CANON ANNUAL REPORT 2011

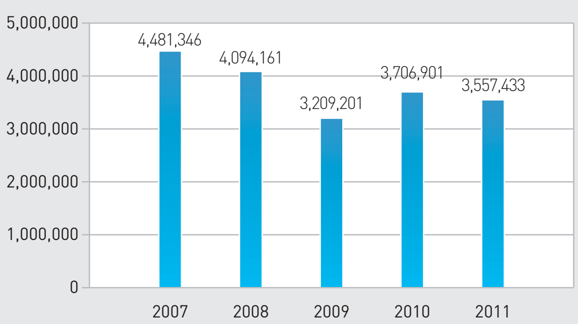
Fiscal Year Ended December 31, 2011

FINANCIAL HIGHLIGHTS

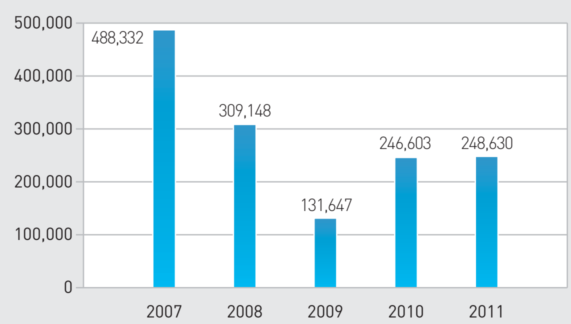
	Millions of yen (except per share amounts)			*Thousands of U.S. dollars (except per share amounts)*
	2011	2010	Change (%)	**2011**
Net sales	**¥3,557,433**	¥3,706,901	-4.0	**$45,608,115**
Operating profit	**378,071**	387,552	-2.4	**4,847,064**
Income before income taxes	**374,524**	392,863	-4.7	**4,801,590**
Net income attributable to Canon Inc.	**248,630**	246,603	+0.8	**3,187,564**
Net income attributable to Canon Inc. stockholders per share:				
—Basic	**¥ 204.49**	¥ 199.71	+2.4	**$ 2.62**
—Diluted	**204.48**	199.70	+2.4	**2.62**
Total assets	**¥3,930,727**	¥3,983,820	-1.3	**$50,393,936**
Canon Inc. stockholders' equity	**¥2,551,132**	¥2,645,782	-3.6	**$32,706,821**

Notes:
1. Canon's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.
2. U.S. dollar amounts are translated from yen at the rate of JPY78=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2011, solely for the convenience of the reader.

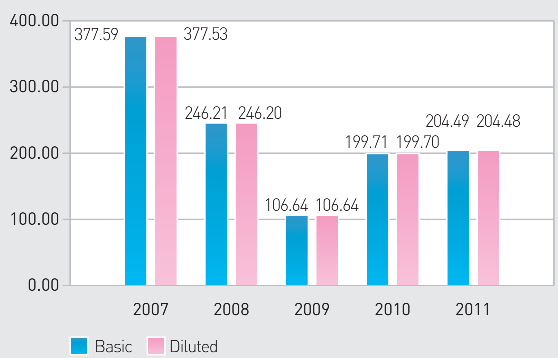
Net Sales
(Millions of yen)



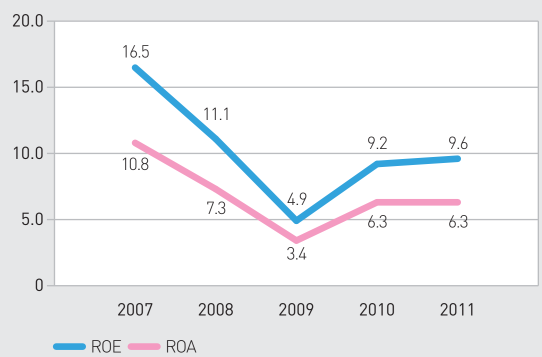
Net Income Attributable to Canon Inc.
(Millions of yen)



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 and industrial and other equipment. Through these products, the Company meets growing customer needs that are becoming increasingly diversified and sophisticated. Today, the Canon brand is recognized and trusted throughout the world.

In 1996, Canon launched its Excellent Global Corporation Plan with the aim of becoming a company worthy of admiration and respect the world over. Currently, the Company is working to achieve the overwhelming No. 1 position in its existing core businesses and expand related and peripheral businesses by strengthening its advanced solutions business, centered on innovative products, and through other measures. At the same time, Canon is nurturing its operations in the fields of medical equipment and industrial equipment, the latter including intelligent robots, to establish new core businesses. The Company is working to fulfill its responsibilities 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*

Canon's corporate philosophy is *kyosei*. A concise definition of this word would be "Living and working together for the common good." But Canon's definition is broader: *kyosei* is "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*. Truly global companies must foster good relations, not only with their customers and the communities in which they operate, but also with nations, and they need to address environmental issues worldwide. In addition, global companies must bear responsibility for the impact of their activities on society. For this reason, Canon's goal is to contribute to global prosperity and to 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, and even 200, years. Toward this end, the Company has been promoting its Excellent Global Corporation Plan, launching Phase IV of the initiative in 2011. Building on the financial strengths that the Company has continuously reinforced through the implementation of the plan, Canon aims to join the ranks of the world's top 100 companies in terms of major management indicators.

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Cover Photo:
The entry-level EOS Rebel T3i (EOS 600D in some areas), which complements Canon's lineup of high-performance digital SLR cameras, has contributed to increased sales volume and expanded market share. The camera offers such advanced features as a Scene Intelligent Auto mode and a Vari-angle Clear View LCD monitor.

TO OUR STOCKHOLDERS

FUJIO MITARAI
Chairman & CEO
Canon Inc.

PERFORMANCE IN 2011

In fiscal 2011, ended December 31, 2011, the world economy continued growing, albeit moderately, driven by the expansion of newly emerging countries. Looking back, however, it was a demanding year due to a succession of challenging events. In addition to the Great East Japan Earthquake, these included economic turmoil in Europe, which was triggered by the Greek debt crisis in May and gave rise to the sharp appreciation of the yen, as well as massive flooding in Thailand in October. We extend our sincerest condolences to all those affected by the Japan earthquake and the Thai floods, and pray for a speedy recovery of the disaster-stricken areas.

Amid these challenging circumstances, Canon posted consolidated net sales of ¥3,557.4 billion, down 4.0% from the previous fiscal year. On the profit side, however, we stepped up efforts to reduce costs and worked exhaustively to improve our expenditure efficiency through the comprehensive promotion of automated production, in-house production and "man-machine cell" production, which integrates manual and automated processes. Accordingly, the Company was able to enhance profitability, realizing a 0.7 point increase in the gross profit ratio to 48.8%, and a 0.1 point improvement in the operating profit ratio to 10.6%. Moreover, net income attributable to Canon Inc. increased 0.8% to ¥248.6 billion, marking the second consecutive year of year-on-year profit growth.

"Canon will overcome the difficult business environment and return to a path of growth."

The earthquake in Japan and floods in Thailand had a negative impact on net sales of approximately ¥230.0 billion, and on operating profit of approximately ¥120.0 billion. Excluding the effect of these disasters on our performance, net sales would have increased while operating profit would have jumped approximately 30.0%—even despite the yen's sharp appreciation and the economic instability. We believe, therefore, that we have further boosted the market competitiveness of our products and the Company has made good progress in reducing costs.

Canon continues to adopt a proactive approach to steadily returning profits to stockholders while taking into consideration future investments, free cash flow and consolidated business performance. For 2011, Canon has decided to pay a full-year cash dividend of ¥120.00 per share, the same level as the previous year.

BECOMING A TRULY EXCELLENT GLOBAL CORPORATION

In 2011, Canon launched Phase IV of the Excellent Global Corporation Plan, a five-year management initiative that will conclude in 2015. Under Phase IV, the Company will renew its emphasis on sound growth by undertaking a rapid transformation ahead of the changing times with the aim of joining the ranks of the world's top 100 companies in terms of all major management indicators. In line with these strategies, the Company has set the following performance targets for 2015, the final year of Phase IV: net sales of at least ¥5 trillion, an operating profit ratio of 20% or higher, net income ratio of 10% or higher, and a stockholders' equity ratio of 75% or higher. Through the achievement of these targets, Canon aims to realize great strides toward becoming a truly excellent global corporation.

PROGRESS OF PHASE IV

Under Phase IV, Canon is implementing the following six strategies:

1. Achieving the overwhelming No. 1 position in all core businesses and expanding related and peripheral businesses;
2. Developing new business through globalized diversification and establishing the Three Regional Headquarters management system;
3. Establishing a world-leading globally optimized production system;
4. Comprehensively reinforcing global sales capabilities;
5. Building the foundations of an environmentally advanced corporation;
6. Imparting a corporate culture, and cultivating human resources befitting a truly excellent global company.

With respect to the first strategy, within the digital commercial printing market, in 2011 Canon launched products developed jointly with Netherlands-based Océ N.V., which became a consolidated subsidiary in 2010. In addition, targeting Canon's full-scale entry into the motion picture production industry commonly associated with Hollywood movies, the Company launched the Cinema EOS System, featuring our extensive lineup of interchangeable lenses supporting next-generation high-definition 4K resolution and interchangeable-lens digital cinema cameras. Canon has also laid the groundwork for the Company's entry into the retail photo-finishing service market with a commercial photo printer, DreamLabo 5000.

Regarding the second strategy, in the medical equipment field, a donation provided by Canon made possible the establishment in May 2011 of the Clinical Research Center for Medical Equipment Development (CRCMed) at Kyoto University. Working in collaboration with Kyoto University, the

Company plans to accelerate clinical research into the use of optical ultrasound mammography systems.

Under the fourth strategy, Canon further strengthened sales and marketing functions in China, where economic growth continues, and worked to tap into such emerging markets as India, Brazil and Russia. We have also boosted our cooperative efforts with Océ N.V. and taken steps to reinforce our solutions business supporting improved office productivity.

In addition, we have worked to reduce the cost of sales ratio through the promotion of “man-machine cell” production along with boosting the automated production rate for toner cartridges.

SUSTAINED GROWTH THROUGH ADVANCES IN MANUFACTURING

Although economic growth rates are slowing in emerging countries, forecasts point to continued growth. By contrast, Canon cannot expect major overall growth in developed countries, which are facing structural factors hindering their economies. Accordingly, a full-scale recovery will take more time, especially in the eurozone. Meanwhile, the yen is expected to remain at historical highs, underscoring the ongoing difficult business climate for Canon.

Nevertheless, I believe that Canon is capable of achieving growth regardless of the circumstances. To date, Canon has overcome the challenge of a strong yen through the conviction that earnings can be generated through manufacturing. Canon’s strength lies in its ability to differentiate its products, improve quality and continually realize cost reductions. These stem from the Company’s tireless pursuit of advances in manufacturing, including switchover from conveyor belt-based production to the cell production system, the adoption of “man-machine cell” production, and the development of automated production systems. Going forward, Canon will further hone this strength by reaffirming its commitment to its own production systems with the aim of becoming a company capable of realizing sustained growth.

2012 marks the second fiscal year of Phase IV. As the entire Canon Group works in concert to fulfill our 2015 targets, we look forward to your ongoing understanding and support.

FUJIO MITARAI
Chairman & CEO
Canon Inc.

INTERVIEW WITH THE CEO

Q Please share with us the results of Phases I, II and III of Canon's Excellent Global Corporation Plan?

A In Phase I, we worked to strengthen the Company's financial standing and succeeded in cutting our debt by more than half. In Phase II, which focused on reinforcing product competitiveness, we completed the digitization of our copying machines and cameras. And in Phase III, we sought to expand Canon's business scale while implementing M&A.

Back in September 1995, when I became president, Canon's financial condition was weak and there was considerable waste stemming from redundancies across the Company's various businesses, because each business focused solely on optimizing its own operations.

In Phase I, therefore, we concentrated on strengthening the Company's financial standing. Specifically, we significantly increased productivity through the introduction of cash flow management, the cell production system, and other measures. We also extensively eliminated waste by transforming our focus from partial optimization to total optimization, which reduced our debt by more than half.

During Phase II, we worked to reinforce Canon's product competitiveness. By fully digitizing our copying machines and cameras, we laid the groundwork for the successes that we enjoy today, and created a debt-free company.

In Phase III, we sought to expand Canon's business scope. Here, we expanded our business in the printing and medical-equipment fields and broadened our sales networks while actively carrying out M&A. Due to the global financial crisis in 2008, however, the Company's business suffered a contraction in terms of scale.

THE EXCELLENT GLOBAL CORPORATION PLAN

Phase I 1996–2000

Strengthened our financial structure by thoroughly eliminating wastefulness, with production reforms playing a major role, based on changing our mindset with a focus on total optimization and profitability.

Phase II 2001–2005

Recognized the need for digitalization and raised product competitiveness by enhancing our development infrastructure and reinforcing key components.

Phase III 2006–2010

Strove to achieve "Sound Growth," seeking high growth levels by establishing new businesses while raising the profitability of existing businesses. With the global economy plunging into the global recession, shifted direction towards "improving the quality of management."

Set up an even stronger financial structure and increased momentum towards a dramatic leap forward from now.

Phase IV 2011–2015

Tackle again the challenge of achieving "Sound Growth" through timely change in advance of changes in the times.

Slogan:
"Aiming for the Summit –Speed & Sound Growth"

Q Under Phase IV, you are targeting "new heights" and "reforms." Please elaborate.

A This refers to reforming our business domains and the functions common to manufacturing operations as we strive to achieve our consolidated net sales target of ¥5 trillion in 2015. Specifically, we will promote new applications for existing products in other fields while fostering the medical and industrial equipment businesses. At the same time, we will further enhance the Three Regional Headquarters management system and establish a globally optimized production system.

By "new heights" we mean surpassing the record-high performance we achieved in 2007. Specifically, in 2015 we are targeting net sales of at least ¥5 trillion, an operating profit ratio of 20% or higher, and a net income ratio of 10% or higher.

To realize these targets, we must pursue two reforms. The first entails reforming our business domains. In the Company's core businesses, we will laterally expand our business domains through new applications for existing products in other fields. In other words, we will deploy technologies of existing products to enter different fields. In addition, we will accelerate our efforts in the medical and industrial equipment fields, which represent the pillars of new business domains for Canon.

The second reform involves transforming functions common to our manufacturing operations. These include research and development, production, and sales and marketing. Specifically, we will further upgrade our Three Regional Headquarters management system, with headquarter functions undertaken not only in Japan, but also in the United States and Europe for the products developed in those regions. Meanwhile, with respect to production operations, we will seek to establish a globally optimized production system based on the comprehensive consideration of various factors, such as costs, taxation systems, logistics methods, ease of parts procurement, and manpower.

2015 PERFORMANCE TARGETS

Net Sales	5 Trillion yen or more
Operating Profit Ratio	20% or more
Net Income Ratio	10% or more
Stockholders' Equity Ratio	75% or more

KEY STRATEGIES FOR PHASE IV

01 Achieving the overwhelming No.1 position in all core businesses and expanding related and peripheral businesses

02 Developing new business through globalized diversification and establishing the Three Regional Headquarters management system

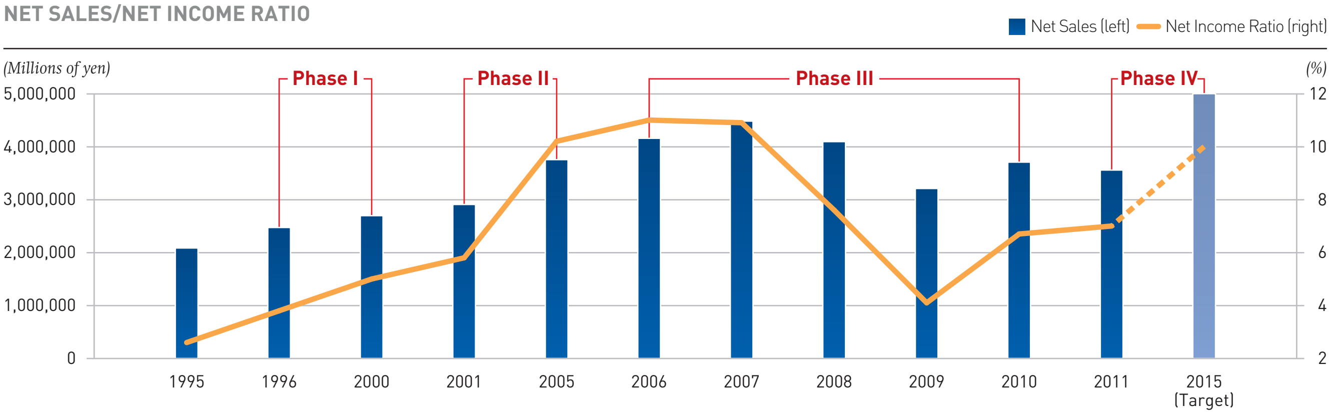
03 Establishing a world-leading globally optimized production system

04 Comprehensively reinforcing global sales capabilities

05 Building the foundation of an environmentally advanced corporation

06 Imparting a corporate culture, and cultivating human resources befitting a truly excellent global company

NET SALES/NET INCOME RATIO



01 ACHIEVING THE OVERWHELMING NO.1 POSITION IN ALL CORE BUSINESSES AND EXPANDING RELATED AND PERIPHERAL BUSINESSES

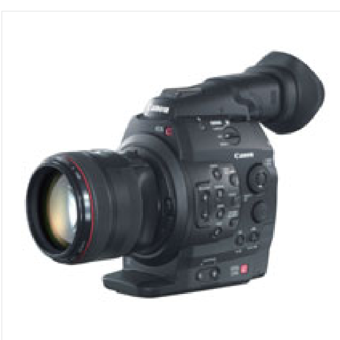
MAIN INITIATIVES

Q In what ways have you deployed innovation to develop appealing products in core businesses? Also, can you describe specific initiatives aimed at raising earnings through the expansion of solutions and services?

A We developed a professional-use digital cinema camera built off the video-recording capabilities of our digital single-lens reflex (SLR) cameras, and developed the DreamLabo 5000, a commercial photo printer incorporating enhanced inkjet-printing technologies. In addition, we are working to upgrade office network multifunction device (MFD)-based solutions and services.

In 2011, through the lateral development of an existing product, we successfully launched the EOS C300 Digital Cinema Camera, an interchangeable-lens digital video camcorder that expanded off the video-recording capabilities offered by our digital SLR cameras. In 2008 we released the EOS 5D Mark II digital SLR camera, boasting video image quality that captured the attention of the U.S. motion picture industry, an opportunity we seized upon to develop the EOS C300. We also developed the DreamLabo 5000 commercial photo printer, realized by building off the inkjet-printing technologies we have cultivated over the years.

As for boosting earnings through solutions and services, we offer network MFDs and deliver solutions and services tailored to the workflows of our customers, which enables us to increase earnings. Meanwhile, until recently, office IT systems had made use of servers located in the office. But now, the spread of cloud services has sparked a fundamental transformation of network-based communication systems. Responding swiftly to this changing environment, we created Canon Business Imaging Online, a cloud service platform that works in conjunction with imageRUNNER ADVANCE office network MFDs. We are also working to enhance the cloud-based solutions and services of our sales companies worldwide.



Canon's new large-scale 8.29-megapixel CMOS sensor, used in the EOS C300 Digital Cinema Camera, meets motion picture industry needs with enhanced sensitivity and reduced noise.

02 DEVELOPING NEW BUSINESS THROUGH GLOBALIZED DIVERSIFICATION AND ESTABLISHING THE THREE REGIONAL HEADQUARTERS MANAGEMENT SYSTEM

MEDICAL IMAGING

New Expansion in Medical Imaging	
Optical Ultrasound Mammography System The Kyoto University/Canon Joint Research Project	Digital Radiography Systems
	Ophthalmic Diagnostic Systems
	Medical IT Solutions
	Genetic Diagnosis Technologies
Target: 100 Billion Yen by 2015	

INDUSTRIAL EQUIPMENT

Existing Businesses	New Businesses
Semiconductor Lithography Systems	Intelligent Robots
Organic LED Panel Manufacturing Equipment (Canon Tokki Corporation) Die Bonders (Canon Machinery Inc.) Vacuum Thin-Film Deposition Equipment (Canon ANELVA Corporation)	Machine Vision for Industry

Q What are your reasons for selecting medical equipment and industrial equipment as new business pillars? What are some of the specific initiatives being carried out in these areas?

A In the medical equipment field, we noted advancements in elemental technologies for applications in medical care and saw opportunities for further development. As for industrial equipment, we concluded that demand in the factory automation area would expand in developed countries facing aging populations with decreasing working populations.

Reflecting the needs of the times, we determined that demand for medical equipment and industrial equipment will grow in the future.

In the medical equipment field, because disease will never disappear as long as humans exist, there will always be demand for medical care. Also, we have noted rapid advances in non-invasive optical ultrasound and other elemental medical technologies, and we can foresee further progress in the future. At Canon, we plan to fully mobilize our expertise in optical and office-imaging technologies to expand our business in such areas as diagnostic imaging solutions, optical ultrasound diagnostic imaging systems and genetic diagnostic systems. As for diagnostic imaging systems that employ optical ultrasound, we are conducting clinical research in collaboration with Kyoto University. Going forward, we plan to form alliances in the United States and Europe with venture companies offering promising new technologies, acquiring new technologies with which we will continue to expand our business.

Regarding industrial equipment, as developed countries face aging populations and decreasing working populations in the future, we expect demand for automated production facilities to increase. Canon is currently developing intelligent robots and will initially address needs for automation and unmanned production at the Company's manufacturing bases. In the future, however, we will pursue business opportunities in the field of factory automation.

Océ is expected to play a key role under the Three Regional Headquarters management system.

GLOBAL DIVERSIFICATION

Develop a Global R&D Structure
New Innovation Centers in the U.S. and Europe

U.S.	Europe
Establish Institutes with responsibilities spanning basic research to leading-edge technology application	Promote diversification utilizing Océ as a foothold

Q What, specifically, is the kind of framework you aim to achieve with the Three Regional Headquarters management system?

A As globalization continues to progress, we cannot keep pace with market changes unless we promote the international diversification of our operations beyond Japan. For this reason, we aim to create a Three Regional Headquarters management system, with headquarter functions in the United States and Europe for the products developed in those regions.

Looking back on Canon's history, diversification began when we augmented our camera-related optical and mechanical technologies with electronic technologies to produce calculators. To this we added chemical technologies to make copying machines and laser printers, followed by communication technologies to produce facsimile machines. In other words, Canon's approach to diversification is based on entering into new businesses that reflect emerging needs by complementing existing technologies with new, highly compatible technologies.

To date, all of our diversification has been carried out in Japan. Since Phase II, however, there has been a surge in the wave of globalization, prompting us to recognize the need to further diversify internationally. In Phase III, therefore, we sought to establish the Three Regional Headquarters management system, placing headquarter functions in the United States and Europe for the products developed in those regions. The U.S. headquarters will be responsible for products developed in America, while the European headquarters will handle products developed in Europe. While Canon Inc. will remain the parent company in terms of the capital structure, what we have in mind is the creation of three regional product-business headquarters. Moreover, rather than developing all necessary technologies from scratch, we will adopt a realistic approach that involves the active use of M&A to acquire technologies as needed.

In Europe, we made Océ N.V., with its advanced commercial printing technologies, a consolidated subsidiary, which enabled us to realize a commercial printing base. In Phase IV, we plan to complete the Three Regional Headquarters management system through the promotion of further M&A.

03 ESTABLISHING A WORLD-LEADING GLOBALLY OPTIMIZED PRODUCTION SYSTEM

Q How do you plan to create a globally optimized production system? Also, what criteria do you apply when selecting the countries where manufacturing will be carried out?

A We will build the most rational globally optimized production system following the comprehensive consideration of various factors in each region, including costs, tax systems and labor force. The criterion we use when selecting where to carry out production is the ratio of labor costs to total manufacturing costs.

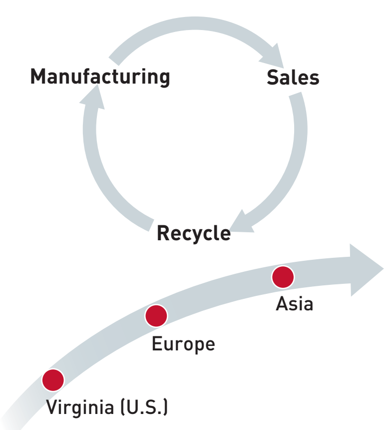
Drawing on lessons learned from the Great East Japan Earthquake and the floods in Thailand, we will establish a globally optimized production system that thoroughly pursues economic rationality based on the comprehensive consideration of various factors in each country and region, including costs, tax systems, logistics methods, ease of parts procurement, and labor force.

When selecting where to carry out production, more important than whether labor costs may be high or low is the proportion of labor cost to manufacturing cost. Even if labor costs are high, provided the value added to products is sufficiently high, then the labor cost ratio will decline. At Canon, we strive to hold the ratio of labor costs to manufacturing costs below a certain level, which provides us with a standard for determining whether to manufacture in Japan or overseas. Currently, we produce high-value-added products in Japan, while products with lower added value and a higher labor cost ratio are made elsewhere. If we are unable to turn a profit despite such efforts, then we will withdraw from that business.

In addition, particularly for consumables, we would like to accelerate our efforts to realize localized production, in which the entire process from production to sales, all the way through to the recycling of used products, is carried out within a single region.

GLOBALLY OPTIMIZED PRODUCTION SYSTEM

LOCALIZED PRODUCTION



04 COMPREHENSIVELY REINFORCING GLOBAL SALES CAPABILITIES

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Canon is rapidly expanding its sales networks to meet strong demand from emerging markets. (The showroom of the Mumbai Office of Canon India Pvt. Ltd.)

Q How will you reinforce your sales capabilities in developed countries? What about emerging countries displaying significant growth?

A In developed countries we are working to enhance solutions and services for office network multifunction device (MFD)s. In China and Southeast Asia, where our sales networks have not kept pace with market growth, we are doing our utmost to expand our organizational reach.

Although we already have fully established sales networks in developed countries, in order to achieve further growth, we are working to upgrade solutions and services for network MFDs. Specifically, positioning the imageRUNNER ADVANCE at the core with an eye toward cloud applications, our sales companies worldwide are working to strengthen their network MFD solutions business, expand their customer bases, and enhance services through alliances with leading companies in the IT and cloud-computing fields and software companies.

In China, where our sales network is seriously insufficient, we are diligently working to boost our sales presence. There are around 300 cities in China with populations exceeding one million and we are making efforts to cover all of them with our network. Because it takes time to gather the required human resources, we are rapidly working to broaden our organization in China.

As for India, Indonesia, Vietnam and Thailand, we are working hard to expand our sales networks in these countries as well—especially in India and Indonesia.

Strengthening our sales and marketing capabilities depends entirely on organizational expansion, which is why we are moving with speed and urgency in China and Southeast Asia.

05 BUILDING THE FOUNDATIONS OF AN ENVIRONMENTALLY ADVANCED CORPORATION

The imageRUNNER ADVANCE series realizes a reduction in total CO_2 emissions, through an environmentally conscious design method to set and control CO_2 emission reduction targets for each stage of the product lifecycle.

Q What is Canon doing about environmental issues?

A In addition to developing products with high environmental performance, we will emphasize a localized production model for toner cartridges and other initiatives in order to reduce the environmental burden of our business activities.

Our policy is to develop energy-saving technologies and materials with low environmental burden while raising the performance of our products. In 1990 we launched our Toner Cartridge Collection and Recycling Program and now carry out the localized recycling of cartridges in the United States, Japan, China and France. We are also promoting localized production, reducing energy consumption and carbon dioxide emissions associated with product transportation.

06 IMPARTING A CORPORATE CULTURE, AND CULTIVATING HUMAN RESOURCES BEFITTING A TRULY EXCELLENT GLOBAL COMPANY

Q What are your thoughts with respect to hiring non-Japanese exchange students and promoting foreigners to management positions? Also, how do you cultivate globally competent human resources?

A We will be proactive in recruiting and appointing non-Japanese employees. At the same time, we will cultivate global human resources through such means as global management training and by assigning Japanese staff to overseas positions.

Managers from Group companies worldwide gather at the Canon Global Management Institute in Japan to study corporate strategies and engage in cross-cultural exchanges.

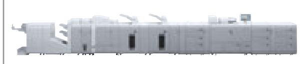
We have many local people serving in executive positions at our marketing companies around the world. In fact, in Europe, our largest regional market, all of the presidents of our marketing companies except for one are from Europe. And, in addition to proactively recruiting non-Japanese exchange students, we offer a global management training program in coordination with the Institute for International Management Development (IMD), a business school in Switzerland. Meanwhile, there are always around 1,000 of our Japanese employees posted at our marketing and manufacturing companies worldwide. In this way, we are cultivating large numbers of human resources capable of embracing diversity and responding flexibly while respecting local cultures and customs.

AT A GLANCE

BUSINESS UNITS	MAIN PRODUCTS

OFFICE BUSINESS UNIT


Office Network MFDs


Digital Production Printing Systems


Laser Printers


Large-Format Inkjet Printers

- Office Network Multifunction Devices (MFDs)
- Laser Printers
- Laser MFDs
- Solutions Software
- Toner Cartridges
- Digital Production Printing Systems
- Large-Format Inkjet Printers

CONSUMER BUSINESS UNIT


Digital SLR Cameras

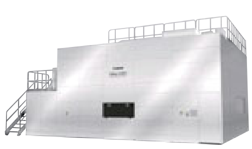

Digital Camcorders


Inkjet Printers


Multimedia Projectors

- Digital Single Lens Reflex (SLR) Cameras
- Compact Digital Cameras
- Digital Camcorders
- Interchangeable Lenses
- Inkjet Printers
- Multimedia Projectors
- Image Scanners
- Broadcast Equipment
- Calculators

INDUSTRY AND OTHERS BUSINESS UNIT


LCD Lithography Systems


Ophthalmic Equipment

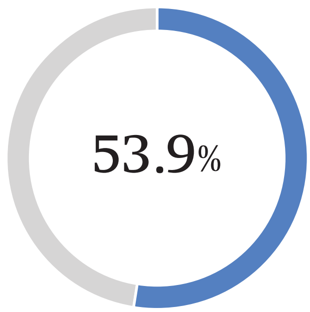

Semiconductor Lithography Systems

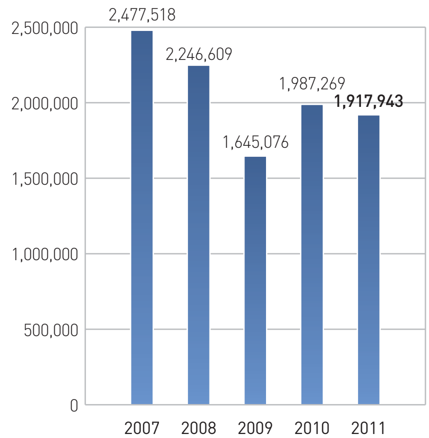

Document Scanners

- LCD Lithography Systems
- Semiconductor Lithography Systems
- Ophthalmic Equipment
- Digital Radiography Systems
- Document Scanners
- Handy Terminals
- Color Label Printers
- Die Bonders
- Organic LED Panel Manufacturing Equipment
- Vacuum Thin-Film Deposition Equipment

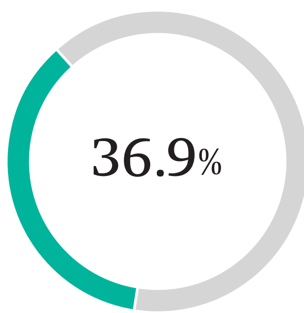
OUTLINE	CONSTITUTION OF SALES (%)	NET SALES (Millions of yen)

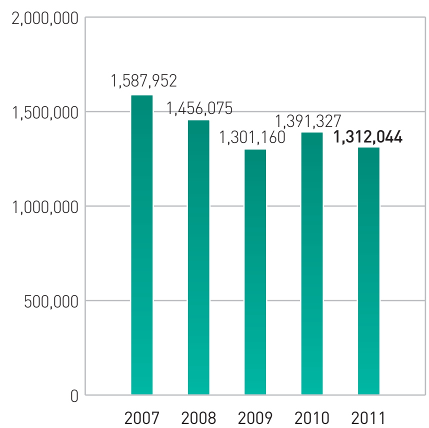
In this segment, Canon offers a comprehensive range of multifunction devices (MFDs), printers, and other equipment featuring high image quality, high resolution, and high speed. Leveraging these products, Canon works in close collaboration with various Group companies and alliance partners to deliver optimal solutions tailored to match the customer's business operations. These include various document solutions, such as office document management and the output of records. At the same time, the Company provides top-quality services and support in a swift and reliable manner.



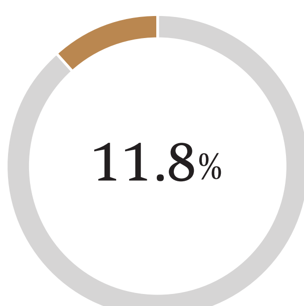


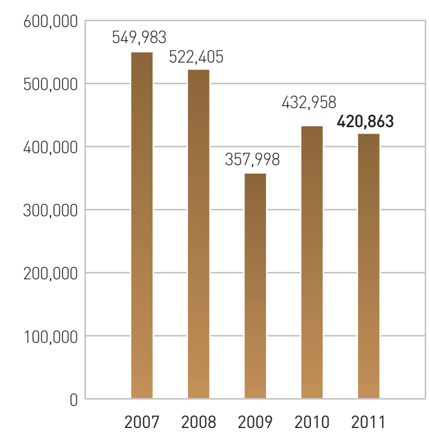
Canon's offerings in this segment include digital cameras, digital camcorders, interchangeable lenses, inkjet printers, and calculators. Canon's digital cameras and digital camcorders—designed to deliver unparalleled image quality—have earned particularly high acclaim worldwide, thanks to in-house developed lenses, CMOS sensors, and image processors. Also widely popular are Canon's inkjet printers, which are easy to use and produce beautiful pictures at high speeds.





Applying optical technologies and image-processing technologies amassed over many years, Canon provides high-value-added products to a wide range of industries. The Company is already prominent globally as a manufacturer of LCD lithography and semiconductor lithography systems. In addition, Canon is focusing on the medical equipment field—one of its next-generation core businesses. The Company is aggressively promoting sales of its cutting-edge digital radiography systems and ophthalmic equipment, which employ Canon's highly regarded medical imaging technologies.





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.

OFFICE BUSINESS UNIT

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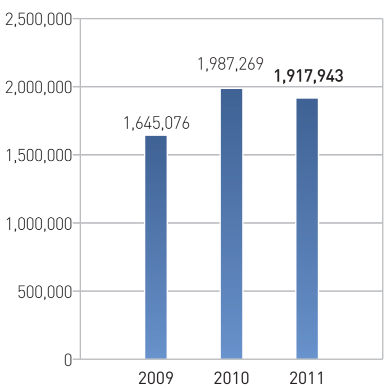
Canon has expanded the functions of its office network MFDs, which realize enhanced coordination with IT systems and are compatible with various types of system application software, offering an optimal usage environment for all sorts of document-related tasks.



NET SALES
(Millions of yen)

2011 REVIEW

In the market for office network multifunction devices (MFDs), demand for MFDs remained largely unchanged from the previous year thanks to increased worldwide demand for color devices. In Japan, the Great East Japan Earthquake disrupted parts supplies. While production levels were down temporarily, however, production had mostly returned to normal by autumn. Sales of color models, such as the imageRUNNER ADVANCE C5000/C2000 series, grew steadily in both value and volume terms.

Sales for digital production printing systems increased considerably, centering on color printers in Europe, Asia, and Oceania. In Japan, sales of high-speed monochrome printers, such as the imageRUNNER ADVANCE 8105 PRO, were strong, as were sales of imagePRESS C7010VP in the Americas, resulting in a year-on-year increase in worldwide sales in both value and volume terms. Strong sales of the imagePRESS C7010VPS, the first product developed jointly by Canon and Océ N.V., contributed to overall revenue growth.

The imageRUNNER ADVANCE C5051, a mainstay model, which has contributed to revenues of office network MFDs since its launch, meets various business needs, employing high-speed output of 51 ppm.

The imagePRESS C7010VP achieves high image quality and high-precision digital printing that rivals offset printing, with a printing speed of up to 70 ppm.

The imagePROGRAF iPF8300S, utilizing the LUCIA EX eight-color ink system, realizes the expanded reproducible color gamut, and offers improved output speed and image quality performance.

Sales of MFDs (including laser devices) for individual and SOHO use increased in value and volume terms year on year in Europe and Asia. Despite a drop in sales in Japan and the Americas due to falling sales prices, in terms of volume, Canon maintained more or less the same sales level as in 2010.

In laser printers, sales were affected by sluggish demand in Europe. Sales on a unit basis, however, exceeded the previous year's level because of growth in sales of printers, primarily monochrome offerings, in emerging countries, where demand is strong.

In large-format inkjet printers, sales in some regions stagnated due to the earthquake in Japan and financial problems in Europe. However, the overall growth rate for sales volume exceeded the industry average. There are two main factors for this firm performance. One is the expansion of sales realized through the cultivation of CAD markets in emerging countries. The other is the launch of the imagePROGRAF iPF8300S/iPF6300S. This latest release, featuring the LUCIA EX, a new pigment ink, helped boost sales in the poster and proofing markets.

As a result of the above, consolidated net sales in the Office Business Unit amounted to ¥1,917.9 billion, a year-on-year decline of 3.5%.

2012 INITIATIVES

In the market for office use, Canon will upgrade the lineup and increase sales of the imageRUNNER ADVANCE series. The Company will also promote its cloud business in collaboration with major companies in the field of IT and cloud businesses. By raising its profile as a solutions provider, meanwhile, Canon will strive to broaden its market share on a global scale. In the production printing market, Canon will draw on synergies generated by its alliance with Océ N.V. to reinforce and expand its business.

In laser printers, we will launch new products focusing primarily on models designed for high-volume printing, and continue efforts to increase market share and enhance profitability.

In large-format inkjet printers, the Company will strengthen its sales and marketing functions in emerging countries. At the same time, Canon will step up marketing activities in the poster and proofing markets. The Company will also target further sales expansion by launching competitive products while closely monitoring market and competitive trends.

CONSUMER BUSINESS UNIT

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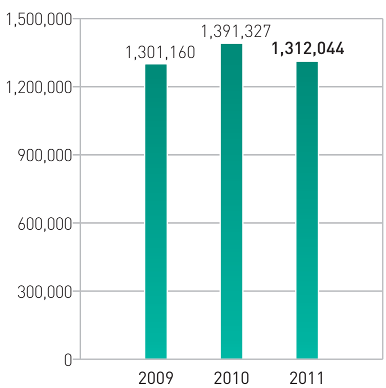
Canon's digital SLR cameras, which use groundbreaking technology such as proprietary lenses, CMOS sensors, and image processors, lead the world with their high image quality and contribute to sales.



NET SALES
(Millions of yen)

2011 REVIEW

In Japan, demand for digital single lens reflex (SLR) cameras slumped due to the Great East Japan Earthquake, although demand remained steady in other world markets. The downtrend in production levels caused by the earthquake had mostly ended by the summer of 2011. Canon worked hard to increase sales, centering on the entry-level model EOS Rebel T3i (EOS 600D in some areas), as well as the advanced-amateur model EOS 5D Mark II. Since November, Canon has also been affected by shortages in parts supplies due to floods in Thailand. Despite this and other setbacks during the period, on a full-year basis, sales of digital SLR cameras grew steadily in both value and volume terms.

Demand for compact digital cameras stayed stagnant in developed countries, but grew in emerging countries. Compact digital cameras that sold particularly well were the PowerShot ELPH 100 HS (IXUS 115 HS in some areas) and the PowerShot SX230 HS. Nonetheless, total sales of compact digital cameras declined year on year, in both volume and value terms, on the back of the earthquake in Japan and the shortage of parts supplies caused by the floods in Thailand.

The EOS Rebel T3i (EOS 600D in some areas) includes Scene Intelligent Auto (automatically selecting the most appropriate setting) and a Vari-Angle Clear View LCD monitor, enabling shooting from various angles.

The PowerShot ELPH 100 HS (IXUS 115 HS in some areas) delivers exceptional performance in low-light settings through the HS System, incorporating a CMOS sensor and DIGIC 4 image processor.

The PIXMA MG6200 series features enhanced basic performance, including a Quiet Mode and wireless LAN connectivity, and improved ease of use.

In digital camcorders, facing an overall downturn in market demand, Canon focused on sales of high-definition models, for which demand is expected to increase. These included the VIXIA HFR 21 (LEGRIA HFR 21 in some areas) and the VIXIA HFM 41 (LEGRIA HFM 41 in some areas).

In the broadcast equipment market, there was healthy demand for lenses for high-definition televisions, as well as an increase in portable lens sales volume. Accordingly, Canon retained its high market share.

In inkjet printers, the economic downturn in Europe and the effects of the earthquake in Japan and floods in Thailand adversely affected the market. Worldwide, sales of inkjet printers slightly declined from the previous year. In this environment, Canon introduced new products that meet diversifying needs, such as the PIXMA MG 6200 series, which is equipped with a Quiet Mode and has both cloud and Wi-Fi (wireless LAN) operation. Thanks to these efforts to strengthen the product lineup, sales volume of inkjet printers increased year on year. However, a fall in production caused by the Thai floods and the impact of the yen's appreciation inevitably resulted in a sales decrease in value terms. By contrast, sales of consumables remained strong.

In image scanners, Canon retained its top world market share amid contraction across the entire market.

As a result of the above, the Consumer Business Unit posted consolidated net sales of ¥1,312.0 billion, down 5.7% from the previous year.

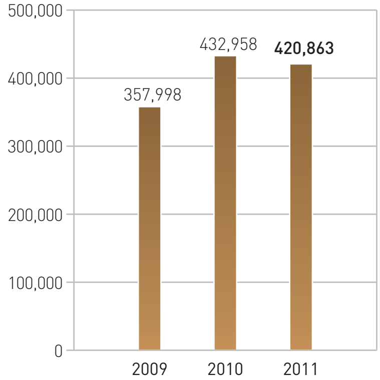
2012 INITIATIVES

In Hollywood and elsewhere in the motion picture industry, there is increasing demand for digital camcorders with superior image resolution, as well as a growing market for highly reliable interchangeable lenses with excellent image quality. Accordingly, Canon will expand its business targeting the commercial sector by focusing on enhancing its Cinema EOS System. Launched in 2011, this system features lenses and cameras for use in movie production.

Meanwhile, the retail photo-finishing service market is also showing an expansionary trend. This business includes over-the-counter and Web-based print-service business targeting the production of photo prints, photo albums and other high-value-added photo materials. Seeking to capitalize on this growing market opportunities, Canon will concentrate on expanding sales of the DreamLabo 5000. This commercial photo printer, featuring high productivity coupled with high-quality photos and detailed text, uses the inkjet method, which is ideally suited to the production of high-value-added photo materials.

INDUSTRY AND OTHERS BUSINESS UNIT

Canon, through its semiconductor lithography systems, achieves ever higher levels of performance and functionality to meet the strict cutting-edge demands of the industry, while focusing on the development of future technologies. These technologies also serve as a driving force behind Canon's optical and control technologies.



NET SALES
(Millions of yen)

2011 REVIEW

In semiconductor lithography systems, Canon enjoyed healthy demand for i-line steppers owing to brisk capital investment by makers of NAND-flash memory devices and image sensors, underpinned by strong demand for smartphones. Against this background, in July 2011 Canon released the FPA-5510iV i-line stepper, its first back-end semiconductor manufacturing tool. The new product is ideal for 3D packaging—a next-generation packaging technology. During the year, the Great East Japan Earthquake had some impact on production facilities in Japan, but the pace of restoration was greater than anticipated. Accordingly, sales of Canon's semiconductor lithography systems increased significantly, both in value and volume terms.

In LCD lithography systems, capital investment was solid in the industry of small and medium-size LCD panels because of the booming market for smartphones and other devices. However, due to weak capital investment in large-scale panels for TVs and the like, overall sales on LCD lithography systems declined year on year, both in value and volume terms.

In medical equipment, Canon released in succession new mainstay digital radiography systems, including CXDI-501C. The Company also enjoyed year-on-year increases, both in value and volume terms of the systems—centering on the CXDI-50 series and CXDI-70C Wireless—owing to healthy sales in the United

The FPA-5510iV, a back-end semiconductor lithography system, meeting the demand for integration on semiconductor devices while realizing high performance, can be used in 3D packaging.

The CXDI-501C, a new slim, lightweight digital radiography system, incorporates a convenient handle design for superior portability, enables quick imaging, and reduces X-ray exposure to patients.

The System-ELVESS features a fully automated manufacturing process, encompassing the vacuum vapor deposition of OLED materials through to encapsulation, realizing high productivity and expandability.

States and China. As for ophthalmic equipment, overall sales remained relatively unchanged from the previous year owing to efforts to boost sales of the CR-2 non-mydriatic retinal cameras, the new tonometer TX-20 and other products, combined with the positive effects of mainly the large business deal gained in Australia.

With respect to document scanners manufactured by Canon Electronics Inc., weak sales in the United States, due to a stagnating market for check scanners for financial institutions, were offset by increased sales in Japan and Europe. As a result, total sales of document scanners were largely unchanged from the previous year.

Sales of organic LED (OLED) panel manufacturing equipment made by Canon Tokki Corporation (formerly Tokki Corporation) increased dramatically year on year, thanks to proactive capital investment among OLED panel manufacturers.

There was a decline in sales of die bonders made by Canon Machinery Inc., as semiconductor device manufacturers curbed their capital investment. However, sales of FA system-related devices rose substantially owing to a continuation of solid orders received, mainly in China and South Korea, for rechargeable battery-related devices for automobiles.

Sales of magnetic head and disk thin-film deposition equipment made by Canon ANELVA Corporation declined year on year. However, sales of LED thin-film deposition equipment increased, and sales of semiconductor thin-film deposition equipment were maintained at previous-year levels.

As a result, consolidated net sales of the Industry and Others Business Unit amounted to ¥420.9 billion, down 2.8% from the previous year.

2012 INITIATIVES

Going forward, Canon will focus on the medical equipment and intelligent robot fields as core areas for new business expansion.

In the medical equipment field, Canon will strive to grow its digital radiography system business by delivering higher levels of precision, image quality, and sensitivity. At the same time, Canon will seek to broaden its presence in retinal cameras offering greater functionality. In addition, the Company will emphasize development of genetic diagnostic systems, as well as mammography equipment incorporating optical ultrasound technologies that both have minimal impact on the body and enable early detection of cancer and other conditions.

In intelligent robots, Canon will deploy a variety of recognition technologies amassed through its experience in cameras and office equipment—including face recognition, character recognition, and image retrieval technologies—to develop Super Machine Vision (vision system for automatic production robots handling assembly and inspection processes), which is superior to human vision system. Canon will also consider future sales to third parties and step up related initiatives.

2011 TOPICS

OFFICE BUSINESS UNIT

CANON AND OCÉ UNVEIL SUCCESSION OF JOINTLY DEVELOPED PRODUCTS

Since Canon welcomed the Dutch company Océ N.V. into the Canon Group in 2010, Canon has been working to strengthen its business foundation by building a powerful, complementary relationship with Océ covering both technologies and products. In 2011, Canon and Océ unveiled a succession of jointly developed products. They include the imagePRESS C7010VPS series of digital production printing systems and the imageRUNNER ADVANCE C9000S PRO series of color network multifunction devices (MFDs) incorporating an Océ-made printer controller, and a series of monochrome production printing systems that combines a new engine developed by Océ with a high-performance Canon scanner. Through ongoing collaboration with Océ, Canon will continue strengthening its product lineup in the production printing market to deliver solutions that meet a wide range of needs.

imageRUNNER ADVANCE C9000S PRO series

CONSUMER BUSINESS UNIT

AIMING TO CREATE A NEW COMMERCIAL PHOTO PRINTER MARKET, CANON LAUNCHES A NEW BRAND "DreamLabo"

The proliferation of digital cameras has sparked a rapid increase in the number of photos taken, leading to a rise in the use of Internet-based services for ordering photo albums and other merchandise. Demand for high-quality print-on-demand (POD) systems that can produce high-resolution photos together with high-quality text is also expected to increase. Against this background, Canon launched its DreamLabo 5000 commercial photo printer. Here, Canon leveraged its inkjet technologies amassed over many years—including its FINE (Full-photolithography Inkjet Nozzle Engineering) high-precision print head technology—and has achieved further advances to deliver photo images with a level of color representation*1 that is on the whole superior to that of silver halide systems, along with high-definition text. DreamLabo's exceptional productivity enables high-speed printing of the contents of a 20-page A4-size photo album in just 72 seconds.*2

DreamLabo 5000

*1 Compared with conventional silver halide photos. Based on Canon research.

*2 A completed photo album requires a separate bookbinding process.

CONSUMER BUSINESS UNIT

FULL-FLEDGED ENTRY INTO MOTION PICTURE PRODUCTION MARKET IN HOLLYWOOD

In recent years, the motion picture industry has seen advances in digitization and image resolution. Canon has already earned accolades for the exceptional image quality and sublime imaging expression offered by "EOS MOVIES," which utilizes its EOS digital SLR cameras and its wide array of EF lenses, and has been used in Hollywood movie production. Against this background, Canon launched the Cinema EOS System in November 2011. This system enables expressive images of exceptional quality, thanks to its combination of high-performance components. These include a diverse lineup of interchangeable lenses compatible with 4K resolution (the next-generation high-definition standard), a digital video camcorder equipped with a large CMOS sensor that delivers image resolution of approximately 8.29 megapixels, and a next-generation digital SLR camera with a 4K video recording function. The launch of the Cinema EOS System provides Canon with a platform for expanding into the broader field of cinematographic lenses and cameras.


Cinema EOS System

INDUSTRY AND OTHERS BUSINESS UNIT

CANON ENHANCES CXDI-SERIES DIGITAL RADIOGRAPHY SYSTEM LINEUP

Since releasing the world's first digital radiography system in 1998, Canon has made significant contributions to the digital evolution in diagnostic imaging. In 2011, Canon introduced a succession of new products to the medical imaging market. For example, Canon released four models in the new CXDI-401 series of stationary full-size systems, which can be used without the need to substantially modify existing analog imaging diagnostic equipment. Canon also launched the slim, lightweight, portable CXDI-501C/501G fitted with a convenient handle, as well as the CXDI-80C Wireless, an 11 x 14-inch, cassette-sized model that can transmit image data wirelessly. Canon's digital radiography systems enable high image quality and high-resolution diagnostic imaging with reduced X-ray exposure for patients. In addition to hospital-based X-ray imaging, these systems will be used in a variety of settings, including mobile health care vehicles and at the scene of disasters.


CXDI-80C Wireless

CORPORATE GOVERNANCE

Canon maintains sound corporate governance as part of efforts to maximize its stockholders' value and become a truly excellent global corporation.

The *San-ji* ("Three Selfs") spirit are an important guiding principle to become a truly excellent global corporation.

BASIC POLICY AND CORPORATE GOVERNANCE STRUCTURE

Canon recognizes that management supervision functions and management transparency are vital to strengthening its corporate governance 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 internal auditing structure underpinned by 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. As of December 31, 2011, the board consisted of 19 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 management system by business unit, facilitate efficient decision making and realize a mutual supervisory function for such matters as compliance and ethics.

Directors & Corporate Auditors (as of December 31, 2011)

Chairman & CEO

Fujio Mitarai

President & COO

Tsuneji Uchida

Executive Vice President & CFO

Toshizo Tanaka
Senior General Manager, External Relations Center
Senior General Manager, Corporate Communications Center
Group Executive, Finance & Accounting Headquarters
Vice Chairman, Supervisory Board of Océ N. V.

Executive Vice President & CTO

Toshiaki Ikoma
Group Executive, Corporate R&D

Senior Managing Directors

Kunio Watanabe
Group Executive, Corporate Planning Development Headquarters

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

Yasuo Mitsuhashi
Chief Executive, Peripheral Products Operations

Shigeyuki Matsumoto
Group Executive, Device Technology Development Headquarters

Managing Directors

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

Masahiro Osawa
Group Executive, Global Procurement Headquarters
Group Executive, General Affairs 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

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

Masaya Maeda
Chief Executive, Image Communication Products Operations

Directors

Yasuhiro Tani
Group Executive, Digital Platform Technology Development Headquarters

Makoto Araki
Group Executive, Information & Communication Systems Headquarters

Corporate Auditors

Keijiro Yamazaki

Shunji Onda

Tadashi Ohe *(Outside)*

Kazunori Watanabe *(Outside)*

Kuniyoshi Kitamura *(Outside)*

Governance Structure (as of December 31, 2011)

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 15 as of December 31, 2011.

AUDITING SYSTEM

Canon has five corporate auditors, including three outside corporate auditors who have no personal, capital or business affiliations with the Company. Canon has notified the stock exchanges in Tokyo, Osaka, Nagoya, Fukuoka and Sapporo of the designation of these outside corporate auditors as independent auditors, as provided under the regulations of the stock exchanges. Corporate auditors' duties include attending meetings of the Board of Directors and of the Executive Committee, 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 Internal Control Committee is responsible for Groupwide internal controls, including securing credibility of 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, 2011, internal control over financial reporting has been assessed as effective by the management and an independent registered public accounting firm. (Please refer to pages 97 and 99.)

At Group companies worldwide, employees carry with them compliance cards.

OTHER 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 "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

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 stockholders 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 stockholder approval. Pursuant to the Corporation Law, the stockholders 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 com-makes decisions regarding information disclosure, including necessity, content and timing. The Disclosure Committee makes such decisions after receiving reports on information that might need to be disclosed 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 company 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 various 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.

pensation 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 stockholders elect the corporate auditors by resolution of a general meeting of shareholders. The Company currently has five corporate auditors, although the minimum number of corporate auditors required pursuant to the Corporation Law is three.

Unlike the NYSE Corporate Governance Rules, Japanese laws and regulations, including the Corporation Law, do not require corporate auditors to be experts in accounting or to have any other area of expertise. Under the Corporation Law, a board of corporate auditors may determine the auditing policies and methods for investigating the business and assets of a company, and may resolve other matters concerning the execution of the corporate auditor's duties. The Board of Corporate Auditors prepares auditors' reports and may veto a proposal for the nomination of corporate auditors, accounting auditors and the determination of the amount of compensation for the accounting auditors put forward by the Board of Directors.

Under the Corporation Law, the half or more of a company's corporate auditors must be "outside" corporate auditors. These are individuals who are prohibited to have ever been a director, executive officer, manager, or employee of the Company or its subsidiaries. The Company's current corporate auditor system meets these requirements. In addition, pursuant to the regulations of the Japanese stock exchanges, the Company is required to have one or more "independent director(s) or independent corporate auditor(s)" which terms are defined under the relevant regulations of the Japanese stock exchanges as "outside directors" or "outside corporate auditors" (each of which terms is defined under the Corporation Law) who are unlikely to have any conflict of interests with shareholders of the Company.

Among the five members on the Company's board of auditors, three are outside corporate auditors. In addition, all such three outside corporate auditors are also qualified as independent corporate auditors under the regulations of the Japanese stock exchanges.

The qualifications for an "outside" or "independent" corporate auditor under the Corporation Law or the regulations of the Japanese stock exchanges are different from the audit committee independence requirement under the NYSE Corporate Governance Rules.

4. Shareholder Approval of Equity Compensation Plans

The NYSE Corporate Governance Rules require that shareholders be given the opportunity to vote on all equity compensation plans and any material revisions of such plans, with certain limited exceptions. Under the Corporation Law, a company is required to obtain stockholder approval regarding the stock options to be issued to directors and corporate auditors as part of remuneration of directors and corporate auditors.

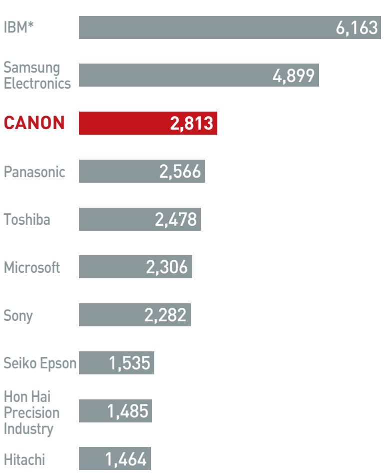
RESEARCH & DEVELOPMENT

Seeking new possibilities for Canon, the Company is establishing R&D structures in Japan, the United States, and Europe under a Three Regional Headquarters management system. At the same time, Canon will develop the medical and industrial fields into new business pillars.

Deleted due to portrait rights.

Canon is actively advancing research and development activities, which may take a relatively long time. For example, the Company is currently engaged in the development of next-generation printing material technology.

2011 TOP TEN U.S. PATENT HOLDERS BY COMPANY



* IBM is an abbreviation for International Business Machines Corporation.

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

EXPANSION OF OUR INNOVATION CENTERS

Canon's growth to date has been attributable to employing strong technologies to develop competitive products, mainly in Japan, and then disseminating those offerings around the world. Going forward, the Company will set up innovation centers in Europe and the United States as well, laying the foundation for the Three Regional Headquarters management system that Canon envisions.

In the United States, Canon will set up centers to pursue activities ranging from research into fundamental technologies in healthcare and other new business fields to the application of cutting-edge technologies. In Europe, the Company will reinforce R&D on business products, spearheaded by Océ N.V., in addition to R&D in new business fields.

R&D EXPENSES AND PATENTS

Canon is bolstering R&D activities to enable the ongoing development of innovative products and services. In the year under review, R&D expenses amounted to ¥307.8 billion, down 2.5%, or ¥8.0 billion, from the previous year. The ratio of R&D expenses to net sales was 8.7%. By segment, the Company allocated ¥103.4 billion (33.6% of total R&D expenses) to the Office Business

Canon succeeded in developing an ultra-large-scale CMOS image sensor, which is expected to be used in surveillance cameras for night use and other applications.

Canon U.S. Life Sciences, Inc. is Canon's base for research and development of groundbreaking genetic diagnostic systems in the United States, where genetic diagnosis is gaining momentum.

Unit, ¥82.7 billion (26.9%) to the Consumer Business Unit, and ¥27.1 billion (8.8%) to the Industry and Others Business Unit. Basic R&D expenses not allocated to specific business units amounted to ¥94.6 billion (30.7%). This focus on R&D activities has cemented Canon's high status in the field of intellectual property. In 2011, Canon was granted 2,813 patents in the United States.

REINFORCING CORE TECHNOLOGIES

Canon is concentrating efforts on pre-competitive fields, involving research that can take more than ten years. At the same time, the Company is continually bolstering activities centered on key components and key devices in order to enhance the competitiveness of its products. In 2011, a telescope equipped with Canon's world-class ultra-high sensitivity CMOS image sensor, measuring around 20 cm by 20 cm, made the world's first video recording of meteors in dark conditions with an equivalent apparent magnitude of 10.

MEDICAL AND INDUSTRIAL EQUIPMENT

Canon is drawing on its imaging technologies, amassed over many years, to diversify into the medical imaging field. Recently, the Company provided Kyoto University with a donation to establish the Clinical Research Center for Medical Equipment Development (CRCMeD), founded in 2011. Under the Kyoto University/Canon Joint Research Project, the Center is accelerating clinical research into the use of an optical ultrasound mammography system in breast cancer examinations. Because it does not expose patients to radiation, this method significantly reduces the physical effects on patients. Our R&D base in the United States is undertaking research on genetic diagnostic systems with the aim of establishing practical applications for these systems in the near future. In addition to the current joint research project with the University of Utah, we commenced joint research with the University of Maryland in 2011, in order to nurture future technologies.

In the field of factory automation, Canon is working to realize intelligent robots for industrial applications. One technology being developed for these robots is Super Machine Vision, which employs cutting-edge image recognition and image measuring technologies to realize vision that is superior to human vision. Canon is also considering applying such technologies to the areas of hazard prediction and elderly nursing care.

In addition, by applying Mixed Reality (MR) technology—an imaging technology that seamlessly integrates the real and virtual worlds in real time—Canon is aiming to commercialize development and manufacturing solutions for application in design and manufacturing operations.

PRODUCTION

In addition to establishing a globally optimized production system, Canon seeks improved quality and productivity by putting a priority on conducting production operations itself to ensure the progress of its manufacturing expertise.

Canon Virginia Inc. realizes a "Made in America" production model for toner cartridges, which promotes "manufacturing in the local market."

Canon's "man-machine cell" production integrates automated equipment into the cell production system. (Nagasaki Canon Inc.)

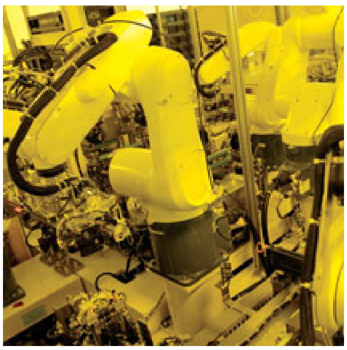
ESTABLISHING A GLOBALLY OPTIMIZED PRODUCTION SYSTEM

Canon aims to establish a globally optimized production system that identifies the most suitable locations worldwide for the production of individual products based on a comprehensive assessment of various considerations. These factors include cost, taxation, logistics, the ease of parts procurement, and the workforce. An optimized system will lead to additional improvements in productivity for the entire Canon Group.

In the United States, for example, Canon has implemented a business model for toner cartridges that incorporates everything from automated production to sales, collection, and recycling at the point of consumption of its products. Canon is considering to apply this model in Europe and Asia as well.

BOLSTERING PRODUCTION CAPACITY

Under the globally optimized production system, Canon is working to reinforce its production structure on a global scale in anticipation of growth in product demand.



Canon is aiming to achieve fully automated production that realizes high quality and stable operation 24 hours a day, 365 days a year.

In 2011, Canon Hi-Tech (Thailand) Ltd. commenced operations at its new inkjet printer plant, and Hita Canon Materials Inc. began construction of a toner cartridge parts and toner plant, which is scheduled to start operation sometime in 2012.

IMPROVING PRODUCTIVITY

By putting a priority on conducting production operations itself, Canon seeks to raise quality and reduce costs through progress in manufacturing by making full use of the expertise and insights of individual workers engaged in production. To this end, the Company has adopted a cell production system—an approach that fully utilizes the creativity of individual workers. Canon continues to improve productivity by making efforts to increase production efficiencies in cell production while rolling out "man-machine cell" production systems that integrate manual and automated processes.

In addition to increasing the rate of automation in the production of toner cartridges, Canon will be promoting automated production of other items that lend themselves to this method.

Until now, Canon has been undertaking the production of image sensors and other key components and devices in-house. Due to shortages of some components as a result of the Great East Japan Earthquake and the floods in Thailand, Canon is escalating the shift to in-house production while assessing the importance of individual components.

Meanwhile, by implementing IT innovations that link development, design, production, logistics, and sales and seek to achieve further efficiencies, Canon aims to establish advanced supply chain management that is capable of withstanding fluctuations in demand.

BELIEF IN "INTERNAL PRODUCTION"

In-House Production	Automation	Man-Machine Cell
• Cost Reduction • Product Differentiation • Technology Protection • Production Flexibility • Lead Time Reduction • Quality Improvement	• Production Efficiency Improvement • Production Localization	• Production Efficiency Improvement • Cost Reduction from Design Phase • Lead Time Reduction • Further Automation
Internal Production		

QUALITY FIRST

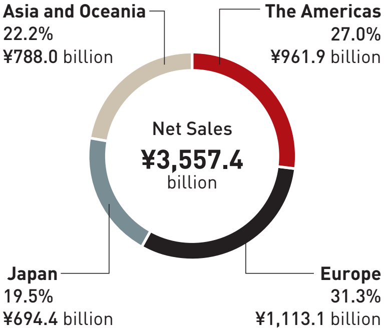
As a manufacturer, quality is Canon's most important lifeline. With the goal of further improving product quality, Canon is working to control quality defects by focusing on actual numbers instead of percentages, with the aim of integrating company-wide management and analysis. Canon will continue pursuing optimal quality through close collaboration between the production and development departments, in order to create designs that expedite manufacturing, as well as by making the most of quality improvement initiatives being implemented by workers on the factory floor.

SALES & MARKETING

Canon bolsters its sales and marketing capabilities by providing advanced solutions and innovative products tailored to meet the characteristics of each region.

Canon launched Cinema EOS System, and has opened the Canon Hollywood Professional Technology & Support Center for professionals in the motion picture and television industries.

CONSTITUTION OF SALES BY REGION



GENERAL REVIEW

In all existing core businesses, Canon is strengthening its sales, marketing, and service functions by responding to actual conditions based on analyses of the features of each region.

In 2011, Canon focused on expanding sales in emerging countries and resource-producing countries that are experiencing significant economic growth. In China, Canon increased its sales force and implemented various other measures aimed at boosting sales.

Canon has been expanding its businesses by taking full advantage of the products and sales network of Océ N.V. on a global scale. Canon made efforts to market globally a standardized Canon Managed Document Services (Canon MDS), a comprehensive document management service that creates optimal document input-output environments for customers, targeting global companies as its main customers. At the same time, Canon has engaged in a cloud-based solutions business by offering a document management service using a cloud platform, and other services.

At Graphispag 2011, an international print media trade fair held in Barcelona, Canon and Océ shared a booth, displaying their lineup of products and solutions.

Deleted due to portrait rights.

Canon China's showroom in Beijing displays Canon's latest products, including hands-on demonstration by staff members.

THE AMERICAS

In the year under review, sales in the Americas totaled ¥961.9 billion (27.0% of consolidated net sales).

In April 2011, Canon established a solutions business subsidiary, Canon Information and Imaging Solutions, Inc., in the United States. In addition to Canon's existing documentation-oriented solutions, the new company will pursue broader solutions, including IT-based applications. Canon Information and Imaging Solutions seeks to enhance customer service value and expand its customer base by cultivating previously untapped markets.

EUROPE (EUROPE, THE MIDDLE EAST AND AFRICA)

Sales in Europe amounted to ¥1,113.1 billion (31.3% of consolidated net sales).

In 2011, Canon Europe Ltd. further strengthened its sales and marketing functions in emerging markets, such as Russia and Turkey, by increasing its sales force in those markets and through other measures. Accordingly, Canon Europe steadily expanded its business in those markets. In addition, Canon Europe has expedited expansion of Canon's solutions business by focusing on Canon's proprietary Managed Print Services (MPS), and stepping up sales of uniFLOW, a unified print and scan platform solution that now has smartphone connectivity.

ASIA AND OCEANIA

In Japan, sales totaled ¥694.4 billion (19.5% of consolidated net sales), while sales in Oceania and Asia (excluding Japan) amounted to ¥788.0 billion (22.2% of consolidated net sales).

In Japan, initiatives to bolster Canon's solutions business included the establishment of an organization dedicated to cloud service and the launch of a cloud-based document management service ahead of other developed countries.

In China and Southeast Asia, Canon worked hard to further expand its sales networks and offer an extensive product lineup amid continued steady growth in each market. As a result, it achieved a double-digit increase in sales for the entire Asian region compared with the previous year.

In Australia's challenging business environment, Canon worked to improve the efficiency of sales activities and increase the market share of its products in the local market.

CORPORATE SOCIAL RESPONSIBILITY

Canon is promoting CSR activities with the aim of becoming a truly excellent global corporation that is admired and respected the world over.

Under the Canon—Green Library for Kids program, which is part of the Canon—For a Green Vietnam project, Canon has donated more than 40,000 used books to elementary and junior high schools in Vietnam.

CANON'S BASIC APPROACH TO CSR

Canon recognizes that its corporate activities are supported by the development of society as a whole, and contributes to the realization of a better society as a good corporate citizen, effectively leveraging its advanced technological strengths, global business deployment, and diverse, specialized human resources.

ENVIRONMENTAL ACTIVITIES

In line with "Action for Green," the Canon Environmental Vision, Canon strives to support both enriched lifestyles and the global environment. As an environmentally advanced corporation, we are steadily working to cut CO_2 emissions and use resources effectively over the entire product lifecycle while providing customers improved functionality and ease of use. In 2011, we rolled out new software called the Ecology Information Plug-in*. This software allows the monitoring of power consumption and CO_2 emissions of office-use MFDs and laser printers.

In 1990, Canon established Toner Cartridge Collection and Recycling Program—an unthinkable initiative in the electronic devices field at the time—and has achieved the recycling of used cartridges collected without using them for landfill.

Canon is also engaged in various initiatives aimed at protecting the environment, tackling important environmental issues such as biodiversity and global warming.

* The Ecology Information Plug-in is available as an option with Canon's imageWARE Enterprise Management Console network device management utility.

The WWF-Canon Polar Bear Tracker project has revealed new evidence that indicates the progressive melting of Arctic ice.
© Angela Plumb/WWF-Canon

WWF-Canon Polar Bear Tracker

Canon Europe Ltd. became WWF (World Wide Fund for Nature)'s conservation partner in 1998. Since 2007, we have been promoting the WWF-Canon Polar Bear Tracker project, which tracks the movements of polar bears in the Arctic by satellite as a means of studying the impact of global warming. As part of the project, the WWF and Canon Europe have established a polar bear-themed environmental education website for children to increase children's awareness of global environmental conservation.

Continued Support for the Canon Envirothon in North America

Since 1998, Canon U.S.A., Inc. has been a sponsor of the Canon Envirothon, an environmental contest for high school students. With more than 500,000 teenagers taking part in the Canon Envirothon each year, it has grown into one of the largest contests of its kind in North America. Participants deepen their understanding of the natural environment through hands-on fieldwork and other activities.

The top ten teams in Canon's Envirothon, an environmental contest, are awarded Canon scholarships, to fund further study.

SOCIAL CONTRIBUTION ACTIVITIES

Canon conducts wide-ranging social contribution activities in all parts of the world, as a "good corporate citizen."

Providing Aid to Areas Hit by the Great East Japan Earthquake

Following the Great East Japan Earthquake that occurred in March 2011, Canon has been providing support for restoration and reconstruction efforts through a variety of activities. In addition to making monetary donations, we have donated Canon products such as five portable digital radiography systems given to the Japanese Red Cross Society to support medical efforts. We also donated office equipment and refrigerated containers to support the recovery of the fishing industry in cooperation with the "Signal of Hope" project.

In 2011, under the "Tsuzuri Project," Canon donated to Kennin-ji temple in Kyoto high-resolution facsimiles it had made of 20 sliding panels belonging to the temple's collection. The panels, which have been designated as "Important Cultural Property," comprise 16 panels of the "Seven Sages in a Bamboo Grove" series and four panels of the "Landscapes" series.

The Tsuzuri Project

Canon and the non-profit organization Kyoto Culture Association jointly promote a project called the "Tsuzuri Project" (Official title: Cultural Heritage Inheritance Project). The aim of the project is to blend Canon's latest digital technology and traditional Japanese crafts, such as gold leaf craftwork, to create high resolution facsimiles of folding screens and other ancient Japanese cultural assets, while keeping the original cultural assets in more favorable environments. In 2011, reproductions of six assets were donated to temples and museums. In the four years since the launch of the project in 2007, a total of 21 cultural assets have been reproduced and donated.

Canon Vietnam's "For a bright future" Scholarship Program

In 2011, Canon Vietnam Co., Ltd. continued implementing a scholarship project, "For a bright future" program, for secondary school students in underprivileged regions. This program is aimed at helping and encouraging underprivileged students to continue studying. Thanks to this program, in 2011, 600 underprivileged students received Canon scholarships, covering educational and living expenses.

ADDRESSING THE ISSUE OF CONFLICT MINERALS

The term "conflict minerals" refers to certain minerals originating in the Democratic Republic of the Congo and adjoining countries in Africa, the profit from the trade of which, provided through the global supply chain, is alleged to be funding armed groups in that region. There is growing concern worldwide about the issue of conflict minerals. In the United States, for example, legislation has been enacted requiring publicly listed companies to disclose their usage of such minerals.

Canon began investigations into conflict minerals in 2010 and established a project team at its headquarters in 2011. In these ways, the Company is working to create a framework for responding to legal regulations and guidelines from international organizations. Seeking to ensure that customers use Canon's products with peace of mind, the Company is working together with business partners and industry entities to identify the history of minerals used in its products with the aim of avoiding the use of conflict minerals.

Canon invites engineers and technicians from production sites in Southeast Asia and China to the Manufacturing Training Center in Japan to take part in training programs.

CULTIVATING DIVERSE HUMAN RESOURCES

In order to achieve sustainable globalization, Canon must work constantly to cultivate a talented workforce. Canon has established a management training program to train executives, and help them to upgrade their skills and strengthen their sense of mission. Given our priority to keep production in-house, it is important for us to cultivate personnel with world-class skills and expertise on a global scale.

FINANCIAL SECTION

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

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

Economic environment

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

Market environment

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

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

Summary of operations

Owing to the historically high valuation of the yen combined with the effects of the earthquake and floods, all of Canon's businesses faced extremely demanding conditions throughout the year. Amid this harsh environment, Group-wide efforts to swiftly restore production in the aftermath of the disasters, coupled with efforts to maximize production and boost sales, led to net sales for the year totaling ¥3,557.4 billion (U.S.$45,608 million), a year-on-year decline of 4.0%. Despite the significant negative impact of the strong yen and the effects of the earthquake and floods, the gross profit ratio rose 0.7 points year-on-year to 48.8%, owing to the further acceleration of production innovation activities. Gross profit, however, decreased by 2.6% to ¥1,736.8 billion (U.S.$22,266 million) for the year. Operating expenses totaled ¥1,358.7 billion (U.S.$17,419 million), a decrease of 2.6%, owing to comprehensive spending cuts across the Canon Group implemented after the earthquake to control expenses more efficiently. Cost-reduction and expense-cutting activities contributed to further reinforcing the company's financial structure, which helped make up for the significant drop in revenue in the first half of the year mainly triggered by the earthquake, while also absorbing the financial impact of the strong yen and the floods in the second half of the year. As a result, operating profit dipped 2.4% to ¥378.1 billion (U.S.$4,847 million) for the year and other income (deductions) declined ¥8.9 billion (U.S.$114 million), mainly due to foreign currency exchange losses, leading to income before income taxes of ¥374.5 billion (U.S.$4,802 million), a decrease of 4.7% year-on-year. Net income attributable to Canon Inc., however, grew by 0.8% to ¥248.6 billion (U.S.$3,188 million) for the year owing to the lower effective income tax rate compared with the previous year.

Key performance indicators

The following are the key performance indicators ("KPIs") that

Canon uses in managing its business. The changes from year to year in these KPIs are set forth in the table shown on page 39.

Revenues

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

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

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

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

Cash flow management

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

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

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

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

KEY PERFORMANCE INDICATORS

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue recognition

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

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

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

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

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

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

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

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

Allowance for doubtful receivables

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

Valuation of inventories

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

Impairment of long-lived assets

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

Property, plant and equipment

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

Goodwill and other intangible assets

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

Income taxes

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

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

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

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

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

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

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen					Thousands of U.S. dollars
	2011	change	2010	change	2009	**2011**
Net sales	**¥3,557,433**	**-4.0%**	¥3,706,901	+15.5%	¥3,209,201	**$45,608,115**
Operating profit	**378,071**	**-2.4%**	387,552	+78.6%	217,055	**4,847,064**
Income before income taxes	**374,524**	**-4.7%**	392,863	+79.1%	219,355	**4,801,590**
Net income attributable to Canon Inc.	**248,630**	**+0.8%**	246,603	+87.3%	131,647	**3,187,564**

Sales

Canon's consolidated net sales in fiscal 2011 totaled ¥3,557,433 million (U.S.$45,608 million), representing a 4.0% decrease from the previous fiscal year. This decrease of sales was owing to the historically high valuation of the yen combined with the effects of the earthquake and floods. All of Canon's businesses faced extremely demanding conditions throughout the year.

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

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

Cost of sales

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

Gross profit

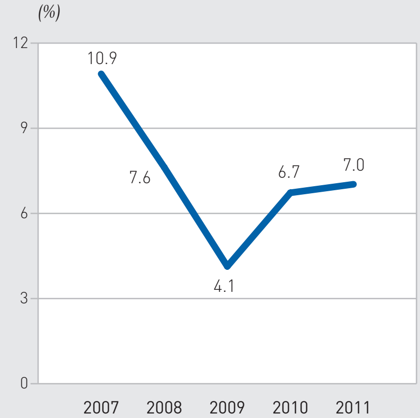
Canon's gross profit in fiscal 2011 decreased by 2.6% to ¥1,736,763 million (U.S.$22,266 million) from fiscal 2010. The gross profit ratio, however, rose by 0.7 points year on year to 48.8%. Despite the significant negative impact of the strong yen and the effects of the earthquake and floods, this gross profit ratio improvement was achieved due to the further acceleration of production innovation activities.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Owing to thorough spending cuts across the Canon Group implemented after the earthquake to control expenses more

RETURN ON SALES

(%)



efficiently, total operating expenses decreased by 2.6% to ¥1,358,692 million (U.S.$17,419 million) in fiscal 2011.

Operating profit

Operating profit in fiscal 2011 decreased 2.4% to a total of ¥378,071 million (U.S.$4,847 million) from fiscal 2010. The ratio of operating profit to net sales increased 0.1% to 10.6% from fiscal 2010.

Other income (deductions)

Other income (deductions) for fiscal 2011 decreased ¥8,858 million (U.S.$114 million) to ¥(3,547) million (U.S.$45 million), mainly due to foreign currency exchange losses and earnings and losses on investments in affiliated companies.

Income before income taxes

Income before income taxes in fiscal 2011 was ¥374,524 million (U.S.$4,802 million), a decrease of 4.7% from fiscal 2010, and constituted 10.5% of net sales.

Income taxes

Provision for income taxes in fiscal 2011 decreased by ¥19,745 million (U.S.$253 million) from fiscal 2010. The effective tax rate during fiscal 2011 dropped by 3.5% compared with fiscal 2010.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in fiscal 2011 increased by 0.8% to ¥248,630 million (U.S.$3,188 million), which represents a 7.0% return on net sales.

Segment information

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

•**The Office Business Unit** mainly includes Office network digital MFDs / Color network digital MFDs / Personal-use network digital MFDs / Office copying machines / Full-color copying machines / Personal-use copying machines / Laser printers / Large format inkjet printers/ Digital production printers

•**The Consumer Business Unit** mainly includes Digital SLR cameras / Compact digital cameras / Interchangeable lenses / Digital video camcorders / Inkjet multifunction printers / Single function inkjet printers / Image scanners / Broadcast equipment/ Calculators

•**The Industry and Others Business Unit** mainly includes Semiconductor lithography equipment / LCD lithography equipment / Medical image recording equipment / Ophthalmic products / Magnetic heads / Micromotors / Computers / Handy terminals / Document scanners

Sales by segment

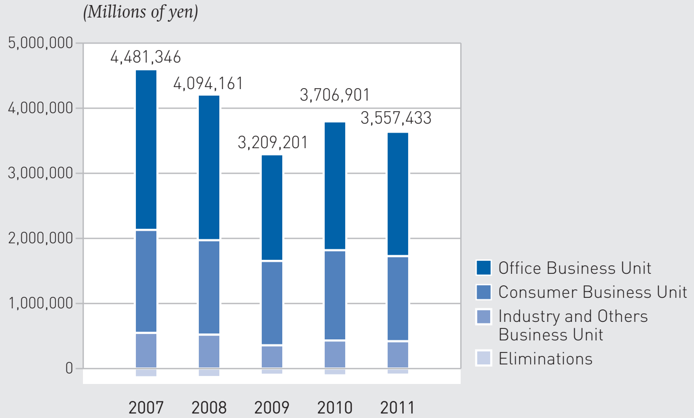
Please refer to the table of sales by segment in Note 23 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

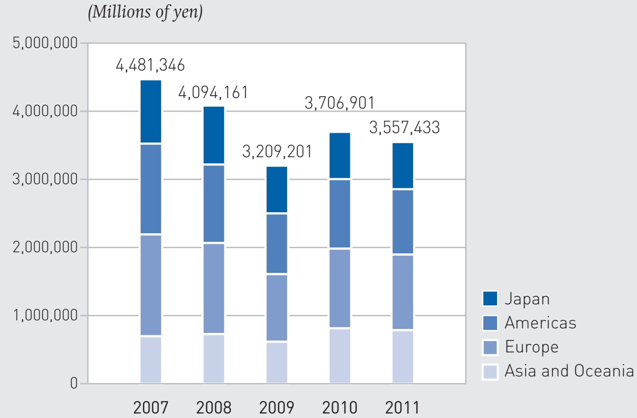
SALES BY SEGMENT

	Millions of yen					*Thousands of U.S. dollars*
	2011	change	2010	change	2009	**2011**
Office	**¥1,917,943**	**-3.5%**	¥1,987,269	+20.8%	¥1,645,076	**$ 24,589,013**
Consumer	**1,312,044**	**-5.7%**	1,391,327	+6.9%	1,301,160	**16,821,077**
Industry and Others	**420,863**	**-2.8%**	432,958	+20.9%	357,998	**5,395,679**
Eliminations	**(93,417)**	**—**	(104,653)	—	(95,033)	**(1,197,654)**
Total	**¥3,557,433**	**-4.0%**	¥3,706,901	+15.5%	¥3,209,201	**$ 45,608,115**

SALES BY SEGMENT
(Millions of yen)



SALES BY GEOGRAPHIC AREA
(Millions of yen)



Sales of the Office Business Unit constituting 53.9% of consolidated net sales. Sales volume of color and monochrome network digital MFDs continued to increase. As for laser printers, while booming demand in emerging economies fueled steady unit sales growth of primarily monochrome models in the first half of the year, demand slowed in the second half, mainly in European markets. However, the appreciation of the yen also significantly impacted sales for the segment, resulting a decrease in sales by 3.5% to ¥1,917,943 million (U.S.$24,589 million) in fiscal 2011.

Sales of the Consumer Business Unit constituting 36.9% of consolidated net sales. Although Canon was affected by supply shortages caused by the quake and flooding, efforts to ramp up production and boost sales in response to robust demand resulted in significant increases in year-on-year sales volumes for such digital SLR cameras as the competitively priced EOS Digital Rebel T3i/T2i/T3, along with the EOS 5D Mark II and the new EOS 60D advanced-amateur models. As for compact digital cameras, while such models as the PowerShot ELPH 100 HS/300 HS, PowerShot SX230 HS and PowerShot ELPH 310 HS recorded healthy sales, unit sales for the year declined due to sluggish markets in developed countries and the impact on production following the earthquake and floods. With respect to inkjet printers, although the floods in Thailand had a negative impact on production, unit sales increased year on year, largely owing to growth in emerging markets. As a result, sales for the segment, which were also negatively affected by the strong yen, dropped 5.7% in fiscal 2011 to ¥1,312,044 million (U.S.$16,821 million).

Sales of the Industry and Others Business Unit decreased by 2.8% in fiscal 2011, to ¥420,863 million (U.S.$5,396 million). Within this segment, i-line steppers recorded healthy sales thanks to active investment in semiconductor lithography equipment for the manufacture of digital semiconductor devices, which are used in smartphones and environmentally friendly products. Unit sales of LCD lithography equipment, on the other hand, dropped substantially in the face of shrinking demand for equipment used in the production of large-size panels. Sales of the Industry and Others Business Unit constituted 11.8% of consolidated net sales in fiscal 2011.

Intersegment sales of ¥93,417 million (U.S.$1,198 million), representing 2.6% of total sales, are eliminated from the total sales of the three segments, and are described as “Eliminations.”

Sales by geographic area

Please refer to the table of sales by geographic area in Note 23 of the Notes to Consolidated Financial Statements.

A geographical analysis indicates that net sales in fiscal 2011 decreased in all geographic areas.

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

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

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

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

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 23 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in fiscal 2011 decreased by ¥34,057 million (U.S.$437 million) to ¥259,265 million (U.S.$3,324 million). This decrease resulted primarily from the decrease in sales.

Operating profit for the Consumer Business Unit in fiscal 2011 decreased by ¥26,771million (U.S.$343 million) to ¥211,294 million (U.S.$2,709 million). This decrease resulted primarily from the decrease in sales.

Operating profit for the Industry and Others Business Unit in fiscal 2011 recorded a profit of ¥24,300 million (U.S.$312 million) a turnaround from fiscal 2010, largely owing to the improvement of the gross profit ratio.

SALES BY REGION

	Millions of yen					*Thousands of U.S. dollars*
	2011	change	2010	change	2009	**2011**
Japan	**¥ 694,450**	**-0.2%**	¥ 695,749	-0.9%	¥ 702,344	**$ 8,903,205**
Americas	**961,955**	**-6.0%**	1,023,299	+14.4%	894,154	**12,332,756**
Europe	**1,113,065**	**-5.1%**	1,172,474	+17.8%	995,150	**14,270,064**
Asia and Oceania	**787,963**	**-3.4%**	815,379	+32.0%	617,553	**10,102,090**
Total	**¥3,557,433**	**-4.0%**	¥3,706,901	+15.5%	¥3,209,201	**$45,608,115**

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

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

The operating profit on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. Please refer to the table of geographic information in Note 23 of the Notes to Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents in fiscal 2011 decreased by ¥67,352 million (U.S.$863 million) to ¥773,227 million (U.S.$9,913 million), compared with ¥840,579 million in fiscal 2010 and ¥795,034 million in fiscal 2009. Canon's cash and cash equivalents are typically denominated both in Japanese yen and in U.S. dollar, with the remainder denominated in foreign currencies.

Net cash provided by operating activities in fiscal 2011 decreased by ¥274,851 million (U.S.$3,524 million) from the previous year to ¥469,562 million (U.S.$6,020 million). Cash flow from operating activities consisted of the following key components: the major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, and income taxes.

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

Net cash used in investing activities in fiscal 2011 was ¥256,543 million (U.S.$3,289 million), decreased by ¥85,590 (U.S.$1,097 million) million from ¥342,133 million in fiscal 2010, mainly as a result of corporate acquisition conducted in the previous year. The purchases of fixed assets, which totaled ¥238,129 million (U.S.$3,053 million) in fiscal 2011, were focused on items relevant to raising production capacity and reducing production cost.

Canon defines "free cash flow" by deducting the cash flows from investing activities from the cash flows from operating activities. For fiscal 2011, free cash flow totaled ¥213,019 million (U.S.$2,731 million) as compared with ¥402,280 million for fiscal 2010. Canon's management recognizes that constant and intensive investment in facilities and R&D is required to maintain and strengthen the competitiveness of its products. Canon's management seeks to meet its capital requirements with cash flow principally earned from its operations, therefore, its capital resources are primarily sourced from internally generated funds. Accordingly, Canon has included the information with regard to free cash flow as its management frequently monitors this indicator, and believes that such indicator is beneficial to the understanding of investors. Furthermore, Canon's management believes that this indicator is significant in understanding Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities. Canon refers to this indicator together with relevant U.S. GAAP financial measures shown in its consolidated statements of cash flows and consolidated balance sheets for cash availability analysis.

Net cash used in financing activities totaled ¥257,513 million (U.S.$3,301 million) in fiscal 2011, mainly resulting from the dividend payout of ¥152,784 million (U.S.$1,959 million), and repurchase of treasury stock. The Company paid dividends in fiscal 2011 of ¥125.00 (U.S.$1.60) per share.

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

Short-term loans (including the current portion of long-term debt) amounted to ¥8,343 million (U.S.$107 million) at December 31, 2011 compared with ¥7,200 million at December 31, 2010. Long-term debt (excluding the current portion) amounted to ¥3,368 million (U.S.$43 million) at December 31, 2011 compared with ¥4,131 million at December 31, 2010.

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

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

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

Increase in property, plant and equipment on an accrual basis in fiscal 2011 amounted to ¥226,869 million (U.S.$2,909 million) compared with ¥158,976 million in fiscal 2010 and ¥216,128 million in fiscal 2009. For fiscal 2012, Canon projects its increase in property, plant and equipment will be approximately ¥300,000 million (U.S.$3,846 million).

Employer contributions to Canon's worldwide defined benefit pension plans were ¥30,510 million (U.S.$391 million) in fiscal 2011, ¥21,435 million in fiscal 2010 and ¥18,232 million in fiscal 2009. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥12,511 million (U.S.$160 million) in fiscal 2011, ¥11,780 million in fiscal 2010, and ¥9,148 million in fiscal 2009.

Working capital in fiscal 2011 increased by ¥25,969 million (U.S.$333 million), to ¥1,259,457 million (U.S.$16,147 million), compared with ¥1,233,488 million in fiscal 2010 and ¥1,234,089 million in fiscal 2009. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for fiscal 2011 was 2.41 compared to 2.38 for fiscal 2010 and to 2.57 for fiscal 2009.

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

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

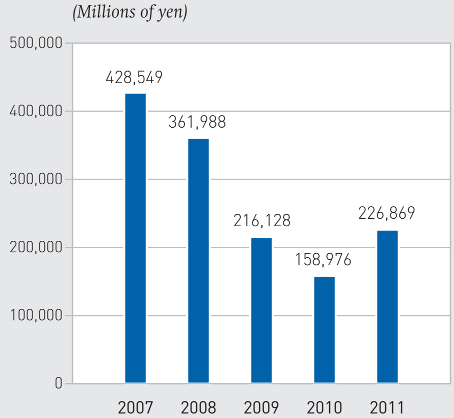
Debt to total assets ratio was 0.3%, 0.3% and 0.3% as of December 31, 2011, 2010 and 2009, respectively. Canon had short-term loans and long-term debt of ¥11,711 million (U.S.$150 million) as of December 31, 2011, ¥11,331 million as of December 31, 2010 and ¥9,781 million as of December 31, 2009.

OFF-BALANCE SHEET ARRANGEMENTS

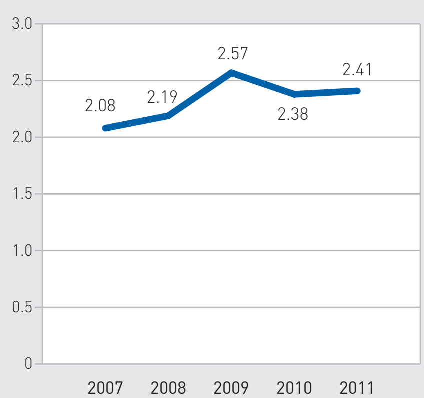
As part of its ongoing business, Canon does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating 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 1 year to 10 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥15,245 million (U.S.$195 million) at December 31, 2011. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees were insignificant.

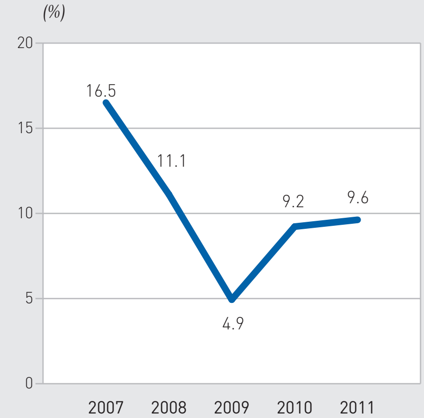
INCREASE IN PROPERTY, PLANT AND EQUIPMENT
(Millions of yen)



WORKING CAPITAL RATIO



RETURN ON CANON INC. STOCKHOLDERS' EQUITY
(%)



CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

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

		Payments due by period			
Millions of yen	***Total***	*Less than 1year*	*1-3 years*	*3-5 years*	*More than 5 years*
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**¥ 4,597**	¥ 2,026	¥ 2,055	¥ 398	¥ 118
Other long-term debt	**2,473**	1,676	605	164	28
Operating lease obligations	**72,798**	22,259	27,475	12,593	10,471
Purchase commitments for:					
Property, plant and equipment	**66,287**	66,287	—	—	—
Parts and raw materials	**75,823**	75,823	—	—	—
Other long-term liabilities:					
Contribution to defined benefit pension plans	**30,877**	30,877	—	—	—
Total	**¥252,855**	¥198,948	¥30,135	¥13,155	¥10,617

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 13, Income Taxes in the Notes to Consolidated Financial Statements for further details. Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

		Payments due by period			
Thousands of U.S. dollars	***Total***	*Less than 1year*	*1-3 years*	*3-5 years*	*More than 5 years*
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**$ 58,936**	$ 25,975	$ 26,346	$ 5,102	$ 1,513
Other long-term debt	**31,705**	21,487	7,756	2,103	359
Operating lease obligations	**933,308**	285,372	352,243	161,449	134,244
Purchase commitments for:					
Property, plant and equipment	**849,833**	849,833	—	—	—
Parts and raw materials	**972,090**	972,090	—	—	—
Other long-term liabilities:					
Contribution to defined benefit pension plans	**395,859**	395,859	—	—	—
Total	**$3,241,731**	$2,550,616	$386,345	$168,654	$136,116

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2011, accrued product warranty costs amounted to ¥11,691 million (U.S.$150 million).

At December 31, 2011, commitments outstanding for the purchase of property, plant and equipment were approximately ¥66,287 million (U.S.$850 million), and commitments outstanding for the purchase of parts and raw materials were approximately ¥75,823 million (U.S.$972 million), both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During fiscal 2012, Canon expects to contribute ¥21,946 million (U.S.$281 million) to its Japanese defined benefit pension plans and ¥8,931 million (U.S.$115 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

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

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

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

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

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

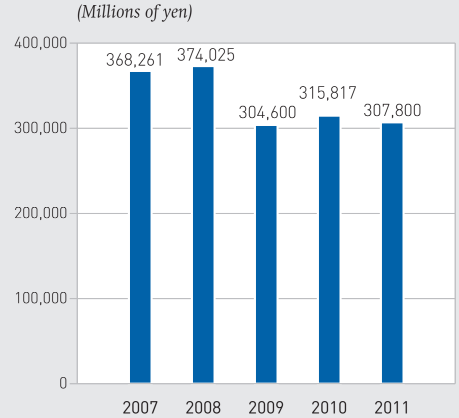
Canon has fully introduced 3D-CAD systems across the Canon group, boosting R&D efficiency to curtail product development times and costs. Moreover, Canon enhanced and evolved its simulation, measurement, and analysis technologies by establishing leading-edge facilities, including one of Japan's highest-performance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

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

Canon's consolidated R&D expenses were ¥307,800 million (U.S.$3,946 million) in fiscal 2011, ¥315,817 million in fiscal 2010 and ¥304,600 million in fiscal 2009. The ratios of R&D expenses to the consolidated total net sales for fiscal 2011, 2010 and 2009 were 8.7%, 8.5% and 9.5%, respectively.

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

R&D EXPENSES
(Millions of yen)



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, 2011 and 2010.

	Millions of yen		Thousands of U.S. dollars	
Available-for-sale securities	*Cost*	*Fair value*	*Cost*	*Fair value*
Due within one year	¥ 20	¥ 20	$ 256	$ 256
Due after one year through five years	962	926	12,333	11,872
Due after five years through ten years	1,646	1,608	21,103	20,615
Equity securities	15,911	17,724	203,987	227,231
	¥18,539	¥20,278	$237,679	$259,974

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, 2011. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2012.

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

Thousands of U.S. dollars	*U.S.$*	*Euro*	*Others*	*Total*
Forwards to sell foreign currencies:				
Contract amounts	$2,789,308	$1,903,564	$325,782	$5,018,654
Estimated fair value	(13,244)	61,487	(1,025)	47,218
Forwards to buy foreign currencies:				
Contract amounts	$ 424,116	$ 537,628	$ —	$ 961,744
Estimated fair value	2,244	(22,436)	—	(20,192)

All of Canon's long-term debt is fixed rate debt. Canon expects that fair value changes and cash flows resulting from reasonable near-term changes in interest rates will be immaterial. Accordingly, Canon believes interest rate risk is insignificant. See also Note 10 of the Notes to Consolidated Financial Statements.

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

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2011, 2010 and 2009. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥457 million (U.S.$6 million), ¥302 million and ¥462 million for the years ended December 31, 2011, 2010 and 2009, respectively.

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

LOOKING FORWARD

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

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

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

- ***Boost the competitiveness of current core products***, by refining and further accelerating development and design capabilities with the aid of information technologies to enable planning and timely launch of exceptional products and services that are unmatched by the competition. We expect to focus on the creation of products and services that integrate cloud computing to quickly seize business opportunities in this new era.
- ***Launch and expand new businesses***, by carving out new business segments through the launch of strategic products, such as DreamLabo and the Cinema EOS System. As for the practical application of promising new technologies, we aim to realize rapid commercialization and will actively make use of M&A opportunities as needed.
- ***Strengthen sales capacity in accordance with market characteristics***, by expanding market share in developed countries and expanding profits by strengthening direct sales of Group companies, solutions, and service businesses. In emerging countries, we aim to achieve sales growth that exceeds the pace of market growth by realizing sales methods and systems tailored to the actual market conditions in each country.
- ***Pursue cost reductions while accelerating the optimization of global production***, by continuing to pursue the strategies we have implemented to date, such as automated production and in-house production, and explore cost-reduction methods based on new ideas and innovative technologies. In addition, we will work to minimize transportation costs while, at the same time, strive to position manufacturing bases and allocate production in ways that minimize costs and risks from a comprehensive perspective, taking into account such factors as exchange rates, tax policies, labor costs, procurement and logistics.

- ***Establish an R&D structure and cultivate technologies that will open future possibilities***, by establishing R&D centers in the United States and Europe with the aim of creating continuous innovation in concert with efforts in Japan. In addition, cultivating basic technologies in the medical and industrial equipment fields, areas positioned as next-generation business domains.
- ***Achieve optimization of company-wide business processes***, by thoroughly utilizing Canon's company-wide integrated IT systems, pursuing total optimization of all business processes, including development, production, sales and service.
- ***Further instill a commitment to "quality first,"*** by targeting the elimination of quality problems, advancing the methods used to manage material defects and working to embed quality from the upstream stages of product planning and design.
- ***Strengthen foundation as an excellent company***, by strengthening global management functions and cultivating human resources to lead these reforms, and promoting thorough compliance and executing Canon's environmental vision based on its newly drafted CSR activity policy.

Office Business Unit

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

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

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

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

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

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

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

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

Consumer Business Unit

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

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

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

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

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

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

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

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

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

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

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

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

Industry and Others Business Unit

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

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

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

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

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

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

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

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

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

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

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

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

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

Forward looking statements

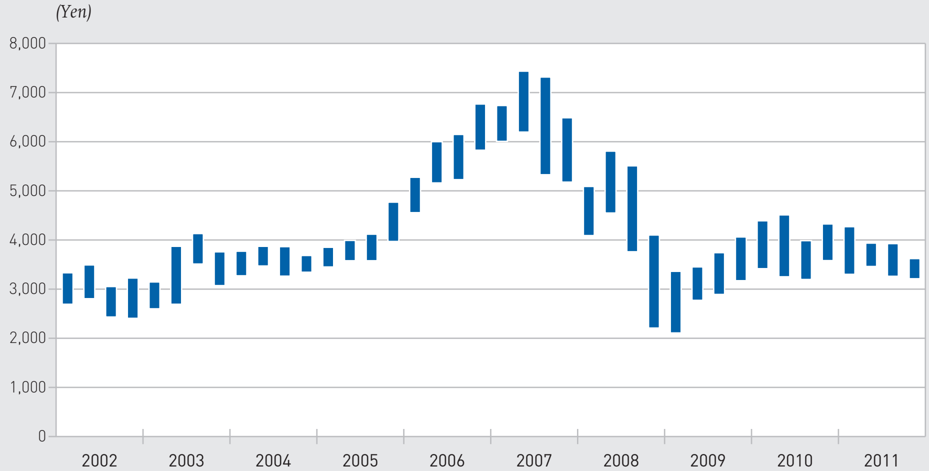
The foregoing discussion and other disclosure in this report contains forward-looking statements that reflect management's current views with respect to certain future events and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements. 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; 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)			
	2011	2010	2009	2008
Net sales:				
Domestic	¥ 694,450	¥ 695,749	¥ 702,344	¥ 868,280
Overseas	2,862,983	3,011,152	2,506,857	3,225,881
Total	3,557,433	3,706,901	3,209,201	4,094,161
Percentage of previous year	96.0%	115.5%	78.4%	91.4%
Net income attributable to Canon Inc.	248,630	246,603	131,647	309,148
Percentage of sales	7.0%	6.7%	4.1%	7.6%
Advertising	81,232	94,794	78,009	112,810
Research and development expenses	307,800	315,817	304,600	374,025
Depreciation of property, plant and equipment	210,179	232,327	277,399	304,622
Increase in property, plant and equipment	226,869	158,976	216,128	361,988
Long-term debt, excluding current installments	¥ 3,368	¥ 4,131	¥ 4,912	¥ 8,423
Canon Inc. stockholders' equity	2,551,132	2,645,782	2,688,109	2,659,792
Total assets	3,930,727	3,983,820	3,847,557	3,969,934
Per share data:				
Income before cumulative effect of change in accounting principle:				
Basic	¥ 204.49	¥ 199.71	¥ 106.64	¥ 246.21
Diluted	204.48	199.70	106.64	246.20
Net income attributable to Canon Inc. stockholders per share:				
Basic	204.49	199.71	106.64	246.21
Diluted	204.48	199.70	106.64	246.20
Dividends per share	120.00	120.00	110.00	110.00
Stock price:				
High	4,280	4,520	4,070	5,820
Low	3,220	3,205	2,115	2,215
Average number of common shares in thousands	1,215,832	1,234,817	1,234,482	1,255,626
Number of employees	198,307	197,386	168,879	166,980

COMMON STOCK PRICE RANGE (Tokyo Stock Exchange)

(Yen)



						Thousands of U.S. dollars (except per share amounts)
2007	2006	2005	2004	2003	2002	**2011**
¥ 947,587	¥ 932,290	¥ 856,205	¥ 849,734	¥ 801,400	¥ 732,551	**$ 8,903,205**
3,533,759	3,224,469	2,897,986	2,618,119	2,396,672	2,207,577	**36,704,910**
4,481,346	4,156,759	3,754,191	3,467,853	3,198,072	2,940,128	**45,608,115**
107.8%	110.7%	108.3%	108.4%	108.8%	101.1%	**96.0%**
488,332	455,325	384,096	343,344	275,730	190,737	**3,187,564**
10.9%	11.0%	10.2%	9.9%	8.6%	6.5%	**7.0%**
132,429	116,809	106,250	111,770	100,278	71,725	**1,041,436**
368,261	308,307	286,476	275,300	259,140	233,669	**3,946,154**
309,815	235,804	205,727	174,397	168,636	158,469	**2,694,603**
428,549	379,657	383,784	318,730	210,038	198,702	**2,908,577**
¥ 8,680	¥ 15,789	¥ 27,082	¥ 28,651	¥ 59,260	¥ 81,349	**$ 43,179**
2,922,336	2,986,606	2,604,682	2,209,896	1,865,545	1,591,950	**32,706,821**
4,512,625	4,521,915	4,043,553	3,587,021	3,182,148	2,942,706	**50,393,936**
¥ 377.59	¥ 341.95	¥ 288.63	¥ 258.53	¥ 209.21	¥ 145.04	**$ 2.62**
377.53	341.84	288.36	257.85	207.17	143.20	**2.62**
377.59	341.95	288.63	258.53	209.21	145.04	**2.62**
377.53	341.84	288.36	257.85	207.17	143.20	**2.62**
110.00	83.33	66.67	43.33	33.33	20.00	**1.54**
7,450	6,780	4,780	3,880	4,140	3,500	**54.87**
5,190	4,567	3,460	3,273	2,607	2,413	**41.28**
1,293,296	1,331,542	1,330,761	1,328,048	1,317,974	1,315,074	
131,352	118,499	115,583	108,257	102,567	97,802	

Notes:
1. U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY78, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2011.
2. 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, 2011 and 2010

	Millions of yen		Thousands of U.S. dollars (Note 2)
ASSETS	**2011**	2010	**2011**
Current assets:			
Cash and cash equivalents (Note 1)	**¥ 773,227**	¥ 840,579	**$ 9,913,167**
Short-term investments (Note 3)	**125,517**	96,815	**1,609,192**
Trade receivables, net (Note 4)	**533,208**	557,504	**6,836,000**
Inventories (Note 5)	**476,704**	384,777	**6,111,590**
Prepaid expenses and other current assets (Notes 7, 13 and 18)	**244,649**	250,754	**3,136,525**
Total current assets	**2,153,305**	2,130,429	**27,606,474**
Noncurrent receivables (Note 19)	**16,772**	16,771	**215,026**
Investments (Note 3)	**51,790**	81,529	**663,974**
Property, plant and equipment, net (Notes 6, 7 and 10)	**1,190,836**	1,201,968	**15,267,128**
Intangible assets, net (Note 9)	**138,030**	153,021	**1,769,615**
Other assets (Notes 7, 9, 12 and 13)	**379,994**	400,102	**4,871,719**
Total assets	**¥3,930,727**	¥3,983,820	**$50,393,936**

LIABILITIES AND EQUITY			
Current liabilities:			
Short-term loans and current portion of long-term debt (Note 10)	**¥ 8,343**	¥ 7,200	**$ 106,962**
Trade payables (Note 11)	**380,532**	383,251	**4,878,615**
Accrued income taxes (Note 13)	**45,900**	72,482	**588,462**
Accrued expenses (Notes 12 and 19)	**299,422**	299,710	**3,838,744**
Other current liabilities (Notes 6, 13 and 18)	**159,651**	134,298	**2,046,807**
Total current liabilities	**893,848**	896,941	**11,459,590**
Long-term debt, excluding current installments (Note 10)	**3,368**	4,131	**43,179**
Accrued pension and severance cost (Note 12)	**249,604**	197,609	**3,200,051**
Other noncurrent liabilities (Note 13)	**70,240**	75,502	**900,513**
Total liabilities	**1,217,060**	1,174,183	**15,603,333**
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 2011 and 2010	**174,762**	174,762	**2,240,538**
Additional paid-in capital	**401,572**	400,425	**5,148,359**
Legal reserve (Note 14)	**59,004**	57,930	**756,462**
Retained earnings (Note 14)	**3,059,298**	2,965,237	**39,221,769**
Accumulated other comprehensive income (loss) (Note 15)	**(481,773)**	(390,459)	**(6,176,577)**
Treasury stock, at cost; 132,231,296 shares in 2011 and 105,295,975 shares in 2010	**(661,731)**	(562,113)	**(8,483,730)**
Total Canon Inc. stockholders' equity	**2,551,132**	2,645,782	**32,706,821**
Noncontrolling interests	**162,535**	163,855	**2,083,782**
Total equity	**2,713,667**	2,809,637	**34,790,603**
Total liabilities and equity	**¥3,930,727**	¥3,983,820	**$50,393,936**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2011, 2010 and 2009

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2011	2010	2009	**2011**
Net sales	**¥3,557,433**	¥3,706,901	¥3,209,201	**$45,608,115**
Cost of sales (Notes 6, 9, 12 and 19)	**1,820,670**	1,923,813	1,781,808	**23,341,923**
Gross profit	**1,736,763**	1,783,088	1,427,393	**22,266,192**
Operating expenses (Notes 1, 6, 9, 12, 16 and 19):				
Selling, general and administrative expenses	**1,050,892**	1,079,719	905,738	**13,472,974**
Research and development expenses	**307,800**	315,817	304,600	**3,946,154**
	1,358,692	1,395,536	1,210,338	**17,419,128**
Operating profit	**378,071**	387,552	217,055	**4,847,064**
Other income (deductions):				
Interest and dividend income	**8,432**	6,022	5,202	**108,103**
Interest expense	**(988)**	(1,931)	(336)	**(12,667)**
Other, net (Notes 1, 3, 18 and 21)	**(10,991)**	1,220	(2,566)	**(140,910)**
	(3,547)	5,311	2,300	**(45,474)**
Income before income taxes	**374,524**	392,863	219,355	**4,801,590**
Income taxes (Note 13)	**120,415**	140,160	84,122	**1,543,782**
Consolidated net income	**254,109**	252,703	135,233	**3,257,808**
Less: Net income attributable to noncontrolling interests	**5,479**	6,100	3,586	**70,244**
Net income attributable to Canon Inc.	**¥ 248,630**	¥ 246,603	¥ 131,647	**$ 3,187,564**

	Yen			U.S. dollars (Note 2)
Net income attributable to Canon Inc. stockholders per share (Note 17):				
Basic	**¥ 204.49**	¥ 199.71	¥ 106.64	**$ 2.62**
Diluted	**204.48**	199.70	106.64	**2.62**
Cash dividends per share	**120.00**	120.00	110.00	**1.54**

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, 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
Acquisition of subsidiaries								19,168	19,168
Equity transactions with noncontrolling interests and other		(3,787)		(13,453)	(680)	55,250	37,330	(43,214)	(5,884)
Dividends paid to Canon Inc. stockholders				(136,103)			(136,103)		(136,103)
Dividends paid to noncontrolling interests								(2,827)	(2,827)
Transfer to legal reserve			3,243	(3,243)			—		—
Comprehensive income (loss):									
Net income				246,603			246,603	6,100	252,703
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					(122,667)		(122,667)	(4,251)	(126,918)
Net unrealized gains and losses on securities					(222)		(222)	76	(146)
Net gains and losses on derivative instruments					833		833	(66)	767
Pension liability adjustments					(6,905)		(6,905)	(2,422)	(9,327)
Total comprehensive income (loss)							117,642	(563)	117,079
Repurchase of treasury stock, net		(81)		(4)		(61,111)	(61,196)		(61,196)
Balance at December 31, 2010	174,762	400,425	57,930	2,965,237	(390,459)	(562,113)	2,645,782	163,855	2,809,637
Equity transactions with noncontrolling interests and other		**1,193**		**(609)**			**584**	**(247)**	**337**
Dividends paid to Canon Inc. stockholders				**(152,784)**			**(152,784)**		**(152,784)**
Dividends paid to noncontrolling interests								**(2,838)**	**(2,838)**
Transfer to legal reserve			**1,074**	**(1,074)**			**—**		**—**
Comprehensive income:									
Net income				**248,630**			**248,630**	**5,479**	**254,109**
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					**(53,251)**		**(53,251)**	**(835)**	**(54,086)**
Net unrealized gains and losses on securities					**(2,017)**		**(2,017)**	**(99)**	**(2,116)**
Net gains and losses on derivative instruments					**(462)**		**(462)**	**13**	**(449)**
Pension liability adjustments					**(35,584)**		**(35,584)**	**(2,793)**	**(38,377)**
Total comprehensive income							**157,316**	**1,765**	**159,081**
Repurchase of treasury stock, net		**(46)**		**(102)**		**(99,618)**	**(99,766)**		**(99,766)**
Balance at December 31, 2011	**¥174,762**	**¥401,572**	**¥59,004**	**¥3,059,298**	**¥(481,773)**	**¥(661,731)**	**¥2,551,132**	**¥162,535**	**¥2,713,667**

	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, 2010	$2,240,538	$5,133,654	$742,693	$38,015,859	$(5,005,885)	$(7,206,577)	$33,920,282	$2,100,705	$36,020,987
Equity transactions with noncontrolling interests and other		15,295		(7,808)			7,487	(3,166)	4,321
Dividends paid to Canon Inc. stockholders				(1,958,769)			(1,958,769)		(1,958,769)
Dividends paid to noncontrolling interests								(36,385)	(36,385)
Transfer to legal reserve			13,769	(13,769)			—		—
Comprehensive income:									
Net income				3,187,564			3,187,564	70,244	3,257,808
Other comprehensive income (loss), net of tax (Note 15):									
Foreign currency translation adjustments					(682,705)		(682,705)	(10,705)	(693,410)
Net unrealized gains and losses on securities					(25,859)		(25,859)	(1,269)	(27,128)
Net gains and losses on derivative instruments					(5,923)		(5,923)	166	(5,757)
Pension liability adjustments					(456,205)		(456,205)	(35,808)	(492,013)
Total comprehensive income							2,016,872	22,628	2,039,500
Repurchase of treasury stock, net		(590)		(1,308)		(1,277,153)	(1,279,051)		(1,279,051)
Balance at December 31, 2011	$2,240,538	$5,148,359	$756,462	$39,221,769	$(6,176,577)	$(8,483,730)	$32,706,821	$2,083,782	$34,790,603

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Canon Inc. and Subsidiaries
Years ended December 31, 2011, 2010 and 2009

	Millions of yen			*Thousands of U.S. dollars (Note 2)*
	2011	2010	2009	**2011**
Cash flows from operating activities:				
Consolidated net income	**¥254,109**	¥252,703	¥135,233	**$ 3,257,808**
Adjustments to reconcile consolidated net income to net cash provided by operating activities:				
Depreciation and amortization	**261,343**	276,193	315,393	**3,350,551**
Loss on disposal of fixed assets	**8,937**	21,120	8,215	**114,577**
Impairment loss of fixed assets (Note 6)	**598**	1,288	15,466	**7,667**
Impairment loss of investments	**8,130**	23,330	2,398	**104,231**
Equity in (earnings) losses of affiliated companies	**7,368**	(10,471)	12,649	**94,461**
Deferred income taxes	**29,129**	29,381	20,712	**373,449**
(Increase) decrease in trade receivables	**9,991**	(6,671)	48,244	**128,090**
(Increase) decrease in inventories	**(109,983)**	(17,532)	143,580	**(1,410,038)**
Increase (decrease) in trade payables	**35,766**	115,726	(76,843)	**458,538**
Increase (decrease) in accrued income taxes	**(25,653)**	25,228	(21,023)	**(328,885)**
Increase (decrease) in accrued expenses	**8,938**	77	(9,827)	**114,590**
Increase (decrease) in accrued (prepaid) pension and severance cost	**(2,315)**	4,147	4,765	**(29,679)**
Other, net	**(16,796)**	29,894	12,273	**(215,334)**
Net cash provided by operating activities	**469,562**	744,413	611,235	**6,020,026**
Cash flows from investing activities:				
Purchases of fixed assets (Note 6)	**(238,129)**	(199,152)	(327,983)	**(3,052,936)**
Proceeds from sale of fixed assets (Note 6)	**3,273**	3,303	8,893	**41,962**
Purchases of available-for-sale securities	**(2,160)**	(10,891)	(3,253)	**(27,692)**
Proceeds from sale and maturity of available-for-sale securities	**1,934**	3,910	2,460	**24,795**
Increase in time deposits, net	**(34,111)**	(80,904)	(11,345)	**(437,321)**
Acquisitions of subsidiaries, net of cash acquired	**29**	(55,686)	(2,979)	**372**
Purchases of other investments	**(373)**	(1,955)	(37,981)	**(4,782)**
Other, net	**12,994**	(758)	1,944	**166,589**
Net cash used in investing activities	**(256,543)**	(342,133)	(370,244)	**(3,289,013)**
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	**725**	5,902	3,361	**9,295**
Repayments of long-term debt	**(4,670)**	(5,739)	(6,282)	**(59,872)**
Increase (decrease) in short-term loans, net	**2,466**	(74,933)	(280)	**31,615**
Dividends paid	**(152,784)**	(136,103)	(135,793)	**(1,958,769)**
Repurchases of treasury stock, net	**(99,766)**	(61,196)	(42)	**(1,279,051)**
Other, net	**(3,484)**	(7,828)	(3,343)	**(44,667)**
Net cash used in financing activities	**(257,513)**	(279,897)	(142,379)	**(3,301,449)**
Effect of exchange rate changes on cash and cash equivalents	**(22,858)**	(76,838)	17,226	**(293,051)**
Net change in cash and cash equivalents	**(67,352)**	45,545	115,838	**(863,487)**
Cash and cash equivalents at beginning of year	**840,579**	795,034	679,196	**10,776,654**
Cash and cash equivalents at end of year	**¥773,227**	¥840,579	¥795,034	**$ 9,913,167**
Supplemental disclosure for cash flow information (Note 22):				
Cash paid during the year for:				
Interest	**¥ 914**	¥ 1,924	¥ 384	**$ 11,718**
Income taxes	**120,696**	80,212	82,906	**1,547,385**

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Canon Inc. and Subsidiaries

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

(a) Description of Business

Canon Inc. (the "Company") and subsidiaries (collectively "Canon") is one of the world's leading manufacturers in such fields as office products, consumer products and industry and other products. Office products consist mainly of network digital multifunction devices ("MFDs"), copying machines, laser printers, large format inkjet printers and digital production printers. Consumer products consist mainly of digital single-lens reflex ("SLR") cameras, compact digital cameras, interchangeable lenses, digital video camcorders, inkjet multifunction printers, single function inkjet printers, image scanners and broadcast equipment. Industry and other products consist mainly of semiconductor lithography equipment, lithography equipment for liquid crystal display ("LCD") panels, and medical equipment. Canon's consolidated net sales for the years ended December 31, 2011, 2010 and 2009 were distributed as follows: the Office Business Unit 53.9%, 53.6% and 51.3%, the Consumer Business Unit 36.9%, 37.5% and 40.5%, the Industry and Others Business Unit 11.8%, 11.7% and 11.2%, and elimination between segments 2.6%, 2.8% and 3.0%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 23.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. 80.5%, 81.2% and 78.1% of consolidated net sales for the years ended December 31, 2011, 2010 and 2009 were generated outside Japan, with 27.0%, 27.6% and 27.9% in the Americas, 31.3%, 31.6% and 31.0% in Europe, and 22.2%, 22.0% and 19.2% in Asia and Oceania, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted 19.3%, 20.1% and 20.0% of consolidated net sales for the years ended December 31, 2011, 2010 and 2009, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 27 plants in Japan and 17 overseas plants which are located in countries or regions such as the United States, Germany, France, Netherlands, Taiwan, China, Malaysia, Thailand and Vietnam.

(b) Basis of Presentation

The Company and its domestic subsidiaries maintain their books of account in conformity with financial accounting standards of Japan. Foreign subsidiaries maintain their books of account in conformity with financial accounting standards of the countries of their domicile.

Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with U.S. generally accepted accounting principles ("GAAP"). These adjustments were not recorded in the statutory books of account.

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its majority owned subsidiaries and those variable interest entities where the Company or its consolidated subsidiaries are the primary beneficiaries. All significant intercompany balances and transactions have been eliminated.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant estimates and assumptions are reflected in valuation and disclosure of revenue recognition, allowance for doubtful receivables, valuation of inventories, impairment of long-lived assets, environmental liabilities, valuation of deferred tax assets, uncertain tax positions and employee retirement and severance benefit obligations. Actual results could differ materially from those estimates.

(e) Translation of Foreign Currencies

Assets and liabilities of the Company's subsidiaries located outside Japan with functional currencies other than Japanese yen are translated into Japanese yen at the rates of exchange in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the year. Gains and losses resulting from translation of financial statements are excluded from earnings and are reported in other comprehensive income (loss).

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses was a net loss of ¥3,287 million ($42,141 thousand) for the year ended December 31, 2011, and were net gains of ¥3,089 million and ¥1,842 million for the years ended December 31, 2010 and 2009, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months classified as available-for-sale securities of ¥204,307 million ($2,619,321 thousand) and ¥249,907 million at December 31, 2011 and 2010, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Additionally, certain debt securities with original maturities of less than three months classified as held-to-maturity securities of ¥1,000 million at December 31, 2010 were also included in cash and cash equivalents. Fair value for these securities approximates their costs.

(g) Investments

Investments consist primarily of time deposits with original maturities of more than three months, debt and marketable equity securities, investments in affiliated companies and non-marketable equity securities. Canon reports investments with maturities of less than one year as short-term investments.

Canon classifies investments in debt and marketable equity securities as available-for-sale or held-to-maturity securities. Canon does not hold any trading securities, which are bought and held primarily for the purpose of sale in the near term.

Available-for-sale securities are recorded at fair value. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of other comprehensive income (loss) until realized. Held-to-maturity securities are recorded at amortized cost, adjusted for amortization of premiums and accretion of discounts.

Available-for-sale and held-to-maturity securities are regularly reviewed for other-than-temporary declines in the carrying amount based on criteria that include the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and Canon's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. For debt securities for which the declines are deemed to be other-than-temporary and there is no intent to sell, impairments are separated into the amount related to credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income (loss). For debt securities for which the declines are deemed to be other-than-temporary and there is an intent to sell, impairments in their entirety are recognized in earnings. For equity securities for which the declines are deemed to be other-than-temporary, impairments in their entirety are recognized in earnings. Canon recognizes an impairment loss to the extent by which the cost basis of the investment exceeds the fair value of the investment.

Realized gains and losses are determined by the average cost method and reflected in earnings.

Investments in affiliated companies over which Canon has the ability to exercise significant influence, but does not hold a controlling financial interest, are accounted for by the equity method.

Non-marketable equity securities in companies over which Canon does not have the ability to exercise significant influence are stated at cost and reviewed periodically for impairment.

(h) Allowance for Doubtful Receivables

Allowance for doubtful trade and finance receivables is maintained for all customers based on a combination of factors, including aging analysis, macroeconomic conditions and historical experience. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. When all collection options are exhausted including legal recourse, the accounts or portions thereof are deemed to be uncollectable and charged against the allowance.

(i) Inventories

Inventories are stated at the lower of cost or market value. Cost is determined by the average method for domestic inventories and principally by the first-in, first-out method for overseas inventories.

(j) Impairment of Long-Lived Assets

Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset and the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of by sale are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

(k) Property, Plant and Equipment

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

The depreciation period ranges from 3 years to 60 years for buildings and 1 year to 20 years for machinery and equipment.

Assets leased to others under operating leases are stated at cost and depreciated to the estimated residual value of the assets by the straight-line method over the lease term, generally from 2 years to 5 years.

(l) Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful life of 3 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years. Certain costs incurred in connection with developing or obtaining internal use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(m) Environmental Liabilities

Liabilities for environmental remediation and other environmental costs are accrued when environmental assessments or remedial efforts are probable and the costs can be reasonably estimated. Such liabilities are adjusted as further information develops or circumstances change. Costs of future obligations are not discounted to their present values.

(n) Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Canon records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not realizable.

Canon recognizes the financial statement effects of tax positions when it is more likely than not, based on the technical merits, that the tax positions will be sustained upon examination by the tax authorities. Benefits from tax positions that meet the more-likely-than-not recognition threshold are measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties accrued related to unrecognized tax benefits are included in income taxes in the consolidated statements of income.

(o) Stock-Based Compensation

Canon measures stock-based compensation cost at the grant date, based on the fair value of the award, and recognizes the cost on a straight-line basis over the requisite service period, which is the vesting period.

(p) Net Income Attributable to Canon Inc. Stockholders per Share

Basic net income attributable to Canon Inc. stockholders per share is computed by dividing net income attributable to Canon Inc. by the weighted-average number of common shares outstanding during each year. Diluted net income attributable to Canon Inc. stockholders per share includes the effect from potential issuances of common stock based on the assumptions that all stock options were exercised.

(q) Revenue Recognition

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

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

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

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

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

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

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

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

Taxes collected from customers and remitted to governmental authorities are excluded from revenues in the consolidated statements of income.

(r) Research and Development Costs

Research and development costs are expensed as incurred.

(s) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥81,232 million ($1,041,436 thousand), ¥94,794 million and ¥78,009 million for the years ended December 31, 2011, 2010 and 2009, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥43,308 million ($555,231 thousand), ¥56,306 million and ¥45,966 million for the years ended December 31, 2011, 2010 and 2009, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(u) Derivative Financial Instruments

All derivatives are recognized at fair value and are included in prepaid expenses and other current assets, or other current liabilities in the consolidated balance sheets.

Canon uses and designates certain derivatives as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge). Canon formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. Canon also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Canon discontinues hedge accounting prospectively. Changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability in cash flows of the hedged item. Gains and losses from hedging ineffectiveness are included in other income (deductions). Gains and losses related to the components of hedging instruments excluded from the assessment of hedge effectiveness are included in other income (deductions).

Canon also uses certain derivative financial instruments which are not designated as hedges. The changes in fair values of these derivative financial instruments are immediately recorded in earnings.

Canon classifies cash flows from derivatives as cash flows from operating activities in the consolidated statements of cash flows.

(v) Guarantees

Canon recognizes, at the inception of a guarantee, a liability for the fair value of the obligation it has undertaken in issuing guarantees.

(w) Recently Issued Accounting Guidance

In October 2009, the Financial Accounting Standards Board ("FASB") issued new accounting guidance for revenue recognition under multiple-deliverable arrangements. This guidance modifies the criteria for separating consideration under multiple-deliverable arrangements and requires allocation of the overall consideration to each deliverable using the estimated selling price in the absence of vendor-specific objective evidence or third-party evidence of selling price for deliverables. As a result, the residual method of allocating arrangement consideration will no longer be permitted. The guidance also requires additional disclosures about how a vendor allocates revenue in its arrangements and about the significant judgments made and their impact on revenue recognition. This guidance is effective for fiscal years beginning on or after June 15, 2010 and was adopted by Canon from the quarter beginning January 1, 2011. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition.

In October 2009, the FASB issued new accounting guidance for software revenue recognition. This guidance modifies the scope of the software revenue recognition guidance to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. This guidance is effective for fiscal years beginning on or after June 15, 2010 and was adopted by Canon from the quarter beginning January 1, 2011. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition.

In June 2011, the FASB issued an amendment which requires presentation of net income and other comprehensive income in one continuous statement or in two separate but consecutive statements, which will be applied retrospectively for all periods presented. Canon will adopt this amended guidance from the quarter beginning January 1, 2012, and does not expect the adoption of this guidance to have a material impact on Canon's consolidated results of operations and financial condition.

2. 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 ¥78 = U.S.$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on December 30, 2011. 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, 2011 and 2010 were as follows:

December 31

Millions of yen	*Cost*	*Gross unrealized holding gains*	*Gross unrealized holding losses*	*Fair value*
2011: Current:				
Corporate bonds	**¥ 20**	**¥ —**	**¥ —**	**¥ 20**
Noncurrent:				
Government bonds	**¥ 172**	**¥ —**	**¥ 22**	**¥ 150**
Corporate bonds	**569**	**73**	**84**	**558**
Fund trusts	**1,867**	**2**	**43**	**1,826**
Equity securities	**15,911**	**3,200**	**1,387**	**17,724**
	¥18,519	**¥3,275**	**¥1,536**	**¥20,258**

Millions of yen	*Cost*	*Gross unrealized holding gains*	*Gross unrealized holding losses*	*Fair value*
2010: Current:				
Government bonds	¥ 1	¥ —	¥ —	¥ 1
Corporate bonds	1,000	—	—	1,000
	¥ 1,001	¥ —	¥ —	¥ 1,001
Noncurrent:				
Government bonds	¥ 183	¥ —	¥ 22	¥ 161
Corporate bonds	1,017	42	65	994
Fund trusts	1,778	20	—	1,798
Equity securities	18,288	5,768	654	23,402
	¥21,266	¥5,830	¥741	¥26,355

December 31 Thousands of U.S. dollars	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2011: Current:				
Corporate bonds	$ 256	$ —	$ —	$ 256
Noncurrent:				
Government bonds	$ 2,205	$ —	$ 282	$ 1,923
Corporate bonds	7,295	936	1,077	7,154
Fund trusts	23,936	25	551	23,410
Equity securities	203,987	41,026	17,782	227,231
	$237,423	$41,987	$19,692	$259,718

Maturities of available-for-sale debt securities and fund trusts included in short-term investments and investments in the accompanying consolidated balance sheets were as follows at December 31, 2011:

	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	¥ 20	¥ 20	$ 256	$ 256
Due after one year through five years	962	926	12,333	11,872
Due after five years through ten years	1,646	1,608	21,103	20,615
	¥2,628	¥2,554	$33,692	$32,743

Gross realized gains were ¥204 million ($2,615 thousand), ¥641 million and ¥277 million for the years ended December 31, 2011, 2010 and 2009, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥4,281 million ($54,885 thousand), ¥1,961 million and ¥2,482 million for the years ended December 31, 2011, 2010 and 2009, respectively.

At December 31, 2011, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months are ¥125,497 million ($1,608,936 thousand) and ¥95,814 million at December 31, 2011 and 2010, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥14,583 million ($186,962 thousand) and ¥26,475 million at December 31, 2011 and 2010, respectively. Investments with an aggregate cost of ¥14,583 million ($186,962 thousand) and ¥24,053 million were not evaluated for impairment at December 31, 2011 and 2010, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥15,776 million ($202,256 thousand) and ¥26,817 million at December 31, 2011 and 2010, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), were losses of ¥7,368 million ($94,461 thousand), earnings of ¥10,471 million and losses of ¥12,649 million for the years ended December 31, 2011, 2010 and 2009, respectively.

4. TRADE RECEIVABLES

Trade receivables are summarized as follows:

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Notes	**¥ 16,739**	¥ 15,441	**$ 214,603**
Accounts	**528,032**	556,983	**6,769,641**
	544,771	572,424	**6,984,244**
Less allowance for doubtful receivables	**(11,563)**	(14,920)	**(148,244)**
	¥533,208	¥557,504	**$6,836,000**

5. INVENTORIES

Inventories are summarized as follows:

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Finished goods	**¥291,023**	¥232,584	**$3,731,064**
Work in process	**166,076**	116,679	**2,129,180**
Raw materials	**19,605**	35,514	**251,346**
	¥476,704	¥384,777	**$6,111,590**

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*
	2011	2010	**2011**
Land	**¥ 268,493**	¥ 266,631	**$ 3,442,218**
Buildings	**1,367,187**	1,320,121	**17,528,038**
Machinery and equipment	**1,499,331**	1,439,246	**19,222,192**
Construction in progress	**94,507**	85,673	**1,211,629**
	3,229,518	3,111,671	**41,404,077**
Less accumulated depreciation	**(2,038,682)**	(1,909,703)	**(26,136,949)**
	¥1,190,836	¥1,201,968	**$15,267,128**

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was ¥210,179 million ($2,694,602 thousand), ¥232,327 million and ¥277,399 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥47,690 million ($611,410 thousand) and ¥23,306 million at December 31, 2011 and 2010, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

As a result of continued sluggish demand in the semiconductor manufacturing industry and diminished profitability of the semiconductor lithography equipment business, Canon recognized impairment losses related primarily to property, plant and equipment of its semiconductor lithography equipment business, which are included in the results of the Industry and Others Business Unit for the year ended December 31, 2009. Long-lived assets with a carrying amount of ¥15,390 million were written down to their fair value of zero, which was estimated using discounted future cash flows expected to be generated over their remaining useful life. The impairment losses were included in selling, general and administrative expenses in the consolidated statement of income.

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 primarily in foreign countries. These receivables typically have terms ranging from 1 year to 8 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Total minimum lease payments receivable	**¥204,326**	¥215,925	**$2,619,564**
Unguaranteed residual values	**8,195**	11,120	**105,064**
Executory costs	**(2,275)**	(2,063)	**(29,166)**
Unearned income	**(24,955)**	(27,891)	**(319,936)**
	185,291	197,091	**2,375,526**
Less allowance for doubtful receivables	**(7,039)**	(7,983)	**(90,244)**
	178,252	189,108	**2,285,282**
Less current portion	**(66,337)**	(71,500)	**(850,474)**
	¥111,915	¥117,608	**$1,434,808**

The activity in the allowance for credit losses is as follows:

Years ended December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Balance at beginning of year	**¥7,983**	¥9,023	**$102,346**
Charge-offs	**(1,937)**	(3,103)	**(24,833)**
Provision	**2,052**	1,995	**26,308**
Other	**(1,059)**	68	**(13,577)**
Balance at end of year	**¥7,039**	¥7,983	**$ 90,244**

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or individually evaluated for impairment at December 31, 2011 and 2010 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2011 and 2010 was ¥75,391 million ($966,551 thousand) and ¥63,239 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2011 and 2010 was ¥54,791 million ($702,449 thousand) and ¥43,829 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, 2011.

Year ending December 31:	*Millions of yen*		*Thousands of U.S. dollars*	
	Financing leases	*Operating leases*	*Financing leases*	*Operating leases*
2012	¥ 80,411	¥ 7,610	$1,030,910	$ 97,564
2013	58,396	2,367	748,667	30,346
2014	37,177	2,045	476,628	26,218
2015	19,317	1,632	247,654	20,923
2016	8,486	1,559	108,795	19,987
Thereafter	539	248	6,910	3,180
	¥204,326	¥15,461	$2,619,564	$198,218

8. ACQUISITIONS

In March 2010, Canon acquired 45.2% of the total outstanding shares of Océ N.V. ("Océ"), which is listed on NYSE Euronext Amsterdam, principally through a fully self-funded public cash tender offer for consideration of ¥50,374 million, in addition to the 22.9% interest Canon held before the public cash tender offer. In addition, Canon acquired Océ's convertible cumulative financing preference shares representing 19.1% of the total outstanding shares of Océ for consideration of ¥8,027 million. As a result, Canon's aggregate interest represents 87.2% of the total outstanding shares of Océ. The fair value of the 12.8% noncontrolling interest in Océ of ¥18,245 million was measured based on the quoted price of Océ's common stock on the acquisition date.

The acquisition was accounted for using the acquisition method. Prior to the March 2010 acquisition date, Canon accounted for its 22.9% interest in Océ using the equity method. The acquisition-date fair value of the previous equity interest of ¥25,508 million was remeasured using the quoted price of Océ's common stock on the acquisition date and included in the measurement of the total acquisition consideration. In connection with the acquisition, Canon repaid ¥55,378 million of Océ's existing bank debt and ¥22,936 million of Océ's existing United States Private Placement notes, which are included in decrease in short-term loans in the consolidated statement of cash flows.

Océ is engaged in research and development, manufacture and sale of document management systems, printing systems for professionals and high-speed, wide format digital printing systems. Canon and Océ have complementary technologies and products and would benefit from this strong business relationship. Amid the increasingly competitive printing industry, Canon is further strengthening its business foundation in order to solidify its position as one of the global leaders. Canon aims to provide diversified solutions to its customers in the printing industry by making Océ a consolidated subsidiary.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at acquisition date.

	Millions of yen
Current assets	¥122,248
Property, plant and equipment	51,156
Intangible assets	56,297
Goodwill	77,253
Other noncurrent assets	42,658
Non-current assets	227,364
Total acquired assets	349,612
Total assumed liabilities	247,458
Net assets acquired	¥102,154

Intangible assets acquired, which are subject to amortization, consist of customer relationships of ¥32,747 million, patented technologies of ¥11,316 million, and other intangible assets of ¥12,234 million. Canon has estimated the amortization period for the customer relationships and patented technologies to be 5 years and 3 years, respectively. The weighted average amortization period for all intangible assets is approximately 4.4 years.

Goodwill recognized, which is assigned to the Office Business Unit for impairment testing, is attributable primarily to expected synergies from combining operations of Océ and Canon. None of the goodwill is expected to be deductible for income tax purposes.

The amount of net sales of Océ included in Canon's consolidated statement of income from the acquisition date for the year ended December 31, 2010 was ¥246,518 million.

The unaudited pro forma net sales as if Océ had been included in Canon's consolidated statements of income from the beginning of the years ended December 31, 2010 and 2009 were ¥3,772,425 million and ¥3,554,316 million, respectively. Pro forma net income was not disclosed because the impact on Canon's consolidated statements of income was not material.

Canon acquired businesses other than those described above during the years ended December 31, 2011, 2010, and 2009 that were not material to its consolidated financial statements.

9. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets developed or acquired during the year ended December 31, 2011 totaled ¥35,994 million ($461,462 thousand), which are subject to amortization and primarily consist of software of ¥33,217 million ($425,859 thousand), which is mainly for internal use. The weighted average amortization period for software and intangible assets in total is approximately 4 years and 5 years, respectively.

The components of intangible assets subject to amortization at December 31, 2011 and 2010 were as follows:

December 31	2011		2010	
Millions of yen	*Gross carrying amount*	*Accumulated amortization*	*Gross carrying amount*	*Accumulated amortization*
Software	**¥205,235**	**¥115,131**	¥200,245	¥109,200
Customer relationships	**34,957**	**18,724**	37,637	12,107
Patented technologies	**24,342**	**13,317**	25,425	9,377
License fees	**20,425**	**12,867**	22,108	14,436
Other	**19,235**	**6,857**	16,686	4,641
	¥304,194	**¥166,896**	¥302,101	¥149,761

	2011	
Thousands of U.S. dollars	*Gross carrying amount*	*Accumulated amortization*
Software	**$2,631,218**	**$1,476,038**
Customer relationships	**448,167**	**240,051**
Patented technologies	**312,077**	**170,731**
License fees	**261,859**	**164,962**
Other	**246,602**	**87,910**
	$3,899,923	**$2,139,692**

Aggregate amortization expense for the years ended December 31, 2011, 2010 and 2009 was ¥51,164 million ($655,949 thousand), ¥43,866 million and ¥37,994 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥44,931 million ($576,038 thousand) in 2012, ¥33,864 million ($434,154 thousand) in 2013, ¥23,759 million ($304,603 thousand) in 2014, ¥11,482 million ($147,205 thousand) in 2015, and ¥6,134 million ($78,641 thousand) in 2016.

Intangible assets not subject to amortization other than goodwill at December 31, 2011 and 2010 were not significant.

For management reporting purposes, goodwill is not allocated to the segments. Goodwill has been allocated to its respective segment for impairment testing.

The changes in the carrying amount of goodwill by segment, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2011 and 2010 were as follows:

Years ended December 31 *Millions of yen*		*Office*	*Consumer*	*Industry and Others*	*Total*
2011:	Balance at beginning of year	**¥107,301**	**¥12,386**	**¥5,502**	**¥125,189**
	Translation adjustments and other	**(5,241)**	**(298)**	**(629)**	**(6,168)**
	Balance at end of year	**¥102,060**	**¥12,088**	**¥4,873**	**¥119,021**

Millions of yen		*Office*	*Consumer*	*Industry and Others*	*Total*
2010:	Balance at beginning of year	¥ 39,845	¥13,303	¥2,723	¥ 55,871
	Goodwill acquired during the year	79,156	—	3,719	82,875
	Translation adjustments and other	(11,700)	(917)	(940)	(13,557)
	Balance at end of year	¥107,301	¥12,386	¥5,502	¥125,189

Thousands of U.S. dollars	Office	Consumer	Industry and Others	Total
2011: Balance at beginning of year	**$1,375,654**	**$158,795**	**$70,538**	**$1,604,987**
Translation adjustments and other	**(67,192)**	**(3,821)**	**(8,064)**	**(79,077)**
Balance at end of year	**$1,308,462**	**$154,974**	**$62,474**	**$1,525,910**

10. SHORT-TERM LOANS AND LONG-TERM DEBT

Short-term loans consisting of bank borrowings at December 31, 2011 and 2010 were ¥4,641 million ($59,500 thousand) and ¥2,071 million, respectively. The weighted average interest rates on short-term loans outstanding at December 31, 2011 and 2010 were 2.72% and 1.46%, respectively.

Long-term debt consisted of the following:

December 31	Millions of yen		Thousands of U.S. dollars
	2011	2010	**2011**
Loans, principally from banks, maturing in installments through 2020; bearing weighted average interest of 1.68% and 1.83% at December 31, 2011 and 2010, respectively	**¥1,297**	¥1,013	**$16,628**
0.75% Japanese yen notes, due 2012	**1,020**	—	**13,077**
0.84% Japanese yen notes, due 2013	**156**	—	**2,000**
Capital lease obligations	**4,597**	8,247	**58,936**
	7,070	9,260	**90,641**
Less current portion	**(3,702)**	(5,129)	**(47,462)**
	¥3,368	¥4,131	**$43,179**

The aggregate annual maturities of long-term debt outstanding at December 31, 2011 were as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2012	¥3,702	$47,462
2013	1,528	19,589
2014	1,132	14,513
2015	457	5,859
2016	105	1,346
Thereafter	146	1,872
	¥7,070	$90,641

Certain property, plant and equipment with a net book carrying value of ¥2,913 million ($37,346 thousand) at December 31, 2011 were mortgaged primarily to secure loans from banks.

Both short-term and long-term bank loans are made under general agreements which provide that security and guarantees for present and future indebtedness will be given upon request of the bank, and that the bank shall have the right to offset cash deposits against obligations that have become due or, in the event of default, against all obligations due to the bank.

11. TRADE PAYABLES

Trade payables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2011	2010	2011
Notes	¥ 16,519	¥ 13,676	$ 211,782
Accounts	364,013	369,575	4,666,833
	¥380,532	¥383,251	$4,878,615

12. EMPLOYEE RETIREMENT AND SEVERANCE BENEFITS

The Company and certain of its subsidiaries have contributory and noncontributory defined benefit pension plans covering substantially all of their employees. Benefits payable under the plans are based on employee earnings and years of service. The Company and certain of its subsidiaries also have defined contribution pension plans covering substantially all of their employees.

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2011, 2010 and 2009 were ¥12,511 million ($160,397 thousand), ¥11,780 million and ¥9,148 million, respectively.

Obligations and funded status

Reconciliations of beginning and ending balances of the benefit obligations and the fair value of the plan assets are as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2011	2010	2011	2011	2010	2011
Change in benefit obligations:						
Benefit obligations at beginning of year	¥ 593,274	¥ 551,320	$ 7,606,077	¥261,130	¥ 94,170	$3,347,821
Service cost	25,875	23,331	331,731	5,756	5,660	73,795
Interest cost	12,354	12,636	158,385	12,748	11,792	163,436
Plan participants' contributions	—	—	—	2,680	2,460	34,359
Amendments	(1,913)	(423)	(24,526)	—	(149)	—
Actuarial (gain) loss	14,845	22,290	190,321	3,872	(5,946)	49,641
Benefits paid	(17,511)	(15,880)	(224,500)	(8,234)	(7,458)	(105,564)
Acquisition	—	—	—	—	198,754	—
Foreign currency exchange rate changes	—	—	—	(15,822)	(38,153)	(202,847)
Benefit obligations at end of year	626,924	593,274	8,037,488	262,130	261,130	3,360,641
Change in plan assets:						
Fair value of plan assets at beginning of year	460,090	457,208	5,898,590	197,835	75,058	2,536,346
Actual return on plan assets	(17,285)	4,533	(221,603)	2,335	19,307	29,936
Employer contributions	22,282	13,283	285,667	8,228	8,152	105,487
Plan participants' contributions	—	—	—	2,680	2,460	34,359
Benefits paid	(16,351)	(14,934)	(209,628)	(8,201)	(7,413)	(105,141)
Acquisition	—	—	—	—	128,043	—
Foreign currency exchange rate changes	—	—	—	(10,844)	(27,772)	(139,025)
Fair value of plan assets at end of year	448,736	460,090	5,753,026	192,033	197,835	2,461,962
Funded status at end of year	¥(178,188)	¥(133,184)	$(2,284,462)	¥ (70,097)	¥ (63,295)	$ (898,679)

Amounts recognized in the consolidated balance sheets at December 31, 2011 and 2010 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
	2011	2010	2011	2011	2010	2011
Other assets	¥ 54	¥ 345	$ 692	¥ 1,397	¥ 1,318	$ 17,910
Accrued expenses	—	—	—	(132)	(533)	(1,692)
Accrued pension and severance cost	(178,242)	(133,529)	(2,285,154)	(71,362)	(64,080)	(914,897)
	¥(178,188)	¥(133,184)	$(2,284,462)	¥(70,097)	¥(63,295)	$(898,679)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2011 and 2010 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
	2011	2010	2011	2011	2010	2011
Actuarial loss	¥291,778	¥257,625	$3,740,744	¥16,095	¥3,538	$206,346
Prior service credit	(130,712)	(142,473)	(1,675,795)	(345)	(486)	(4,423)
Net transition obligation	—	722	—	—	—	—
	¥161,066	¥115,874	$2,064,949	¥15,750	¥3,052	$201,923

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
	2011	2010	2011	2011	2010	2011
Accumulated benefit obligation	¥595,689	¥565,406	$7,637,038	¥238,675	¥216,239	$3,059,936

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
	2011	2010	2011	2011	2010	2011
Plans with projected benefit obligations in excess of plan assets:						
Projected benefit obligations	¥622,645	¥589,391	$7,982,628	¥259,517	¥258,326	$3,327,140
Fair value of plan assets	444,403	455,862	5,697,474	188,023	193,713	2,410,551
Plans with accumulated benefit obligations in excess of plan assets:						
Accumulated benefit obligations	¥591,830	¥559,468	$7,587,564	¥160,941	¥144,225	$2,063,346
Fair value of plan assets	444,403	453,342	5,697,474	111,527	122,590	1,429,833

Components of net periodic benefit cost and other amounts recognized in other comprehensive income (loss)

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2011, 2010 and 2009 consisted of the following components:

Years ended December 31	Japanese plans				Foreign plans			
	Millions of yen			Thousands of U.S. dollars	Millions of yen			Thousands of U.S. dollars
	2011	2010	2009	2011	2011	2010	2009	2011
Service cost	¥25,875	¥23,331	¥21,759	$331,731	¥ 5,756	¥ 5,660	¥2,426	$ 73,795
Interest cost	12,354	12,636	12,535	158,385	12,748	11,792	4,251	163,436
Expected return on plan assets	(16,485)	(16,591)	(15,808)	(211,346)	(12,112)	(10,540)	(4,211)	(155,282)
Amortization of net transition obligation	722	722	722	9,257	—	—	—	—
Amortization of prior service credit	(13,674)	(13,878)	(13,650)	(175,308)	(93)	(116)	(98)	(1,193)
Amortization of actuarial loss	14,462	14,545	13,923	185,410	621	1,050	1,014	7,962
	¥23,254	¥20,765	¥19,481	$298,129	¥ 6,920	¥ 7,846	¥3,382	$ 88,718

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2011 and 2010 are summarized as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2011	2010	2011	2011	2010	2011
Current year actuarial (gain) loss	¥48,615	¥34,348	$623,270	¥13,649	¥(14,713)	$174,987
Amortization of actuarial loss	(14,462)	(14,545)	(185,410)	(621)	(1,050)	(7,962)
Prior service credit due to amendments	(1,913)	(423)	(24,526)	—	(149)	—
Amortization of prior service credit	13,674	13,878	175,308	93	116	1,193
Amortization of net transition obligation	(722)	(722)	(9,257)	—	—	—
	¥45,192	¥32,536	$579,385	¥13,121	¥(15,796)	$168,218

The estimated prior service credit and actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income (loss) into net periodic benefit cost over the next year are summarized as follows:

	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
Prior service credit	¥(13,137)	$(168,423)	¥(130)	$ (1,667)
Actuarial loss	16,708	214,205	986	12,641

Assumptions

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

December 31	Japanese plans		Foreign plans	
	2011	2010	2011	2010
Discount rate	1.9%	2.1%	4.6%	4.9%
Assumed rate of increase in future compensation levels	3.0%	3.0%	2.4%	2.9%

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

Years ended December 31	*Japanese plans*			*Foreign plans*		
	2011	2010	2009	**2011**	2010	2009
Discount rate	**2.1%**	2.3%	2.4%	**4.9%**	4.9%	5.3%
Assumed rate of increase in future compensation levels	**3.0%**	3.0%	3.0%	**2.9%**	2.8%	3.1%
Expected long-term rate of return on plan assets	**3.6%**	3.6%	3.7%	**5.7%**	6.1%	6.2%

Canon determines the expected long-term rate of return based on the expected long-term return of the various asset categories in which it invests. Canon considers the current expectations for future returns and the actual historical returns of each plan asset category.

Plan assets

Canon's investment policies are designed to ensure adequate plan assets are available to provide future payments of pension benefits to eligible participants. Taking into account the expected long-term rate of return on plan assets, Canon formulates a "model" portfolio comprised of the optimal combination of equity securities and debt securities. Plan assets are invested in individual equity and debt securities using the guidelines of the "model" portfolio in order to produce a total return that will match the expected return on a mid-term to long-term basis. Canon evaluates the gap between expected return and actual return of invested plan assets on an annual basis to determine if such differences necessitate a revision in the formulation of the "model" portfolio. Canon revises the "model" portfolio when and to the extent considered necessary to achieve the expected long-term rate of return on plan assets.

Canon's model portfolio for Japanese plans consists of three major components: approximately 30% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 20% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 40% is invested in equity securities, approximately 55% is invested in debt securities, and approximately 5% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

The equity securities are selected primarily from stocks that are listed on the securities exchanges. Prior to investing, Canon has investigated the business condition of the investee companies, and appropriately diversified investments by type of industry and other relevant factors. The debt securities are selected primarily from government bonds, public debt instruments, and corporate bonds. Prior to investing, Canon has investigated the quality of the issue, including rating, interest rate, and repayment dates, and has appropriately diversified the investments. Pooled funds are selected using strategies consistent with the equity and debt securities described above. As for investments in life insurance company general accounts, the contracts with the insurance companies include a guaranteed interest rate and return of capital. With respect to investments in foreign investment vehicles, Canon has investigated the stability of the underlying governments and economies, the market characteristics such as settlement systems and the taxation systems. For each such investment, Canon has selected the appropriate investment country and currency.

The three levels of input used to measure fair value are more fully described in Note 21. The fair values of Canon's pension plan assets at December 31, 2011 and 2010, by asset category, are as follows:

December 31, 2011	*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)	**¥37,875**	**¥ —**	**¥ —**	**¥ 37,875**	**¥ —**	**¥ —**	**¥ —**	**¥ —**
Foreign companies	**4,804**	**—**	**—**	**4,804**	**3,779**	**—**	**—**	**3,779**
Pooled funds (b)	**—**	**82,380**	**—**	**82,380**	**—**	**47,779**	**—**	**47,779**
Debt securities:								
Government bonds (c)	**17,951**	**—**	**—**	**17,951**	**2,326**	**—**	**—**	**2,326**
Municipal bonds	**—**	**864**	**—**	**864**	**—**	**19**	**—**	**19**
Corporate bonds	**—**	**8,170**	**—**	**8,170**	**—**	**—**	**—**	**—**
Pooled funds (d)	**—**	**190,832**	**—**	**190,832**	**—**	**92,653**	**—**	**92,653**
Mortgage backed securities (and other asset backed securities)	**—**	**4,842**	**—**	**4,842**	**—**	**2,726**	**—**	**2,726**
Life insurance company general accounts	**—**	**92,700**	**—**	**92,700**	**—**	**—**	**—**	**—**
Other assets	**—**	**7,171**	**1,147**	**8,318**	**—**	**42,751**	**—**	**42,751**
	¥60,630	**¥386,959**	**¥1,147**	**¥448,736**	**¥6,105**	**¥185,928**	**¥ —**	**¥192,033**

December 31, 2010	*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 (e)	¥50,177	¥ —	¥ —	¥ 50,177	¥ —	¥ —	¥ —	¥ —
Foreign companies	5,352	—	—	5,352	3,474	—	—	3,474
Pooled funds (f)	—	90,597	—	90,597	—	80,666	—	80,666
Debt securities:								
Government bonds (g)	9,687	—	—	9,687	2,074	—	—	2,074
Municipal bonds	—	323	—	323	—	—	—	—
Corporate bonds	—	6,518	—	6,518	—	—	—	—
Pooled funds (h)	—	194,286	—	194,286	—	104,650	—	104,650
Mortgage backed securities (and other asset backed securities)	—	1,980	—	1,980	—	232	—	232
Life insurance company general accounts	—	91,610	—	91,610	—	—	—	—
Other assets	—	8,521	1,039	9,560	—	6,739	—	6,739
	¥65,216	¥393,835	¥1,039	¥460,090	¥5,548	¥192,287	¥ —	¥197,835

December 31, 2011	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)	$485,577	$ —	$ —	$ 485,577	$ —	$ —	$ —	$ —
Foreign companies	61,590	—	—	61,590	48,449	—	—	48,449
Pooled funds (b)	—	1,056,154	—	1,056,154	—	612,551	—	612,551
Debt securities:								
Government bonds (c)	230,141	—	—	230,141	29,820	—	—	29,820
Municipal bonds	—	11,077	—	11,077	—	244	—	244
Corporate bonds	—	104,744	—	104,744	—	—	—	—
Pooled funds (d)	—	2,446,564	—	2,446,564	—	1,187,859	—	1,187,859
Mortgage backed securities (and other asset backed securities)	—	62,077	—	62,077	—	34,949	—	34,949
Life insurance company general accounts	—	1,188,462	—	1,188,462	—	—	—	—
Other assets	—	91,935	14,705	106,640	—	548,090	—	548,090
	$777,308	$4,961,013	$14,705	$5,753,026	$78,269	$2,383,693	$ —	$2,461,962

(a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥1,129 million ($14,474 thousand).
(b) These funds invest in listed equity securities consisting of approximately 50% Japanese companies and 50% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(c) This class includes approximately 30% Japanese government bonds and 70% foreign government bonds.
(d) These funds invest in approximately 75% Japanese government bonds, 15% foreign government bonds, 5% Japanese municipal bonds, and 5% corporate bonds for Japanese plans. These funds invest in approximately 40% foreign government bonds and 60% corporate bonds for foreign plans.
(e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥1,044 million.
(f) These funds invest in listed equity securities consisting of approximately 50% Japanese companies and 50% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(g) This class includes approximately 50% Japanese government bonds and 50% foreign government bonds.
(h) These funds invest in approximately 60% Japanese government bonds, 20% foreign government bonds, 10% Japanese municipal bonds, and 10% corporate bonds for Japanese plans. These funds invest in approximately 40% foreign government bonds and 60% corporate bonds for foreign plans.

Each level into which assets are categorized is based on inputs used to measure the fair value of the assets, and does not necessarily indicate the risks or ratings of the assets.

Level 1 assets are comprised principally of equity securities and government bonds, which are valued using unadjusted quoted market prices in active markets with sufficient volume and frequency of transactions. Level 2 assets are comprised principally of pooled funds that invest in equity and debt securities, corporate bonds and investments in life insurance company general accounts. Pooled funds are valued at their net asset values that are calculated by the sponsor of the fund and have daily liquidity. Corporate bonds are valued using quoted prices for identical assets in markets that are not active. Investments in life insurance company general accounts are valued at conversion value.

The fair value of Level 3 assets, consisting of hedge funds, was ¥1,147 million ($14,705 thousand) and ¥1,039 million at December 31, 2011 and 2010, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the years ended December 31, 2011 and 2010 were not significant.

Contributions

Canon expects to contribute ¥21,946 million ($281,359 thousand) to its Japanese defined benefit pension plans and ¥8,931 million ($114,500 thousand) to its foreign defined benefit pension plans for the year ending December 31, 2012.

Estimated future benefit payments

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

Year ending December 31:	*Japanese plans*		*Foreign plans*	
	Millions of yen	*Thousands of U.S. dollars*	*Millions of yen*	*Thousands of U.S. dollars*
2012	¥ 15,100	$ 193,590	¥ 8,750	$112,179
2013	16,137	206,885	8,542	109,513
2014	17,301	221,808	8,763	112,346
2015	19,160	245,641	9,228	118,308
2016	20,893	267,859	9,993	128,115
2017-2021	130,449	1,672,423	60,255	772,500

13. 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*
2011: Income before income taxes	**¥287,592**	**¥86,932**	**¥374,524**
Income taxes:			
Current	**¥ 67,671**	**¥23,615**	**¥ 91,286**
Deferred	**21,047**	**8,082**	**29,129**
	¥ 88,718	**¥31,697**	**¥120,415**
2010: Income before income taxes	¥302,965	¥89,898	¥392,863
Income taxes:			
Current	¥ 78,359	¥32,420	¥110,779
Deferred	35,496	(6,115)	29,381
	¥113,855	¥26,305	¥140,160
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

	Thousands of U.S. dollars		
	Japanese	*Foreign*	*Total*
2011: Income before income taxes	**$3,687,077**	**$1,114,513**	**$4,801,590**
Income taxes:			
Current	**$ 867,577**	**$ 302,756**	**$1,170,333**
Deferred	**269,833**	**103,616**	**373,449**
	$1,137,410	**$ 406,372**	**$1,543,782**

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 40% for the years ended December 31, 2011, 2010 and 2009.

Amendments to the Japanese tax regulations were enacted into law on November 30, 2011. As a result of these amendments, the statutory income tax rate will be reduced from approximately 40% to 38% effective from the year beginning January 1, 2013, and to approximately 35% effective from the year beginning January 1, 2016 thereafter. Consequently, the statutory income tax rate utilized for deferred tax assets and liabilities expected to be settled or realized in the period from January 1, 2013 to December 31, 2015 is approximately 38% and for periods subsequent to December 31, 2015 the rate is approximately 35%. The adjustments of deferred tax assets and liabilities for this change in the tax rate amounted to ¥6,599 million ($84,603 thousand) and have been reflected in income taxes in the consolidated statement of income for the year ended December 31, 2011.

A reconciliation of the Japanese statutory income tax rate and the effective income tax rate as a percentage of income before income taxes is as follows:

Years ended December 31	**2011**	2010	2009
Japanese statutory income tax rate	**40.0%**	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.6**	0.8	0.9
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(4.3)**	(3.5)	(5.4)
Tax credit for research and development expenses	**(3.9)**	(5.1)	(2.8)
Change in valuation allowance	**(0.5)**	2.8	5.4
Effect of enacted changes in tax laws and rates on Japanese tax	**1.8**	—	—
Other	**(1.5)**	0.7	0.2
Effective income tax rate	**32.2%**	35.7%	38.3%

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

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Prepaid expenses and other current assets	**¥ 61,961**	¥ 69,197	**$ 794,372**
Other assets	**130,582**	136,727	**1,674,128**
Other current liabilities	**(1,735)**	(2,149)	**(22,244)**
Other noncurrent liabilities	**(43,542)**	(47,827)	**(558,231)**
	¥147,266	¥155,948	**$1,888,025**

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2011 and 2010 are presented below:

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Deferred tax assets:			
Inventories	**¥ 18,885**	¥ 23,836	**$ 242,115**
Accrued business tax	**3,227**	6,200	**41,372**
Accrued pension and severance cost	**90,025**	78,552	**1,154,167**
Research and development—costs capitalized for tax purposes	**12,898**	14,740	**165,359**
Property, plant and equipment	**31,624**	41,737	**405,436**
Accrued expenses	**37,992**	35,823	**487,077**
Net operating losses carried forward	**31,967**	28,373	**409,833**
Other	**38,220**	52,869	**489,999**
	264,838	282,130	**3,395,358**
Less valuation allowance	**(33,788)**	(35,307)	**(433,179)**
Total deferred tax assets	**231,050**	246,823	**2,962,179**
Deferred tax liabilities:			
Undistributed earnings of foreign subsidiaries	**(6,783)**	(8,215)	**(86,962)**
Net unrealized gains on securities	**(1,180)**	(2,119)	**(15,128)**
Tax deductible reserve	**(6,385)**	(6,038)	**(81,859)**
Financing lease revenue	**(40,878)**	(37,353)	**(524,077)**
Prepaid pension and severance cost	**(2,224)**	(2,018)	**(28,513)**
Other	**(26,334)**	(35,132)	**(337,615)**
Total deferred tax liabilities	**(83,784)**	(90,875)	**(1,074,154)**
Net deferred tax assets	**¥147,266**	¥155,948	**$1,888,025**

The net changes in the total valuation allowance were a decrease of ¥1,519 million ($19,474 thousand) for the year ended December 31, 2011, and increases of ¥13,119 million and ¥11,371 million for the years ended December 31, 2010 and 2009, respectively.

Based upon the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the existing valuation allowance, at December 31, 2011.

At December 31, 2011, Canon had net operating losses which can be carried forward for income tax purposes of ¥116,581 million ($1,494,628 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 twenty years as follows:

	Millions of yen	*Thousands of U.S. dollars*
Within one year	¥ 2,588	$ 33,179
After one year through five years	5,097	65,346
After five years through ten years	37,199	476,910
After ten years through twenty years	42,402	543,615
Indefinite period	29,295	375,578
Total	¥116,581	$1,494,628

Income taxes have not been accrued on undistributed earnings of domestic subsidiaries as the tax law provides a means by which the dividends from a domestic subsidiary can be received tax free.

Canon has not recognized deferred tax liabilities of ¥18,112 million ($232,205 thousand) for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2011 and prior years because Canon currently does not expect to have such amounts distributed or paid as dividends to the Company in the foreseeable future. Deferred tax liabilities will be recognized when Canon expects that it will realize those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. At December 31, 2011, such undistributed earnings of these subsidiaries were ¥869,064 million ($11,141,846 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*
	2011	2010	2009	**2011**
Balance at beginning of year	**¥6,035**	¥13,235	¥12,689	**$77,372**
Additions for tax positions of the current year	**149**	73	—	**1,910**
Additions for tax positions of prior years	**431**	805	1,442	**5,526**
Reductions for tax positions of prior years	**(2,139)**	(8,354)	(1,106)	**(27,423)**
Settlements with tax authorities	**(1,264)**	(2,471)	—	**(16,205)**
Additions from acquisitions	**—**	4,066	—	**—**
Other	**(279)**	(1,319)	210	**(3,577)**
Balance at end of year	**¥2,933**	¥ 6,035	¥13,235	**$37,603**

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥2,809 million ($36,013 thousand) and ¥6,035 million at December 31, 2011 and 2010, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in the future period. Based on each of the items of which Canon is aware at December 31, 2011, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2011 and 2010, and interest and penalties included in income taxes for the years ended December 31, 2011, 2010 and 2009 are not material.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2010. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2003. In other major foreign tax jurisdictions, including the United States and Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2004 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2003 in major foreign tax jurisdictions.

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, 2011, 2010 and 2009 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2011 did not reflect current year-end dividends in the amount of ¥72,092 million ($924,256 thousand) which were approved by the stockholders in March 2012.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥1,223,401 million ($15,684,628 thousand) at December 31, 2011.

Retained earnings at December 31, 2011 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥16,217 million ($207,910 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*
	2011	2010	2009	**2011**
Foreign currency translation adjustments:				
Balance at beginning of year	**¥(325,612)**	¥(202,628)	¥(235,968)	**$(4,174,513)**
Adjustments for the year	**(53,251)**	(122,984)	33,340	**(682,705)**
Balance at end of year	**(378,863)**	(325,612)	(202,628)	**(4,857,218)**
Net unrealized gains and losses on securities:				
Balance at beginning of year	**3,020**	3,285	1,135	**38,718**
Adjustments for the year	**(2,017)**	(265)	2,150	**(25,859)**
Balance at end of year	**1,003**	3,020	3,285	**12,859**
Net gains and losses on derivative instruments:				
Balance at beginning of year	**917**	71	1,493	**11,756**
Adjustments for the year	**(462)**	846	(1,422)	**(5,923)**
Balance at end of year	**455**	917	71	**5,833**
Pension liability adjustments:				
Balance at beginning of year	**(68,784)**	(61,546)	(59,480)	**(881,846)**
Adjustments for the year	**(35,584)**	(7,238)	(2,066)	**(456,205)**
Balance at end of year	**(104,368)**	(68,784)	(61,546)	**(1,338,051)**
Total accumulated other comprehensive income (loss):				
Balance at beginning of year	**(390,459)**	(260,818)	(292,820)	**(5,005,885)**
Adjustments for the year	**(91,314)**	(129,641)	32,002	**(1,170,692)**
Balance at end of year	**¥(481,773)**	¥(390,459)	¥(260,818)	**$(6,176,577)**

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*
2011:			
Foreign currency translation adjustments	**¥ (53,839)**	**¥ (247)**	**¥ (54,086)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(7,571)**	**3,010**	**(4,561)**
Reclassification adjustments for gains and losses realized in net income	**4,077**	**(1,632)**	**2,445**
Net change during the year	**(3,494)**	**1,378**	**(2,116)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**4,221**	**(1,708)**	**2,513**
Reclassification adjustments for gains and losses realized in net income	**(5,006)**	**2,044**	**(2,962)**
Net change during the year	**(785)**	**336**	**(449)**
Pension liability adjustments:			
Amount arising during the year	**(59,928)**	**20,252**	**(39,676)**
Reclassification adjustments for gains and losses realized in net income	**2,038**	**(739)**	**1,299**
Net change during the year	**(57,890)**	**19,513**	**(38,377)**
Other comprehensive income (loss)	**¥(116,008)**	**¥20,980**	**¥ (95,028)**
2010:			
Foreign currency translation adjustments	¥(128,271)	¥ 1,353	¥(126,918)
Net unrealized gains and losses on securities:			
Amount arising during the year	(2,179)	671	(1,508)
Reclassification adjustments for gains and losses realized in net income	1,320	42	1,362
Net change during the year	(859)	713	(146)
Net gains and losses on derivative instruments:			
Amount arising during the year	8,409	(3,573)	4,836
Reclassification adjustments for gains and losses realized in net income	(6,990)	2,921	(4,069)
Net change during the year	1,419	(652)	767
Pension liability adjustments:			
Amount arising during the year	(19,170)	8,314	(10,856)
Reclassification adjustments for gains and losses realized in net income	2,323	(794)	1,529
Net change during the year	(16,847)	7,520	(9,327)
Other comprehensive income (loss)	¥(144,558)	¥ 8,934	¥(135,624)
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

	Thousands of U.S. dollars		
	Before-tax amount	*Tax (expense) or benefit*	*Net-of-tax amount*
2011:			
Foreign currency translation adjustments	**$ (690,244)**	**$ (3,166)**	**$ (693,410)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(97,065)**	**38,590**	**(58,475)**
Reclassification adjustments for gains and losses realized in net income	**52,270**	**(20,923)**	**31,347**
Net change during the year	**(44,795)**	**17,667**	**(27,128)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**54,115**	**(21,897)**	**32,218**
Reclassification adjustments for gains and losses realized in net income	**(64,179)**	**26,204**	**(37,975)**
Net change during the year	**(10,064)**	**4,307**	**(5,757)**
Pension liability adjustments:			
Amount arising during the year	**(768,307)**	**259,640**	**(508,667)**
Reclassification adjustments for gains and losses realized in net income	**26,128**	**(9,474)**	**16,654**
Net change during the year	**(742,179)**	**250,166**	**(492,013)**
Other comprehensive income (loss)	**$(1,487,282)**	**$268,974**	**$(1,218,308)**

16. STOCK-BASED COMPENSATION

On May 1, 2011, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 912,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2011 was ¥772 ($9.90).

On May 1, 2010, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 890,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2010 was ¥988.

On May 1, 2009, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 954,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2009 was ¥699.

On May 1, 2008, based on the approval of the stockholders, the Company granted stock options to its directors, executive officers and certain employees to acquire 592,000 shares of common stock. These option awards vest after two years of continued service beginning on the grant date and have a four year contractual term. The grant-date fair value per share of the stock options granted during the year ended December 31, 2008 was ¥1,247.

The compensation cost recognized for these stock options for the years ended December 31, 2011, 2010 and 2009 was ¥748 million ($9,590 thousand), ¥643 million and ¥564 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	**2011**	2010	2009
Expected term of option (in years)	**4.0**	4.0	4.0
Expected volatility	**36.44%**	38.00%	40.08%
Dividend yield	**3.16%**	2.53%	3.51%
Risk-free interest rate	**0.44%**	0.45%	0.64%

A summary of option activity under the stock option plans as of and for the years ended December 31, 2011, 2010 and 2009 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, 2009	592,000	¥5,502		3.3	¥ —	$ —
Granted	954,000	3,287				
Forfeited	(34,000)	4,851				
Outstanding at December 31, 2009	1,512,000	4,119		3.0	588	7,538
Granted	890,000	4,573				
Forfeited	(182,000)	3,479				
Outstanding at December 31, 2010	2,220,000	4,354	$55.82	2.5	722	9,256
Granted	**912,000**	**3,990**	**51.15**			
Exercised	**(65,800)**	**3,287**	**42.14**			
Forfeited	**(24,000)**	**4,282**	**54.90**			
Outstanding at December 31, 2011	**3,042,200**	**¥4,268**	**$54.72**	**2.0**	**¥ 88**	**$ 1,128**
Exercisable at December 31, 2011	**1,274,200**	**¥4,257**	**$54.58**	**0.9**	**¥ 88**	**$ 1,128**

At December 31, 2011, all outstanding option awards were vested or expected to be vested.

A summary of the status of the Company's nonvested shares at December 31, 2011, and changes during the year ended December 31, 2011, is presented below:

Year ended December 31, 2011	Shares	Weighted-average grant-date fair value	
		yen	U.S. dollars
Nonvested at January 1, 2011	**1,662,000**	**¥852**	**$ 10.92**
Granted	**912,000**	**772**	**9.90**
Vested	**(782,000)**	**699**	**8.96**
Forfeited	**(24,000)**	**880**	**11.28**
Nonvested at December 31, 2011	**1,768,000**	**878**	**11.26**

At December 31, 2011, there was ¥606 million ($7,769 thousand) of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted average period of 0.84 year. The total fair value of shares vested during the years ended December 31, 2011 and 2010 was ¥547 million ($7,013 thousand) and ¥696 million, respectively. Cash received from the exercise of stock options for the year ended December 31, 2011 was ¥216 million ($2,769 thousand).

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*
	2011	2010	2009	**2011**
Net income attributable to Canon Inc.	**¥248,630**	¥246,603	¥131,647	**$3,187,564**
	Number of shares			
Average common shares outstanding	**1,215,832,419**	1,234,817,434	1,234,481,836	
Effect of dilutive securities:				
Stock options	**60,552**	50,603	—	
Diluted common shares outstanding	**1,215,892,971**	1,234,868,037	1,234,481,836	
	Yen			*U.S. dollars*
Net income attributable to Canon Inc. stockholders per share:				
Basic	**¥204.49**	¥199.71	¥106.64	**$2.62**
Diluted	**204.48**	199.70	106.64	**2.62**

The computation of diluted net income attributable to Canon Inc. stockholders per share for the years ended December 31, 2011 and 2010 excludes certain outstanding stock options because the effect would be anti-dilutive. The computation of diluted net income attributable to Canon Inc. stockholders per share for the year ended December 31, 2009 excludes 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 twelve months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

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 at December 31, 2011 and 2010 are set forth below:

December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
To sell foreign currencies	**¥391,455**	¥466,361	**$5,018,654**
To buy foreign currencies	**75,016**	48,686	**961,744**

Fair value of derivative instruments in the consolidated balance sheets

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at December 31, 2011 and 2010.

Derivatives designated as hedging instruments

December 31		*Fair value*		
		Millions of yen		*Thousands of U.S. dollars*
	Balance sheet location	**2011**	2010	**2011**
Assets:				
Foreign exchange contracts	Prepaid expenses and other current assets	**¥1,325**	¥2,487	**$16,987**
Liabilities:				
Foreign exchange contracts	Other current liabilities	**1,270**	426	**16,282**

Derivatives not designated as hedging instruments

December 31		*Fair value*		
		Millions of yen		*Thousands of U.S. dollars*
	Balance sheet location	**2011**	2010	**2011**
Assets:				
Foreign exchange contracts	Prepaid expenses and other current assets	**¥3,393**	¥9,463	**$43,500**
Liabilities:				
Foreign exchange contracts	Other current liabilities	**1,340**	487	**17,180**

Effect of derivative instruments in the consolidated statements of income

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the years ended December 31, 2011, 2010 and 2009.

Derivatives in cash flow hedging relationships

Years ended December 31	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
2011: Foreign exchange contracts	**¥ (785)**	Other, net	**¥ 5,006**	Other, net	**¥ (457)**
2010: Foreign exchange contracts	1,419	Other, net	6,990	Other, net	(302)
2009: Foreign exchange contracts	(2,372)	Other, net	2,670	Other, net	(462)
Thousands of U.S. dollars					
2011: Foreign exchange contracts	**$ (10,064)**	Other, net	**$64,179**	Other, net	**$ (5,859)**

Derivatives not designated as hedging instruments

Years ended December 31		Gain (loss) recognized in income on derivative			
		Millions of yen			Thousands of U.S. dollars
	Location	**2011**	2010	2009	**2011**
Foreign exchange contracts	Other, net	**¥11,168**	¥50,794	¥(8,638)	**$143,179**

19. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

At December 31, 2011, commitments outstanding for the purchase of property, plant and equipment approximated ¥66,287 million ($849,833 thousand), and commitments outstanding for the purchase of parts and raw materials approximated ¥75,823 million ($972,090 thousand).

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,171 million ($181,679 thousand) and ¥13,686 million at December 31, 2011 and 2010, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under such operating lease arrangements amounted to ¥38,167 million ($489,321 thousand), ¥40,396 million and ¥36,474 million for the years ended December 31, 2011, 2010 and 2009, 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, 2011 are as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2012	¥22,259	$285,372
2013	15,843	203,115
2014	11,632	149,128
2015	7,120	91,282
2016	5,473	70,167
Thereafter	10,471	134,244
Total future minimum lease payments	¥72,798	$933,308

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 ¥15,245 million ($195,449 thousand) at December 31, 2011. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2011 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, 2011 and 2010 are summarized as follows:

Years ended December 31	*Millions of yen*		*Thousands of U.S. dollars*
	2011	2010	**2011**
Balance at beginning of year	**¥13,343**	¥13,944	**$171,064**
Addition	**14,296**	17,605	**183,282**
Utilization	**(14,649)**	(14,713)	**(187,808)**
Other	**(1,299)**	(3,493)	**(16,653)**
Balance at end of year	**¥11,691**	¥13,343	**$149,885**

Legal proceedings

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

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, although litigation is inherently unpredictable, 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, any reasonably possible range of losses from outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows.

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, 2011 and 2010 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*				*Thousands of U.S. dollars*	
	2011		2010		**2011**	
	Carrying amount	*Estimated fair value*	*Carrying amount*	*Estimated fair value*	*Carrying amount*	*Estimated fair value*
Long-term debt, including current installments	**¥(7,070)**	**¥(7,053)**	¥(9,260)	¥(9,245)	**$(90,641)**	**$(90,423)**
Foreign exchange contracts:						
Assets	**4,718**	**4,718**	11,950	11,950	**60,487**	**60,487**
Liabilities	**(2,610)**	**(2,610)**	(913)	(913)	**(33,462)**	**(33,462)**

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 of fair value estimates

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, 2011 and 2010, one customer accounted for approximately 17% and 21% 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 tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at December 31, 2011 and 2010.

December 31 *Millions of yen*	*Level 1*	*Level 2*	*Level 3*	*Total*
2011: Assets:				
Cash and cash equivalents	**¥ —**	**¥204,307**	**¥ —**	**¥204,307**
Available-for-sale (current):				
Corporate bonds	**20**	**—**	**—**	**20**
Available-for-sale (noncurrent):				
Government bonds	**150**	**—**	**—**	**150**
Corporate bonds	**—**	**104**	**454**	**558**
Fund trusts	**151**	**1,675**	**—**	**1,826**
Equity securities	**17,724**	**—**	**—**	**17,724**
Derivatives	**—**	**4,718**	**—**	**4,718**
Total assets	**¥18,045**	**¥210,804**	**¥454**	**¥229,303**
Liabilities:				
Derivatives	**¥ —**	**¥ 2,610**	**¥ —**	**¥ 2,610**
Total liabilities	**¥ —**	**¥ 2,610**	**¥ —**	**¥ 2,610**

Millions of yen	*Level 1*	*Level 2*	*Level 3*	*Total*
2010: Assets:				
Cash and cash equivalents	¥ —	¥249,907	¥ —	¥249,907
Available-for-sale (current):				
Government bonds	1	—	—	1
Corporate bonds	—	—	1,000	1,000
Available-for-sale (noncurrent):				
Government bonds	161	—	—	161
Corporate bonds	—	44	950	994
Fund trusts	10	1,788	—	1,798
Equity securities	23,402	—	—	23,402
Derivatives	—	11,950	—	11,950
Total assets	¥23,574	¥263,689	¥1,950	¥289,213
Liabilities:				
Derivatives	¥ —	¥ 913	¥ —	¥ 913
Total liabilities	¥ —	¥ 913	¥ —	¥ 913

Thousands of U.S. dollars	Level 1	Level 2	Level 3	Total
2011: Assets:				
Cash and cash equivalents	**$ —**	**$2,619,321**	**$ —**	**$2,619,321**
Available-for-sale (current):				
Corporate bonds	**256**	**—**	**—**	**256**
Available-for-sale (noncurrent):				
Government bonds	**1,923**	**—**	**—**	**1,923**
Corporate bonds	**—**	**1,333**	**5,821**	**7,154**
Fund trusts	**1,936**	**21,474**	**—**	**23,410**
Equity securities	**227,231**	**—**	**—**	**227,231**
Derivatives	**—**	**60,487**	**—**	**60,487**
Total assets	**$231,346**	**$2,702,615**	**$5,821**	**$2,939,782**
Liabilities:				
Derivatives	**$ —**	**$ 33,462**	**$ —**	**$ 33,462**
Total liabilities	**$ —**	**$ 33,462**	**$ —**	**$ 33,462**

Level 1 investments are comprised principally of Japanese 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 based on market approach, 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 cost approach, using 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, based on market approach.

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the years ended December 31, 2011 and 2010.

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2011	2010	**2011**
Balance at beginning of year	**¥1,950**	¥1,340	**$25,000**
Total gains or losses (realized or unrealized):			
Included in earnings	**(2)**	(79)	**(25)**
Included in other comprehensive income (loss)	**(12)**	(7)	**(154)**
Purchases, issuances, and settlements	**(1,482)**	696	**(19,000)**
Balance at end of year	**¥ 454**	¥1,950	**$ 5,821**

Gains and losses included in earnings are mainly related to corporate bonds still held at December 31, 2011 and 2010, 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, 2011, equity securities accounted for by the equity method with a carrying amount of ¥3,577 million ($45,859 thousand) were written down to their fair value of zero, resulting in an other-than-temporary impairment charge of ¥3,577 million ($45,859 thousand), which was included in earnings. Equity securities accounted for by the equity method were classified as Level 3 instruments and valued based on an income approach using unobservable inputs such as projected income of the investment.

During the year ended December 31, 2010, non-marketable equity securities with a carrying amount of ¥5,000 million were written down to their fair value of ¥2,422 million and equity securities accounted for by the equity method with a carrying amount of ¥33,984 million were written down to their fair value of ¥15,164 million, resulting in an other-than-temporary impairment charge totaling ¥21,398 million, which was included in earnings. The non-marketable equity securities were classified as Level 2 instruments and valued based on a market approach using observable inputs such as unadjusted quoted prices for similar instruments in active markets at the measurement date. Equity securities accounted for by the equity method were classified as Level 3 instruments and valued based on a combination of income approach and market approach using both unobservable and observable inputs including the use of inputs such as financial metrics, ratios and projected income of the investees and appropriate comparable public companies.

22. SUPPLEMENTAL CASH FLOW INFORMATION

During the year ended December 31, 2010, the Company executed three separate share exchanges under which the Company made its three listed subsidiaries, Canon Finetech Inc., Canon Machinery Inc. and Tokki Corporation, its wholly owned subsidiaries. The Company issued no new shares, as it issued 10,000,853 shares of treasury stock for these transactions in total.

As a result of the share exchanges, the carrying amount of the Company's noncontrolling interest in Canon Finetech Inc., Canon Machinery Inc. and Tokki Corporation was decreased from ¥38,644 million to zero.

23. 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 / Personal-use network digital MFDs / Office copying machines / Full-color copying machines / Personal-use copying machines / Laser printers / Large format inkjet printers / Digital production printers

Consumer Business Unit:
Digital SLR cameras / Compact digital cameras / Interchangeable lenses / Digital video camcorders / Inkjet multifunction printers / Single function inkjet printers / Image scanners / Broadcast equipment / Calculators

Industry and Others Business Unit:
Semiconductor lithography equipment / LCD lithography equipment / Medical image recording equipment / Ophthalmic products / Magnetic heads / Micromotors / Computers / Handy terminals / Document scanners

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, 2011, 2010 and 2009 is as follows:

Millions of yen	*Office*	*Consumer*	*Industry and Others*	*Corporate and eliminations*	*Consolidated*
2011: Net sales:					
External customers	**¥1,912,112**	**¥1,311,023**	**¥334,298**	**¥ —**	**¥3,557,433**
Intersegment	**5,831**	**1,021**	**86,565**	**(93,417)**	**—**
Total	**1,917,943**	**1,312,044**	**420,863**	**(93,417)**	**3,557,433**
Operating cost and expenses	**1,658,678**	**1,100,750**	**396,563**	**23,371**	**3,179,362**
Operating profit	**¥ 259,265**	**¥ 211,294**	**¥ 24,300**	**¥ (116,788)**	**¥ 378,071**
Total assets	**¥ 821,782**	**¥ 452,809**	**¥362,638**	**¥2,293,498**	**¥3,930,727**
Depreciation and amortization	**93,196**	**45,609**	**29,685**	**92,853**	**261,343**
Capital expenditures	**53,888**	**48,192**	**37,648**	**122,753**	**262,481**
2010: Net sales:					
External customers	¥1,978,945	¥1,389,622	¥338,334	¥ —	¥3,706,901
Intersegment	8,324	1,705	94,624	(104,653)	—
Total	1,987,269	1,391,327	432,958	(104,653)	3,706,901
Operating cost and expenses	1,693,947	1,153,262	442,789	29,351	3,319,349
Operating profit (loss)	¥ 293,322	¥ 238,065	¥ (9,831)	¥ (134,004)	¥ 387,552
Total assets	¥ 855,893	¥ 414,022	¥307,029	¥2,406,876	¥3,983,820
Depreciation and amortization	103,548	41,665	37,387	93,593	276,193
Capital expenditures	53,115	36,266	27,105	77,061	193,547
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

Thousands of U.S. dollars	*Office*	*Consumer*	*Industry and Others*	*Corporate and eliminations*	*Consolidated*
2011: Net sales:					
External customers	**$24,514,256**	**$16,807,987**	**$4,285,872**	**$ —**	**$45,608,115**
Intersegment	**74,757**	**13,090**	**1,109,807**	**(1,197,654)**	**—**
Total	**24,589,013**	**16,821,077**	**5,395,679**	**(1,197,654)**	**45,608,115**
Operating cost and expenses	**21,265,103**	**14,112,180**	**5,084,141**	**299,627**	**40,761,051**
Operating profit	**$ 3,323,910**	**$ 2,708,897**	**$ 311,538**	**$ (1,497,281)**	**$ 4,847,064**
Total assets	**$10,535,667**	**$ 5,805,244**	**$4,649,205**	**$29,403,820**	**$50,393,936**
Depreciation and amortization	**1,194,821**	**584,731**	**380,577**	**1,190,422**	**3,350,551**
Capital expenditures	**690,872**	**617,846**	**482,667**	**1,573,756**	**3,365,141**

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, goodwill and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis.

Information by major geographic area as of and for the years ended December 31, 2011, 2010 and 2009 is as follows:

	Millions of yen			*Thousands of U.S. dollars*
	2011	2010	2009	**2011**
Net sales:				
Japan	**¥ 694,450**	¥ 695,749	¥ 702,344	**$ 8,903,205**
Americas	**961,955**	1,023,299	894,154	**12,332,756**
Europe	**1,113,065**	1,172,474	995,150	**14,270,064**
Asia and Oceania	**787,963**	815,379	617,553	**10,102,090**
Total	**¥3,557,433**	¥3,706,901	¥3,209,201	**$45,608,115**
Long-lived assets:				
Japan	**¥1,070,412**	¥1,104,949	¥1,205,887	**$13,723,230**
Americas	**85,824**	69,034	59,273	**1,100,308**
Europe	**83,296**	108,160	44,875	**1,067,897**
Asia and Oceania	**89,334**	72,846	77,146	**1,145,308**
Total	**¥1,328,866**	¥1,354,989	¥1,387,181	**$17,036,743**

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 ¥779,652 million ($9,995,538 thousand), ¥836,645 million and ¥793,428 million for the years ended December 31, 2011, 2010 and 2009, 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, 2011, 2010 and 2009. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information in order to provide financial statements users with useful information.

Millions of yen	*Japan*	*Americas*	*Europe*	*Asia and Oceania*	*Corporate and eliminations*	*Consolidated*
2011: Net sales:						
External customers	**¥ 807,883**	**¥ 952,833**	**¥1,109,256**	**¥ 687,461**	**¥ —**	**¥3,557,433**
Intersegment	**1,873,157**	**16,217**	**4,681**	**744,179**	**(2,638,234)**	**—**
Total	**2,681,040**	**969,050**	**1,113,937**	**1,431,640**	**(2,638,234)**	**3,557,433**
Operating cost and expenses	**2,273,336**	**948,593**	**1,069,489**	**1,388,580**	**(2,500,636)**	**3,179,362**
Operating profit	**¥ 407,704**	**¥ 20,457**	**¥ 44,448**	**¥ 43,060**	**¥ (137,598)**	**¥ 378,071**
Total assets	**¥1,236,468**	**¥ 250,131**	**¥ 427,030**	**¥ 442,263**	**¥1,574,835**	**¥3,930,727**
2010: Net sales:						
External customers	¥ 854,208	¥1,008,200	¥1,163,452	¥ 681,041	¥ —	¥3,706,901
Intersegment	1,974,591	7,975	3,489	723,423	(2,709,478)	—
Total	2,828,799	1,016,175	1,166,941	1,404,464	(2,709,478)	3,706,901
Operating cost and expenses	2,398,439	993,310	1,126,521	1,357,663	(2,556,584)	3,319,349
Operating profit	¥ 430,360	¥ 22,865	¥ 40,420	¥ 46,801	¥ (152,894)	¥ 387,552
Total assets	¥1,321,572	¥ 251,587	¥ 472,785	¥ 421,250	¥1,516,626	¥3,983,820
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

Thousands of U.S. dollars	*Japan*	*Americas*	*Europe*	*Asia and Oceania*	*Corporate and eliminations*	*Consolidated*
2011: Net sales:						
External customers	**$10,357,474**	**$12,215,808**	**$14,221,231**	**$ 8,813,602**	**$ —**	**$45,608,115**
Intersegment	**24,014,834**	**207,910**	**60,013**	**9,540,757**	**(33,823,514)**	**—**
Total	**34,372,308**	**12,423,718**	**14,281,244**	**18,354,359**	**(33,823,514)**	**45,608,115**
Operating cost and expenses	**29,145,334**	**12,161,449**	**13,711,398**	**17,802,308**	**(32,059,438)**	**40,761,051**
Operating profit	**$ 5,226,974**	**$ 262,269**	**$ 569,846**	**$ 552,051**	**$ (1,764,076)**	**$ 4,847,064**
Total assets	**$15,852,154**	**$ 3,206,808**	**$ 5,474,744**	**$ 5,670,038**	**$20,190,192**	**$50,393,936**

24. SUBSEQUENT EVENT

On February 2, 2012, the Board of Directors of the Company approved and implemented a plan to repurchase up to 16 million shares of the Company's common stock at a cost of up to ¥50,000 million ($641,026 thousand) for the period from February 3, 2012 to March 19, 2012. Such repurchases are intended to improve capital efficiency and ensure flexible capital strategy. Common stock repurchased in the Tokyo Stock Exchange between February 3, 2012 and February 16, 2012 under the aforementioned plan was 14,521,600 shares at a cost of ¥50,000 million ($641,026 thousand).

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, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework* (the "COSO criteria").

Based on its assessment, management concluded that, as of December 31, 2011, Canon's internal control over financial reporting was effective based on the COSO criteria.

Canon's independent registered public accounting firm, Ernst & Young ShinNihon LLC, has issued an audit report on the effectiveness of our internal control over financial reporting.

Fujio Mitarai
Chairman & CEO

Toshizo Tanaka
Executive Vice President & CFO

March 29, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ERNST & YOUNG

Ernst & Young ShinNihon LLC
Hibiya Kokusai Bldg.
2-2-3 Uchisaiwai-cho
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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, 2011 and 2010, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2011, 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 opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 29, 2012 expressed an unqualified opinion thereon.

We have also recomputed the translation of the consolidated financial statements as of and for the year ended December 31, 2011 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 29, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ERNST & YOUNG

Ernst & Young ShinNihon LLC
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Tel : +81 3 3503 1191
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, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, equity, and cash flows for each of the three years in the period ended December 31, 2011, all expressed in Japanese yen, and our report dated March 29, 2012 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 29, 2012

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.
1 Chase Manhattan Plaza, Floor 58, New York, N.Y. 10005-1401, 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 29, 2012, 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, 2011)

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.
Nagasaki 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
Tokki Corporation*
Canon Imaging Systems Inc.
Canon Virginia, Inc.
Canon Giessen GmbH
Canon Bretagne S.A.S.
OPTOPOL Technology S.A.
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 Vietnam Co., Ltd.
Canon Electronic Business Machines (H.K.) Co., Ltd.

Research & Development

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.

* Tokki Corporation changed its name to “Canon Tokki Corporation,” effective January 1, 2012.

Marketing & Other

Canon Marketing Japan Inc.
Canon System and Support Inc.
Canon IT Solutions Inc.
Canon Software Inc.
e-System Corporation
ASPAC Inc.
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 Comercio 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) AG
Canon Austria GmbH
Canon Svenska AB
Canon Oy
Canon North-East Oy
Canon Norge A.S.
Canon Ru LLC
Canon CEE GmbH
Canon Eurasia A.S.
Canon Portugal S.A.
Océ N.V.
Canon Middle East FZ-LIC
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.
Canon Optical Industrial Equipment (Shanghai) Inc.
Canon Optical Industrial Equipment Service (Shanghai) Inc.

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