461	$ 22,489
Accrued expenses	—	—	—	(96)	(70)	(1,044)
Accrued pension and severance cost	(94,819)	(92,921)	(1,030,642)	(21,085)	(17,863)	(229,184)
	¥(94,112)	¥(92,115)	$(1,022,957)	¥(19,112)	¥(15,472)	$(207,739)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2009 and 2008 before the effect of income taxes are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Actuarial loss	¥ 237,822	¥ 251,731	$ 2,585,022	¥19,411	¥15,650	$210,989
Prior service credit	(155,928)	(168,904)	(1,694,870)	(670)	(768)	(7,282)
Net transition obligation	1,444	2,166	15,696	—	—	—
	¥ 83,338	¥ 84,993	$ 905,848	¥18,741	¥14,882	$203,707

The accumulated benefit obligation for all defined benefit plans was as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Accumulated benefit obligation	¥522,582	¥493,559	$5,680,239	¥80,361	¥71,627	$873,489

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:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Plans with projected benefit obligations in excess of plan assets:						
Projected benefit obligations	¥545,466	¥516,646	$5,928,978	¥94,123	¥77,083	$1,023,076
Fair value of plan assets	450,647	423,725	4,898,336	72,942	59,150	792,848
Plans with accumulated benefit obligations in excess of plan assets:						
Accumulated benefit obligations	¥509,638	¥485,436	$5,539,543	¥80,314	¥69,471	$ 872,978
Fair value of plan assets	442,756	420,341	4,812,565	72,942	59,089	792,848

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CANON INC. AND SUBSIDIARIES

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, 2009, 2008 and 2007 consisted of the following components:

Years ended December 31	Japanese plans				Foreign plans			
	Millions of yen			Thousands of U.S. dollars	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	2009	2009	2008	2007	2009
Service cost	¥ 21,759	¥ 20,786	¥ 20,161	$ 236,511	¥ 2,426	¥ 3,141	¥ 4,016	$26,369
Interest cost	12,535	12,253	11,888	136,250	4,251	4,991	4,947	46,207
Expected return on plan assets	(15,808)	(19,721)	(21,148)	(171,826)	(4,211)	(5,519)	(5,427)	(45,772)
Amortization of net transition obligation	722	722	722	7,848	—	—	—	—
Amortization of prior service credit	(13,650)	(13,373)	(13,479)	(148,370)	(98)	(271)	(86)	(1,065)
Amortization of actuarial loss	13,923	7,068	4,868	151,337	1,014	898	887	11,022
	¥ 19,481	¥ 7,735	¥ 3,012	$ 211,750	¥ 3,382	¥ 3,240	¥ 4,337	$36,761

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2009 and 2008 are summarized as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009	2009	2008	2009
Current year actuarial (gain) loss	¥ 14	¥111,862	$ 153	¥ 2,900	¥9,451	$31,522
Amortization of actuarial loss	(13,923)	(7,068)	(151,337)	(1,014)	(898)	(11,022)
Prior service credit due to amendments	(674)	(204)	(7,326)	—	(86)	—
Amortization of prior service credit	13,650	13,373	148,370	98	271	1,065
Amortization of net transition obligation	(722)	(722)	(7,848)	—	—	—
	¥ (1,655)	¥117,241	$ (17,988)	¥ 1,984	¥8,738	$21,565

The estimated net transition obligation, 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		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
Net transition obligation	¥ 722	$ 7,848	¥ —	$ —
Prior service credit	(12,873)	(139,924)	(117)	(1,272)
Actuarial loss	12,639	137,380	1,245	13,533

Assumptions

Weighted-average assumptions used to determine benefit obligations are as follows:

December 31	Japanese plans		Foreign plans	
	2009	2008	2009	2008
Discount rate	2.3%	2.4%	5.2%	5.3%
Assumed rate of increase in future compensation levels	3.0%	3.0%	3.5%	3.1%

Weighted-average assumptions used to determine net periodic benefit cost are as follows:

Years ended December 31	Japanese plans			Foreign plans		
	2009	2008	2007	**2009**	2008	2007
Discount rate	**2.4%**	2.5%	2.5%	**5.3%**	5.1%	4.5%
Assumed rate of increase in future compensation levels	**3.0%**	2.9%	2.9%	**3.1%**	3.1%	2.9%
Expected long-term rate of return on plan assets	**3.7%**	3.7%	3.9%	**6.2%**	6.5%	6.0%

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. However, Canon's model portfolio for foreign plans has been developed as follows: approximately 70% is invested in equity securities, approximately 25% is invested in debt securities, and approximately 5% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CANON INC. AND SUBSIDIARIES

The three levels of input used to measure fair value are more fully described in Note 21.

The fair values of Canon's pension plan assets at December 31, 2009, by asset category are as follows:

	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (a)	¥48,844	¥ —	¥ —	¥ 48,844	¥ —	¥ —	¥ —	¥ —
Foreign companies	5,444	—	—	5,444	3,898	—	—	3,898
Pooled funds (b)	—	85,353	—	85,353	—	47,290	—	47,290
Debt securities:								
Government bonds (c)	14,803	—	—	14,803	1,581	—	—	1,581
Municipal bonds	—	879	—	879	—	—	—	—
Corporate bonds	—	7,665	—	7,665	—	6,673	—	6,673
Pooled funds (d)	—	189,870	—	189,870	—	9,343	—	9,343
Mortgage backed securities (and other asset backed securities)	—	943	—	943	—	256	—	256
Life insurance company general accounts	—	94,269	—	94,269	—	—	—	—
Other assets	—	8,367	771	9,138	—	6,017	—	6,017
	¥69,091	¥387,346	¥771	¥457,208	¥5,479	¥69,579	¥ —	¥75,058

	Thousands of U.S. dollars							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (a)	$530,913	$ —	$ —	$ 530,913	$ —	$ —	$ —	$ —
Foreign companies	59,174	—	—	59,174	42,369	—	—	42,369
Pooled funds (b)	—	927,750	—	927,750	—	514,022	—	514,022
Debt securities:								
Government bonds (c)	160,902	—	—	160,902	17,185	—	—	17,185
Municipal bonds	—	9,554	—	9,554	—	—	—	—
Corporate bonds	—	83,315	—	83,315	—	72,533	—	72,533
Pooled funds (d)	—	2,063,804	—	2,063,804	—	101,554	—	101,554
Mortgage backed securities (and other asset backed securities)	—	10,250	—	10,250	—	2,783	—	2,783
Life insurance company general accounts	—	1,024,663	—	1,024,663	—	—	—	—
Other assets	—	90,947	8,380	99,327	—	65,402	—	65,402
	$750,989	$4,210,283	$8,380	$4,969,652	$59,554	$756,294	$ —	$815,848

(a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥950 million ($10,326 thousand) at December 31, 2009.
(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 80% Japanese government bonds and 20% foreign government bonds.
(d) These funds invest in approximately 55% Japanese government bonds, 25% foreign government bonds, 10% Japanese municipal bonds, and 10% corporate bonds.

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.

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 ¥771 million ($8,380 thousand) and ¥712 million at December 31, 2009 and 2008, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the year ended December 31, 2009 were not significant.

Contributions

Canon expects to contribute ¥14,116 million ($153,435 thousand) to its Japanese defined benefit pension plans and ¥3,650 million ($39,674 thousand) to its foreign defined benefit pension plans for the year ending December 31, 2010.

Estimated future benefit payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

Year ending December 31:	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
2010	¥ 13,029	$ 141,620	¥ 1,765	$ 19,185
2011	14,571	158,380	1,867	20,293
2012	15,643	170,033	1,972	21,435
2013	17,120	186,087	2,004	21,783
2014	17,961	195,228	2,074	22,543
2015–2019	114,536	1,244,957	12,939	140,641

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:

Years ended December 31		Millions of yen		
		Japanese	Foreign	Total
2009:	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**
2008:	Income before income taxes	¥382,299	¥ 98,848	¥481,147
	Income taxes:			
	Current	¥168,428	¥ 24,857	¥193,285
	Deferred	(34,073)	1,576	(32,497)
		¥134,355	¥ 26,433	¥160,788
2007:	Income before income taxes	¥575,017	¥193,371	¥768,388
	Income taxes:			
	Current	¥238,921	¥ 60,358	¥299,279
	Deferred	(31,930)	(3,091)	(35,021)
		¥206,991	¥ 57,267	¥264,258

		Thousands of U.S. dollars		
		Japanese	Foreign	Total
2009:	Income before income taxes	**$1,422,359**	**$ 961,934**	**$2,384,293**
	Income taxes:			
	Current	**$ 489,989**	**$ 199,250**	**$ 689,239**
	Deferred	**167,554**	**57,576**	**225,130**
		$ 657,543	**$ 256,826**	**$ 914,369**

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, 2009, 2008 and 2007.

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	**2009**	2008	2007
Japanese statutory income tax rate	**40.0%**	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.9**	0.5	0.3
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(5.4)**	(2.6)	(2.8)
Tax credit for research and development expenses	**(2.8)**	(4.6)	(4.5)
Change in valuation allowance	**5.4**	0.1	0.1
Other	**0.2**	0.0	1.3
Effective income tax rate	**38.3%**	33.4%	34.4%

Net deferred income tax assets and liabilities are included in the accompanying consolidated balance sheets under the following captions:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	**2009**
Prepaid expenses and other current assets	**¥ 94,798**	¥ 96,613	**$1,030,413**
Other assets	**117,263**	130,378	**1,274,598**
Other current liabilities	**(2,018)**	(2,491)	**(21,935)**
Other noncurrent liabilities	**(36,278)**	(29,075)	**(394,326)**
	¥173,765	¥195,425	**$1,888,750**

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2009 and 2008 are presented below:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	**2009**
Deferred tax assets:			
Inventories	**¥ 24,121**	¥ 36,817	**$ 262,185**
Accrued business tax	**3,861**	5,183	**41,967**
Accrued pension and severance cost	**52,639**	51,713	**572,163**
Research and development—costs capitalized for tax purposes	**45,718**	41,661	**496,935**
Property, plant and equipment	**53,011**	58,682	**576,207**
Accrued expenses	**29,409**	27,748	**319,663**
Net operating losses carried forward	**12,305**	6,745	**133,750**
Other	**44,709**	44,894	**485,967**
	265,773	273,443	**2,888,837**
Less valuation allowance	**(22,188)**	(10,817)	**(241,174)**
Total deferred tax assets	**243,585**	262,626	**2,647,663**
Deferred tax liabilities:			
Undistributed earnings of foreign subsidiaries	**(8,023)**	(10,407)	**(87,207)**
Net unrealized gains on securities	**(2,052)**	(607)	**(22,304)**
Tax deductible reserve	**(7,797)**	(8,119)	**(84,750)**
Financing lease revenue	**(35,505)**	(31,035)	**(385,924)**
Prepaid pension and severance cost	**(314)**	(2,644)	**(3,413)**
Other	**(16,129)**	(14,389)	**(175,315)**
Total deferred tax liabilities	**(69,820)**	(67,201)	**(758,913)**
Net deferred tax assets	**¥173,765**	¥195,425	**$1,888,750**

The net changes in the total valuation allowance were increases of ¥11,371 million ($123,598 thousand), ¥1,490 million and ¥2,827 million for the years ended December 31, 2009, 2008 and 2007, 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, 2009.

At December 31, 2009, Canon had net operating losses which can be carried forward for income tax purposes of ¥34,410 million ($374,022 thousand) to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to ten years as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
CANON INC. AND SUBSIDIARIES

	Millions of yen	Thousands of U.S. dollars
Within one year	¥ 1,534	$ 16,674
After one year through five years	7,209	78,359
After five years through ten years	17,501	190,228
Indefinite period	8,166	88,761
Total	¥34,410	$374,022

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 ¥28,092 million ($305,348 thousand) for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2009 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, 2009, such undistributed earnings of these subsidiaries were ¥769,380 million ($8,362,826 thousand).

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	2009
Balance at beginning of year	¥12,689	¥15,791	¥16,087	$137,924
Additions for tax positions of the current year	—	8,700	994	—
Additions for tax positions of prior years	1,442	1,354	1,902	15,674
Reductions for tax positions of prior years	(1,106)	(8,512)	(1,340)	(12,022)
Lapse of the applicable statute of limitations	—	—	(1,311)	—
Settlements with tax authorities	—	(1,208)	(322)	—
Other	210	(3,436)	(219)	2,283
Balance at end of year	¥13,235	¥12,689	¥15,791	$143,859

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥4,746 million ($51,587 thousand) and ¥4,405 million at December 31, 2009 and 2008, 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, 2009, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2009 and 2008, and interest and penalties included in income taxes for the years ended December 31, 2009, 2008 and 2007 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 2006. 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 2002. 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 2005 in Japan and for certain years after 2003 in major foreign tax jurisdictions.

13. Common Stock

For the years ended December 31, 2008 and 2007, the Company issued 127,254 shares and 190,380 shares of common stock, respectively, in connection with the conversion of convertible debt. In accordance with the Corporation Law of Japan, conversion into common stock of convertible debt is accounted for by crediting one-half or more of the conversion price to the common stock account and the remainder to the additional paid-in capital account.

14. 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, 2009, 2008 and 2007 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2009 did not reflect current year-end dividends in the amount of ¥67,896 million ($738,000 thousand) which were approved by the stockholders in March 2010.

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 ¥1,307,735 million ($14,214,511 thousand) at December 31, 2009.

Retained earnings at December 31, 2009 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥10,301 million ($111,967 thousand).

15. Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) are as follows:

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	**2009**
Foreign currency translation adjustments:				
Balance at beginning of year	**¥(235,968)**	¥ 22,796	¥ 22,858	**$(2,564,870)**
Adjustments for the year	**33,340**	(258,764)	(62)	**362,391**
Balance at end of year	**(202,628)**	(235,968)	22,796	**(2,202,479)**
Net unrealized gains and losses on securities:				
Balance at beginning of year	**1,135**	6,287	8,065	**12,337**
Adjustments for the year	**2,150**	(5,152)	(1,778)	**23,370**
Balance at end of year	**3,285**	1,135	6,287	**35,707**
Net gains and losses on derivative instruments:				
Balance at beginning of year	**1,493**	(849)	(1,663)	**16,229**
Adjustments for the year	**(1,422)**	2,342	814	**(15,457)**
Balance at end of year	**71**	1,493	(849)	**772**
Pension liability adjustments:				
Balance at beginning of year	**(59,480)**	6,436	(26,542)	**(646,521)**
Adjustments for the year	**(2,066)**	(65,916)	32,978	**(22,457)**
Balance at end of year	**(61,546)**	(59,480)	6,436	**(668,978)**
Total accumulated other comprehensive income (loss):				
Balance at beginning of year	**(292,820)**	34,670	2,718	**(3,182,825)**
Adjustments for the year	**32,002**	(327,490)	31,952	**347,847**
Balance at end of year	**¥(260,818)**	¥(292,820)	¥ 34,670	**$(2,834,978)**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CANON INC. AND SUBSIDIARIES

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	Millions of yen		
	Before-tax amount	Tax (expense) or benefit	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**
2008:			
Foreign currency translation adjustments	¥(266,568)	¥ 5,893	¥(260,675)
Net unrealized gains and losses on securities:			
Amount arising during the year	(17,485)	6,992	(10,493)
Reclassification adjustments for gains and losses realized in net income	7,752	(3,101)	4,651
Net change during the year	(9,733)	3,891	(5,842)
Net gains and losses on derivative instruments:			
Amount arising during the year	23,121	(9,248)	13,873
Reclassification adjustments for gains and losses realized in net income	(19,219)	7,688	(11,531)
Net change during the year	3,902	(1,560)	2,342
Pension liability adjustments:			
Amount arising during the year	(111,215)	39,233	(71,982)
Reclassification adjustments for gains and losses realized in net income	(4,956)	2,073	(2,883)
Net change during the year	(116,171)	41,306	(74,865)
Other comprehensive income (loss)	¥(388,570)	¥ 49,530	¥(339,040)
2007:			
Foreign currency translation adjustments	¥ (396)	¥ 308	¥ (88)
Net unrealized gains and losses on securities:			
Amount arising during the year	(7,721)	3,231	(4,490)
Reclassification adjustments for gains and losses realized in net income	(580)	2,715	2,135
Net change during the year	(8,301)	5,946	(2,355)
Net gains and losses on derivative instruments:			
Amount arising during the year	589	(236)	353
Reclassification adjustments for gains and losses realized in net income	780	(312)	468
Net change during the year	1,369	(548)	821
Pension liability adjustments:			
Amount arising during the year	71,364	(26,586)	44,778
Reclassification adjustments for gains and losses realized in net income	(7,088)	2,952	(4,136)
Net change during the year	64,276	(23,634)	40,642
Other comprehensive income (loss)	¥ 56,948	¥(17,928)	¥ 39,020

	Thousands of U.S. dollars		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2009:			
Foreign currency translation adjustments	**$ 385,424**	**$(22,707)**	**$ 362,717**
Net unrealized gains and losses on securities:			
Amount arising during the year	**24,251**	**(14,490)**	**9,761**
Reclassification adjustments for gains and losses realized in net income	**23,967**	**(9,630)**	**14,337**
Net change during the year	**48,218**	**(24,120)**	**24,098**
Net gains and losses on derivative instruments:			
Amount arising during the year	**3,239**	**(1,294)**	**1,945**
Reclassification adjustments for gains and losses realized in net income	**(29,022)**	**11,609**	**(17,413)**
Net change during the year	**(25,783)**	**10,315**	**(15,468)**
Pension liability adjustments:			
Amount arising during the year	**(44,729)**	**20,555**	**(24,174)**
Reclassification adjustments for gains and losses realized in net income	**20,772**	**(6,870)**	**13,902**
Net change during the year	**(23,957)**	**13,685**	**(10,272)**
Other comprehensive income (loss)	**$ 383,902**	**$(22,827)**	**$ 361,075**

16. Stock-Based Compensation

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 ($7.60).

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.

The compensation cost recognized for these stock options for the years ended December 31, 2009 and 2008 was ¥564 million ($6,130 thousand) and ¥246 million, respectively, and is included in selling, general and administrative expenses in the consolidated statements of income.

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

	2009	2008
Expected term of option (in years)	**4.0**	4.0
Expected volatility	**40.08%**	37.39%
Dividend yield	**3.51%**	2.10%
Risk-free interest rate	**0.64%**	0.95%

A summary of option activity under the stock option plans as of and for the years ended December 31, 2009 and 2008 is presented below:

	Shares	Weighted-average exercise price		Weighted-average remaining contractual term	Aggregate intrinsic value	
		Yen	U.S. dollars	Year	Millions of yen	Thousands of U.S. dollars
Outstanding at January 1, 2008	—	¥ —				
Granted	592,000	5,502				
Forfeited	—	—				
Outstanding at December 31, 2008	592,000	5,502	$59.80	3.3	¥ —	$ —
Granted	**954,000**	**3,287**	**35.73**			
Forfeited	**(34,000)**	**4,851**	**52.73**			
Outstanding at December 31, 2009	**1,512,000**	**¥4,119**	**$44.77**	**3.0**	**¥588**	**$6,391**

At December 31, 2009, all option awards were nonvested but expected to be vested, and there was ¥558 million ($6,065 thousand) of total unrecognized compensation cost related to these nonvested stock options. That cost is expected to be recognized over a weighted-average period of 0.96 year.

17. Net Income Attributable to Canon Inc. Stockholders per Share

A reconciliation of the numerators and denominators of basic and diluted net income attributable to Canon Inc. stockholders per share computations is as follows:

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	**2009**
Net income attributable to Canon Inc.	**¥131,647**	¥309,148	¥488,332	**$1,430,946**
Effect of dilutive securities:				
1.30% Japanese yen convertible debentures, due 2008	**—**	2	4	**—**
Diluted net income attributable to Canon Inc.	**¥131,647**	¥309,150	¥488,336	**$1,430,946**

	Number of shares		
Average common shares outstanding	**1,234,481,836**	1,255,626,490	1,293,295,680
Effect of dilutive securities:			
1.30% Japanese yen convertible debentures, due 2008	**—**	79,929	221,751
Diluted common shares outstanding	**1,234,481,836**	1,255,706,419	1,293,517,431

	Yen			U.S. dollars
Net income attributable to Canon Inc. stockholders per share:				
Basic	**¥106.64**	¥246.21	¥377.59	**$1.16**
Diluted	**106.64**	246.20	377.53	**1.16**

The computation of diluted net income attributable to Canon Inc. stockholders per share for the years ended December 31, 2009 and 2008 exclude outstanding stock options because the effect would be anti-dilutive.

18. Derivatives and Hedging Activities

Risk management policy

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

Foreign currency exchange rate risk management

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 that 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.

Cash flow hedge

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 amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next 12 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.

Derivatives not designated as hedges

Canon has entered into certain foreign exchange contracts to primarily offset the earnings impact related to fluctuations in foreign currency exchange rates associated with certain assets denominated in foreign currencies. Although these foreign exchange contracts have not been designated as hedges as required in order to apply hedge accounting, the contracts are effective from an economic perspective. The changes in the fair value of these contracts are recorded in earnings immediately.

Contract amounts of foreign exchange contracts as of December 31, 2009 and 2008 are set forth below:

December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	**2009**
To sell foreign currencies	**¥494,314**	¥350,959	**$5,372,978**
To buy foreign currencies	**30,978**	35,247	**336,717**

Fair value of derivative instruments in the consolidated balance sheet

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheet as of December 31, 2009.

Derivatives designated as hedging instruments

December 31, 2009		Millions of yen	Thousands of U.S. dollars
	Balance sheet location	Fair value	Fair value
Liabilities:			
Foreign exchange contracts	Other current liabilities	**¥ 644**	**$ 7,000**

Derivatives not designated as hedging instruments

December 31, 2009		Millions of yen	Thousands of U.S. dollars
	Balance sheet location	Fair value	Fair value
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**¥ 752**	**$ 8,174**
Liabilities:			
Foreign exchange contracts	Other current liabilities	**6,566**	**71,370**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CANON INC. AND SUBSIDIARIES

Effect of derivative instruments on the consolidated statement of income

The following tables present the effect of Canon's derivative instruments on the consolidated statement of income for the year ended December 31, 2009.

Derivatives in cash flow hedging relationships

Year ended December 31, 2009	Gain (loss) recognized in OCI (effective portion)	Gain (loss) reclassified from accumulated OCI into income (effective portion)		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
Millions of yen	Amount	Location	Amount	Location	Amount
Foreign exchange contracts	¥(2,372)	Other, net	¥2,670	Other, net	¥(462)

	Gain (loss) recognized in OCI (effective portion)	Gain (loss) reclassified from accumulated OCI into income (effective portion)		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
Thousands of U.S. dollars	Amount	Location	Amount	Location	Amount
Foreign exchange contracts	$(25,783)	Other, net	$29,022	Other, net	$(5,022)

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2008 and 2007. The amount of net gains or losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was net losses of ¥3,701 million and ¥6,883 million for the years ended December 31, 2008 and 2007, respectively.

Derivatives not designated as hedging instruments

Year ended December 31, 2009	Gain (loss) recognized in income on derivative		
	Location	Amount	
		Millions of yen	Thousands of U.S. dollars
Foreign exchange contracts	Other, net	¥(8,638)	$(93,891)

19. Commitments and Contingent Liabilities

Commitments

At December 31, 2009, commitments outstanding for the purchase of property, plant and equipment approximated ¥21,839 million ($237,380 thousand), and commitments outstanding for the purchase of parts and raw materials approximated ¥64,226 million ($698,109 thousand).

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,210 million ($154,457 thousand) and ¥14,223 million at December 31, 2009 and 2008, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under the operating lease arrangements amounted to ¥36,474 million ($396,457 thousand), ¥41,169 million and ¥36,900 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Future minimum lease payments required under noncancelable operating leases that have initial or remaining lease terms in excess of one year at December 31, 2009 are as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2010	¥16,259	$176,728
2011	13,331	144,902
2012	9,641	104,793
2013	6,551	71,207
2014	5,002	54,370
Thereafter	8,180	88,913
Total future minimum lease payments	¥58,964	$ 640,913

Guarantees

Canon provides guarantees for bank loans of its employees, affiliates and other companies. The guarantees for the employees are principally made for their housing loans. The guarantees of loans of its affiliates and other companies are made to ensure that those companies operate with less financial risk.

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and of 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 is ¥18,526 million ($201,370 thousand) at December 31, 2009. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2009 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued product warranty cost for the years ended December 31, 2009 and 2008 are summarized as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Balance at beginning of year	¥ 17,372	¥ 20,138	$ 188,826
Addition	21,670	30,644	235,543
Utilization	(22,050)	(26,846)	(239,674)
Other	(3,048)	(6,564)	(33,130)
Balance at end of year	¥ 13,944	¥ 17,372	$ 151,565

Legal proceedings

In October 2003, a lawsuit was filed by a former employee against the Company at the Tokyo District Court in Japan. The lawsuit alleges that the former employee is entitled to ¥45,872 million ($498,609 thousand) as reasonable remuneration for an invention related to certain technology used by the Company, and the former employee has sued for a partial payment of ¥1,000 million ($10,870 thousand) and interest thereon. On January 30, 2007, the Tokyo District Court of Japan ordered the Company to pay the former employee approximately ¥33.5 million ($364 thousand) and interest thereon. On the same day, the Company appealed the decision. On February 26, 2009, the Intellectual Property High Court of Japan issued a judgment in the appellate court review and ordered the Company to pay the former employee approximately ¥69.6 million ($757 thousand), consisting of reasonable remuneration of approximately ¥56.3 million ($612 thousand) and interest thereon. On March 12, 2009, the Company appealed the decision to the Supreme Court.

In Germany, Verwertungsgesellschaft Wort ("VG Wort"), a collecting agency 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. Likewise, 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. Canon received a brief from the Federal Constitutional Court in September 2009 to enable the Court to decide on whether to accept the claim, and Canon responded to it in November 2009. 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 and will remain effective through end of 2010. However, in Canon's assessment, the final outcome of the court case regarding the single-function printers sold in Germany before January 1, 2008 remains uncertain.

Canon is involved in various claims and legal actions, including those noted above, arising in the ordinary course of business. Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, Canon believes that any damage amounts claimed in the specific matters discussed above and other outstanding matters are not a meaningful indicator of Canon's potential liability. In the opinion of management, the ultimate disposition of outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows. However, litigation is inherently unpredictable. While Canon believes that it has valid defenses with respect to legal matters pending against it, it is possible that Canon's consolidated financial position, results of operations, or cash flows could be materially affected in any particular period by the unfavorable resolution of one or more of these matters.

20. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk

Fair value of financial instruments

The estimated fair values of Canon's financial instruments at December 31, 2009 and 2008 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses for which fair values approximate their carrying amounts. The summary also excludes investments which are disclosed in Note 3.

December 31	Millions of yen				Thousand of U.S. dollars	
	2009		2008		2009	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	¥ (9,781)	¥ (9,777)	¥(13,743)	¥(13,727)	$(106,315)	$(106,272)
Foreign exchange contracts:						
Assets	752	752	10,516	10,516	8,174	8,174
Liabilities	(7,210)	(7,210)	(678)	(678)	(78,370)	(78,370)

The following methods and assumptions are used to estimate the fair value in the above table.

Long-term debt

The fair values of Canon's long-term debt instruments are based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity.

Foreign exchange contracts

The fair values of foreign exchange contracts are measured based on the market price obtained from financial institutions.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Concentrations of credit risk

At December 31, 2009 and 2008, one customer accounted for approximately 22% and 19% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

21. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy that prioritizes the inputs used to measure fair value is as follows:

Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities.
Level 2 — Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3 — Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

Assets and liabilities measured at fair value on a recurring basis

The following table presents Canon's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2009 and 2008.

December 31

Millions of yen		Level 1	Level 2	Level 3	Total
2009:	Assets:				
	Cash and cash equivalents	**¥ —**	**¥184,856**	**¥ —**	**¥184,856**
	Available-for-sale securities (current):				
	Government bonds	**222**	**—**	**—**	**222**
	Available-for-sale securities (noncurrent):				
	Government bonds	**204**	**—**	**—**	**204**
	Corporate bonds	**—**	**29**	**1,340**	**1,369**
	Fund trusts	**1,589**	**979**	**—**	**2,568**
	Equity securities	**17,726**	**—**	**—**	**17,726**
	Derivatives	**—**	**752**	**—**	**752**
	Total assets	**¥19,741**	**¥186,616**	**¥1,340**	**¥207,697**
	Liabilities:				
	Derivatives	**¥ —**	**¥ 7,210**	**¥ —**	**¥ 7,210**
	Total liabilities	**¥ —**	**¥ 7,210**	**¥ —**	**¥ 7,210**

Millions of yen		Level 1	Level 2	Level 3	Total
2008:	Assets:				
	Cash and cash equivalents	¥ —	¥194,030	¥ —	¥194,030
	Available-for-sale securities (current):				
	Government bonds	1	—	—	1
	Fund trusts	149	—	—	149
	Available-for-sale securities (noncurrent):				
	Government bonds	413	—	—	413
	Corporate bonds	43	29	1,516	1,588
	Fund trusts	1,284	952	—	2,236
	Equity securities	12,218	—	—	12,218
	Derivatives	—	10,516	—	10,516
	Total assets	¥14,108	¥205,527	¥1,516	¥221,151
	Liabilities:				
	Derivatives	¥ —	¥ 678	¥ —	¥ 678
	Total liabilities	¥ —	¥ 678	¥ —	¥ 678

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CANON INC. AND SUBSIDIARIES

Thousands of U.S. dollars	Level 1	Level 2	Level 3	Total
2009: Assets:				
Cash and cash equivalents	$ —	$2,009,304	$ —	$2,009,304
Available-for-sale securities (current):				
Government bonds	2,413	—	—	2,413
Available-for-sale securities (noncurrent):				
Government bonds	2,217	—	—	2,217
Corporate bonds	—	315	14,565	14,880
Fund trusts	17,272	10,641	—	27,913
Equity securities	192,674	—	—	192,674
Derivatives	—	8,174	—	8,174
Total assets	$214,576	$2,028,434	$14,565	$2,257,575
Liabilities:				
Derivatives	$ —	$ 78,370	$ —	$ 78,370
Total liabilities	$ —	$ 78,370	$ —	$ 78,370

Level 1 investments are comprised principally of equity securities, which are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions. Level 2 cash and cash equivalents are valued using quoted prices for identical assets in markets that are not active. Level 3 investments are mainly comprised of corporate bonds, which are valued based on unobservable inputs as the market for the assets was not active at the measurement date.

Derivative financial instruments are comprised of foreign exchange contracts. Level 2 derivatives are valued using quotes obtained from counterparties or third parties, which are periodically validated by pricing models using observable market inputs, such as foreign currency exchange rates and interest rates.

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting of corporate bonds, for the years ended December 31, 2009 and 2008.

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2009	2008	2009
Balance at beginning of year	¥1,516	¥1,889	$16,478
Total gains or losses (realized or unrealized):			
Included in earnings	(221)	(559)	(2,402)
Included in other comprehensive income (loss)	(1)	(8)	(11)
Purchases, issuances, and settlements	46	194	500
Balance at end of year	¥1,340	¥1,516	$14,565

Substantially all gains and losses included in earnings are related to corporate bonds still held at December 31, 2009 and 2008, respectively, and are reported in "Other, net" in the consolidated statements of income.

Assets and liabilities measured at fair value on a nonrecurring basis

During the year ended December 31, 2009, long-lived assets held and used with a carrying amount of ¥15,390 million ($167,283 thousand) were written down to their fair value of zero and classified as Level 3 assets, resulting in an impairment charge of ¥15,390 million ($167,283 thousand), which was included in earnings.

During the year ended December 31, 2009, non-marketable equity securities with a carrying amount of ¥1,468 million ($15,957 thousand) were written down to their fair value of ¥480 million ($5,218 thousand) and classified as Level 3 instruments, resulting in an other-than-temporary impairment charge of ¥988 million ($10,739 thousand), which was included in earnings. During the year ended December 31, 2008, non-marketable equity securities with a carrying amount of ¥513 million were written down to their fair value of ¥112 million and classified as Level 3 instruments, resulting in an other-than-temporary impairment charge of ¥401 million, which was included in earnings.

22. Segment Information

Certain foreign private issuers, including Canon, have been exempted from the segment disclosure requirements of U.S. GAAP in filings with the SEC under the Securities Exchange Act of 1934.

However, in September 2008, the SEC issued its "Foreign Issuer Reporting Enhancements" ("FIRE") rule. The FIRE rule eliminates an instruction to the Form 20-F that permitted certain foreign private issuers to omit segment disclosures required by U.S. GAAP, as well as other enhancements. This aspect of the FIRE rule regarding elimination of ability to omit segment disclosures is effective for fiscal years ended on or after December 15, 2009 and was adopted by Canon in the year ended December 31, 2009 for all periods presented.

Segment information

Canon operates its business in three segments: the Office Business Unit, the Consumer Business Unit, and the Industry and Others Business Unit, which are based on the organizational structure and information reviewed by Canon's management to evaluate results and allocate resources.

The primary products included in each segment are as follows:

Office Business Unit:
Office network digital MFDs, Color network digital MFDs, Office copying machines, Personal-use copying machines, Full-color copying machines, Laser printers, and Large format ink-jet printers

Consumer Business Unit:
Digital SLR cameras, Compact digital cameras, Interchangeable lenses, Digital video camcorders, Inkjet multi-function peripherals, Single function inkjet printers, Image scanners, and Broadcasting equipment

Industry and Others Business Unit:
Semiconductor production equipment, Mirror projection mask aligners for LCD panels, Medical equipment, Components, Computer information systems, Document scanners, and Personal information products

The accounting policies of the segments are substantially the same as those described in the significant accounting policies in Note 1. Canon evaluates performance of, and allocates resources to, each segment based on operating profit.

Information about operating results and assets for each segment as of and for the years ended December 31, 2009, 2008 and 2007 is as follows:

Millions of yen	Office	Consumer	Industry and Others	Corporate and eliminations	Consolidated
2009: Net sales:					
External customers	**¥1,635,056**	**¥1,299,194**	**¥274,951**	**¥ —**	**¥3,209,201**
Intersegment	**10,020**	**1,966**	**83,047**	**(95,033)**	**—**
Total	**1,645,076**	**1,301,160**	**357,998**	**(95,033)**	**3,209,201**
Operating cost and expenses	**1,415,680**	**1,117,668**	**433,954**	**24,844**	**2,992,146**
Operating profit (loss)	**¥ 229,396**	**¥ 183,492**	**¥ (75,956)**	**¥ (119,877)**	**¥ 217,055**
Total assets	**¥ 745,646**	**¥ 437,160**	**¥359,635**	**¥2,305,116**	**¥3,847,557**
Depreciation and amortization	**90,878**	**48,701**	**60,770**	**115,044**	**315,393**
Capital expenditures	**96,718**	**27,503**	**25,644**	**108,387**	**258,252**
2008: Net sales:					
External customers	¥2,223,253	¥1,453,647	¥417,261	¥ —	¥4,094,161
Intersegment	23,356	2,428	105,144	(130,928)	—
Total	2,246,609	1,456,075	522,405	(130,928)	4,094,161
Operating cost and expenses	1,789,263	1,232,951	570,281	5,592	3,598,087
Operating profit (loss)	¥ 457,346	¥ 223,124	¥ (47,876)	¥ (136,520)	¥ 496,074
Total assets	¥ 822,660	¥ 502,927	¥453,581	¥2,190,766	¥3,969,934
Depreciation and amortization	99,962	58,082	71,557	111,736	341,337
Capital expenditures	139,046	52,641	31,445	180,268	403,400

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
CANON INC. AND SUBSIDIARIES

Millions of yen	Office	Consumer	Industry and Others	Corporate and eliminations	Consolidated
2007: Net sales:					
External customers	¥2,456,798	¥1,585,307	¥ 439,241	¥ —	¥4,481,346
Intersegment	20,720	2,645	110,742	(134,107)	—
Total	2,477,518	1,587,952	549,983	(134,107)	4,481,346
Operating cost and expenses	1,912,343	1,260,113	527,039	25,178	3,724,673
Operating profit	¥ 565,175	¥ 327,839	¥ 22,944	¥ (159,285)	¥ 756,673
Total assets	¥ 981,627	¥ 590,208	¥ 535,825	¥2,404,965	¥4,512,625
Depreciation and amortization	97,886	56,278	65,331	122,199	341,694
Capital expenditures	126,857	35,548	113,178	194,081	469,664

Thousands of U.S. dollars	Office	Consumer	Industry and Others	Corporate and eliminations	Consolidated
2009: Net sales:					
External customers	**$17,772,348**	**$14,121,674**	**$2,988,598**	**$ —**	**$34,882,620**
Intersegment	**108,913**	**21,369**	**902,685**	**(1,032,967)**	**—**
Total	**17,881,261**	**14,143,043**	**3,891,283**	**(1,032,967)**	**34,882,620**
Operating cost and expenses	**15,387,826**	**12,148,565**	**4,716,892**	**270,044**	**32,523,327**
Operating profit (loss)	**$ 2,493,435**	**$ 1,994,478**	**$ (825,609)**	**$ (1,303,011)**	**$ 2,359,293**
Total assets	**$ 8,104,848**	**$ 4,751,739**	**$3,909,076**	**$25,055,609**	**$41,821,272**
Depreciation and amortization	**987,804**	**529,359**	**660,543**	**1,250,479**	**3,428,185**
Capital expenditures	**1,051,283**	**298,946**	**278,739**	**1,178,119**	**2,807,087**

Intersegment sales are recorded at the same prices used in transactions with third parties. Expenses not directly associated with specific segments are allocated based on the most reasonable measures applicable. Corporate expenses include certain corporate research and development expenses. Segment assets are based on those directly associated with each segment.

Corporate assets primarily consist of cash and cash equivalents, finance receivables, investments, deferred tax assets and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis.

Geographic information

Information by major geographic area as of and for the years ended December 31, 2009, 2008 and 2007 is as follows:

	Millions of yen			Thousands of U.S. dollars
	2009	2008	2007	**2009**
Net sales:				
Japan	**¥ 702,344**	¥ 868,280	¥ 947,587	**$ 7,634,174**
Americas	**894,154**	1,154,571	1,336,168	**9,719,065**
Europe	**995,150**	1,341,400	1,499,286	**10,816,848**
Other areas	**617,553**	729,910	698,305	**6,712,533**
Total	**¥3,209,201**	¥4,094,161	¥4,481,346	**$34,882,620**
Long-lived assets:				
Japan	**¥1,205,887**	¥1,314,092	¥1,284,283	**$13,107,467**
Americas	**59,273**	43,435	45,492	**644,272**
Europe	**44,875**	47,392	68,944	**487,772**
Other areas	**77,146**	71,407	78,499	**838,543**
Total	**¥1,387,181**	¥1,476,326	¥1,477,218	**$15,078,054**

Net sales are attributed to areas based on the location where the product is shipped to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States are ¥793,428 million ($8,624,217 thousand), ¥1,043,333 million and ¥1,217,096 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Long-lived assets represent property, plant and equipment and intangible assets for each geographic area.

The following information is based on the location of the Company and its subsidiaries as of and for the years ended December 31, 2009, 2008 and 2007. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information as supplemental information based on the disclosure requirements of the Japanese Financial Instruments and Exchange Law.

Millions of yen	Japan	Americas	Europe	Other areas	Corporate and eliminations	Consolidated
2009: Net sales:						
External customers	**¥ 827,762**	**¥ 871,633**	**¥ 991,336**	**¥ 518,470**	**¥ —**	**¥3,209,201**
Intersegment	**1,714,375**	**1,263**	**919**	**534,147**	**(2,250,704)**	**—**
Total	**2,542,137**	**872,896**	**992,255**	**1,052,617**	**(2,250,704)**	**3,209,201**
Operating cost and expenses	**2,288,471**	**860,863**	**964,606**	**1,019,208**	**(2,141,002)**	**2,992,146**
Operating profit	**¥ 253,666**	**¥ 12,033**	**¥ 27,649**	**¥ 33,409**	**¥ (109,702)**	**¥ 217,055**
Total assets	**¥1,386,511**	**¥ 198,094**	**¥ 378,477**	**¥ 384,795**	**¥ 1,499,680**	**¥3,847,557**
2008: Net sales:						
External customers	¥ 998,676	¥1,141,560	¥1,337,147	¥ 616,778	¥ —	¥4,094,161
Intersegment	2,318,521	3,758	4,329	670,678	(2,997,286)	—
Total	3,317,197	1,145,318	1,341,476	1,287,456	(2,997,286)	4,094,161
Operating cost and expenses	2,812,645	1,136,288	1,314,942	1,247,156	(2,912,944)	3,598,087
Operating profit	¥ 504,552	¥ 9,030	¥ 26,534	¥ 40,300	¥ (84,342)	¥ 496,074
Total assets	¥1,607,653	¥ 203,255	¥ 417,562	¥ 344,638	¥ 1,396,826	¥3,969,934
2007: Net sales:						
External customers	¥1,048,310	¥1,329,479	¥1,499,821	¥ 603,736	¥ —	¥4,481,346
Intersegment	2,494,251	4,608	3,496	824,844	(3,327,199)	—
Total	3,542,561	1,334,087	1,503,317	1,428,580	(3,327,199)	4,481,346
Operating cost and expenses	2,768,998	1,281,805	1,441,972	1,378,306	(3,146,408)	3,724,673
Operating profit	¥ 773,563	¥ 52,282	¥ 61,345	¥ 50,274	¥ (180,791)	¥ 756,673
Total assets	¥1,899,452	¥ 280,458	¥ 591,104	¥ 424,244	¥ 1,317,367	¥4,512,625

Thousands of U.S. dollars	Japan	Americas	Europe	Other areas	Corporate and eliminations	Consolidated
2009: Net sales:						
External customers	**$ 8,997,413**	**$9,474,272**	**$10,775,391**	**$ 5,635,544**	**$ —**	**$34,882,620**
Intersegment	**18,634,511**	**13,728**	**9,989**	**5,805,945**	**(24,464,173)**	**—**
Total	**27,631,924**	**9,488,000**	**10,785,380**	**11,441,489**	**(24,464,173)**	**34,882,620**
Operating cost and expenses	**24,874,685**	**9,357,207**	**10,484,847**	**11,078,348**	**(23,271,760)**	**32,523,327**
Operating profit	**$ 2,757,239**	**$ 130,793**	**$ 300,533**	**$ 363,141**	**$ (1,192,413)**	**$ 2,359,293**
Total assets	**$15,070,772**	**$2,153,196**	**$ 4,113,880**	**$ 4,182,554**	**$ 16,300,870**	**$41,821,272**

23. Subsequent Events

Share exchange agreement to make Canon Finetech Inc. a wholly owned subsidiary of Canon Inc.

On February 8, 2010, the Board of Directors of the Company approved a share exchange under which the Company would make Canon Finetech Inc. ("Canon Finetech") its wholly owned subsidiary, and the Company has entered into a share exchange agreement with Canon Finetech on the same date. As of February 8, 2010, the Company owned 57.59% of Canon Finetech. The share exchange is expected to become effective on May 1, 2010. The share exchange ratio is one share of Canon Finetech for 0.38 share of the Company. The Company will issue no new shares of stock, as it plans to issue its treasury stock for this transaction.

In order to secure the fairness of the share exchange ratio, the Company and Canon Finetech determined that each company would separately request an independent third-party appraisal agency to calculate the share exchange ratio, and diligently examined the results of the professional analyses and advice on the calculation of the proposed share exchange ratios submitted by the third-party appraisal agencies. As a result, the Boards of Directors of the Company and Canon Finetech determined the share exchange ratio of 0.38 share of the Company's common stock for each share of Canon Finetech common stock at their meetings held on February 8, 2010.

As a result of the share exchange, the carrying amount of the Company's noncontrolling interest in Canon Finetech will be decreased from ¥31,675 million ($344,293 thousand) to zero. The difference between the fair value of the shares of the Company issued to the noncontrolling interest holders and the decrease in the carrying amount of the noncontrolling interests will be recognized as an adjustment to additional paid-in capital. Additionally, after the date of the exchange, all of the net income of Canon Finetech will be attributable to the Company.

The Company has decided that making Canon Finetech its wholly owned subsidiary would facilitate the organic integration of both companies' management resources, further enhance the synergy effect throughout the Canon Group, and further elevate the flexibility and speed of management.

Acquisition of Océ N.V.

On March 9, 2010, Canon acquired 34.8% of the total outstanding shares of Océ N.V. ("Océ"), which is listed on NYSE Euronext Amsterdam, through a fully self-funded public cash tender offer for consideration of ¥38,785 million ($421,576 thousand), in addition to the 22.9% interest Canon held before the public cash tender offer. Subsequent to the acquisition date, Canon acquired an additional 9.8% of the total outstanding shares of Océ for consideration of ¥10,918 million ($118,674 thousand) during the post-acceptance period of the tender offer and also acquired 0.6% for consideration of ¥671 million ($7,293 thousand) through market purchases. In addition, Canon subsequently acquired Océ's convertible cumulative financing preference shares representing 19.1% of the total outstanding shares of Océ for consideration of ¥8,027 million ($87,250 thousand). As a result, Canon's aggregate interest currently represents 87.2% of the total outstanding shares of Océ. 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.

This acquisition will be accounted for using the acquisition method. Prior to the March 9, 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 ($277,261 thousand) was remeasured using the quoted price of Océ's common stock on the acquisition date, and will be included in the measurement of the total acquisition consideration.

Further information related to the accounting for this business combination has not been disclosed, because none of the activities required to complete the initial accounting for this acquisition have been completed as of the issuance date of the consolidated financial statements.

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 Securities Exchange Act of 1934 , 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, 2009. 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, 2009, 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 our internal control over financial reporting.

Fujio Mitarai
Chairman and CEO

Toshizo Tanaka
Executive Vice President and CFO

March 30, 2010

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ERNST & YOUNG

Ernst & Young ShinNihon LLC
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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, 2009 and 2008, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2009, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 report dated March 16, 2009, we expressed an opinion that, except for the omission of segment reporting information, the 2008 and 2007 consolidated financial statements presented fairly, in all material respects, the consolidated financial position, results of operations and cash flows of Canon Inc. and subsidiaries, in conformity with U.S. generally accepted accounting principles. As described in Note 22, in 2009 the Company adopted segment reporting guidance and revised the disclosures in its 2008 and 2007 consolidated financial statements to conform with U.S. generally accepted accounting principles. Accordingly, our present opinion on the 2008 and 2007 consolidated financial statements, as presented herein, is unqualified rather than qualified.

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, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2009 the Company adopted new accounting guidance for noncontrolling interests in consolidated financial statements.

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, 2009, 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 30, 2010 expressed an unqualified opinion thereon.

We have also recomputed the translation of the consolidated financial statements as of and for the year ended December 31, 2009 into United States dollars. In our opinion, the consolidated financial statements expressed in Japanese yen have been translated into United States dollars on the basis described in Note 2.

Ernst & Young ShinNihon LLC

March 30, 2010

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ERNST & YOUNG

Ernst & Young ShinNihon LLC
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Fax: +81 3 3503 1277

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, 2009, 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, 2009, 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, 2009 and 2008, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2009, all expressed in Japanese yen, and our report dated March 30, 2010 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 30, 2010

TRANSFER AND REGISTRAR'S OFFICE

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

Manager of the Register of Stockholders
Mizuho Trust & Banking Co., Ltd.
2-1, Yaesu 1-chome, Chuo-ku, Tokyo 103-8670, Japan

Depositary and Agent with Respect to American Depositary Receipts for Common Shares
JPMorgan Chase Bank, N.A.
4 New York Plaza, New York, N.Y. 10004, U.S.A.

STOCKHOLDER INFORMATION

Stock Exchange Listings:
Tokyo, Osaka, Nagoya, Fukuoka, Sapporo and New York stock exchanges

American Depositary Receipts are traded on the New York Stock Exchange (CAJ).

Ordinary General Meeting of Shareholders:
March 30, 2010, in Tokyo

Further Information:
For publications or information, please contact the External Relations Headquarters, Canon Inc., Tokyo, or access Canon's Website at
www.canon.com

MAJOR CONSOLIDATED SUBSIDIARIES

(As of December 31, 2009)

MANUFACTURING

Canon Electronics Inc.
Canon Finetech Inc.
Nisca Corporation
Canon Semiconductor Equipment Inc.
Canon Ecology Industry Inc.
Canon Chemicals Inc.
Canon Components, Inc.
Canon Precision Inc.
Oita Canon Inc.
Nagahama Canon Inc.
Oita Canon Materials Inc.
Ueno Canon Materials Inc.
Fukushima Canon Inc.
Canon Optron, Inc.
Canon Mold Co., Ltd.
Canon Machinery Inc.
Canon ANELVA Corporation
SED Inc.
Tokki Corporation
Canon Virginia, Inc.
Canon Giessen GmbH
Canon Bretagne S.A.S.
Canon Inc., Taiwan
Canon Dalian Business Machines, Inc.
Canon Zhuhai, Inc.
Canon Zhongshan Business Machines Co., Ltd.
Tianjin Canon Co., Ltd.
Canon (Suzhou) Inc.
Canon Opto (Malaysia) Sdn. Bhd.
Canon Hi-Tech (Thailand) Ltd.
Canon Engineering (Thailand) Ltd.
Canon Vietnam Co., Ltd.
Canon Electronic Business Machines (H.K.) Co., Ltd.
Canon Imaging Systems Inc.

RESEARCH & DEVELOPMENT

Canon Development Americas, Inc.
Canon Research Centre France S.A.S.
Canon Information Systems Research Australia Pty. Ltd.
Canon Information Technology (Beijing) Co., Ltd.
Canon (Suzhou) System Software Inc.
Canon i-tech, Inc.

MARKETING & OTHER

Canon Marketing Japan Inc.
Canon System & Support Inc.
Canon IT Solutions Inc.
Canon Software Inc.
e-system Corporation
Asia Pacific System Research Co., Ltd.
Canon U.S.A., Inc.
Canon Canada, Inc.
Canon Mexicana, S. de R.L. de C.V.
Canon Latin America, Inc.
Canon do Brasil Industria e Comércio Limitada
Canon Chile, S.A.
Canon Panama, S.A.
Canon Argentina, S.A.
Virtual Imaging, Inc.
Canon Business Solutions, Inc.
Canon Financial Services, Inc.
Canon Information Technology Services, Inc.
Canon Europa N.V.
Canon Europe Ltd.
Canon (UK) Ltd.
Canon Deutschland GmbH
Canon France S.A.S.
Canon Italia S.p.A.
Canon España S.A.
Canon Nederland N.V.
Canon Danmark A/S
Canon Belgium N.V./S.A.
Canon (Schweiz) A.G.
Canon Austria GmbH
Canon Svenska AB
Canon Oy
Canon North-East Oy
Canon Norge AS
Canon Ru LLC
Canon CEE GmbH
Canon Eurasia A.S.
Canon Portugal S.A.
Canon Middle East FZ-LLC
Canon South Africa Pty. Ltd.
Canon Australia Pty. Ltd.
Canon New Zealand Ltd.
Canon Finance Australia Ltd.
Canon (China) Co., Ltd.
Canon Singapore Pte. Ltd.
Canon Hongkong Co., Ltd.
Canon Marketing (Malaysia) Sdn. Bhd.
Canon Marketing (Philippines), Inc.
Canon Marketing (Thailand) Co., Ltd.
Canon India Pvt. Ltd.
Canon Korea Consumer Imaging Inc.
Canon Semiconductor Engineering Korea Inc.
Canon Semiconductor Equipment Taiwan Inc.
Canon Engineering Hong Kong Co., Ltd.

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