

CANON INC
Form 20-F
March 29, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

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

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

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

OR

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

Commission file number 001-15122

CANON KABUSHIKI KAISHA

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

CANON INC.

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

JAPAN

(Jurisdiction of incorporation or organization)

30-2, Shimomaruko 3-chome, Ohta-ku, Tokyo 146-8501, Japan (Address of principal executive offices)

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

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

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

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

As of December 31, 2017, 1,079,755,783 shares of common stock, including 19,648,132 ADSs, were outstanding.

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit

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and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Emerging growth company
If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

U.S. GAAP

International Financial Reporting Standards as issued

Other

by the International Accounting Standards Board

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

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

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CERTAIN DEFINED TERMS, CONVENTIONS AND PRESENTATION OF FINANCIAL INFORMATION

All information contained in this Annual Report is as of December 31, 2017 unless otherwise specified.

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

On March 9, 2018, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥106.74= U.S.\$1.

The Company's fiscal year end is December 31. In this Annual Report 2017 refers to the Company's fiscal year ended December 31, 2017, and other fiscal years of the Company are referred to in a corresponding manner.

FORWARD-LOOKING INFORMATION

This Annual Report contains forward-looking statements and information relating to Canon that are based on beliefs of its management as well as assumptions made by and information currently available to Canon Inc. When used in this Annual Report, the words anticipate, believe, estimate, expect, intend, may, plan, project, should and similar expressions, as they relate to Canon or its management, are intended to forward-looking statements. Such statements, which include, but are not limited to, statements contained in Item 3. Key Information-Risk Factors, Item 4. Information on the Company, Item 5. Operating and Financial Review and Prospects and Item 11. Quantitative and Qualitative Disclosures about Market Risk reflect the current views and assumptions of the Company with respect to future events and are subject to risks and uncertainties. Many factors could cause the actual results, performance or achievements of Canon to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including, among others, changes in general economic and business conditions, changes in currency exchange rates and interest rates, introduction of competing products by other companies, lack of acceptance of new products or services by Canon's targeted customers, inability to meet efficiency and cost reduction objectives, changes in business strategy and various other factors, both referenced and not referenced in this Annual Report. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected, intended, planned or projected. Canon Inc. does not intend or assume any obligation to update these forward-looking statements.

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

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

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

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

| Selected financial data *1: | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|-------------|-------------|-------------|-------------|
| | (Millions of yen, except average number of shares and per share data) | | | | |
| Net sales | ¥ 4,080,015 | ¥ 3,401,487 | ¥ 3,800,271 | ¥ 3,727,252 | ¥ 3,731,380 |
| Operating profit | 331,479 | 228,866 | 355,210 | 363,489 | 337,277 |
| Net income attributable to Canon Inc. | 241,923 | 150,650 | 220,209 | 254,797 | 230,483 |
| Advertising expenses | 61,207 | 58,707 | 80,907 | 79,765 | 86,398 |
| Research and development expenses | 330,053 | 302,376 | 328,500 | 308,979 | 306,324 |
| Depreciation of property, plant and equipment | 189,712 | 199,133 | 223,759 | 213,739 | 223,158 |
| Increase in property, plant and equipment | 147,542 | 171,597 | 195,120 | 182,343 | 188,826 |
| Long-term debt, excluding current installments | 493,238 | 611,289 | 881 | 1,148 | 1,448 |
| Common stock | 174,762 | 174,762 | 174,762 | 174,762 | 174,762 |
| Canon Inc. shareholders' equity | 2,870,630 | 2,783,129 | 2,966,415 | 2,978,184 | 2,910,262 |
| Total assets | 5,198,291 | 5,138,529 | 4,427,773 | 4,460,618 | 4,242,710 |
| Average number of common shares in thousands | 1,085,439 | 1,092,071 | 1,092,018 | 1,112,510 | 1,147,934 |
| Per share data: | | | | | |
| Net income attributable to Canon Inc. shareholders per share: | | | | | |
| Basic | ¥ 222.88 | ¥ 137.95 | ¥ 201.65 | ¥ 229.03 | ¥ 200.78 |
| Diluted | 222.88 | 137.95 | 201.65 | 229.03 | 200.78 |
| Cash dividends declared | 160.00 | 150.00 | 150.00 | 150.00 | 130.00 |
| Cash dividends declared (U.S.\$) *2 | \$ 1.483 | \$ 1.393 | \$ 1.290 | \$ 1.326 | \$ 1.309 |
| Notes: | | | | | |

- The above financial data is prepared in accordance with U.S. generally accepted accounting principles. Canon acquired Toshiba Medical Systems Corporation (TMSC) on December 19, 2016, which was subsequently renamed as Canon Medical Systems Corporation on January 4, 2018. TMSC's consolidated balance sheet and operating result since the acquisition date are reflected in Canon's consolidated financial statements. For further information, please refer to Note 7 of the Notes to Consolidated Financial Statements.
- Annual cash dividends declared (U.S.\$) are translated from yen based on a weighted average of the noon buying rates for yen in New York City as reported by the Federal Reserve Bank of New York in effect on the date of each semiannual dividend payment or on the latest practicable date.

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The following table provides the noon buying rates for Japanese yen in New York City as reported by the Federal Reserve Bank of New York expressed in Japanese yen per U.S.\$1 during the periods indicated and the high and low noon buying rates for Japanese yen per U.S.\$1 during the months indicated. On March 9, 2018, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥106.74 = U.S.\$1.

| Yen exchange rates per U.S. dollar: | Average | Term end | High | Low |
|-------------------------------------|---------|----------|--------|--------|
| 2013 | 98.00 | 105.25 | 105.25 | 86.92 |
| 2014 | 106.63 | 119.85 | 121.38 | 101.11 |
| 2015 | 121.02 | 120.27 | 125.58 | 116.78 |
| 2016 | 109.16 | 116.78 | 121.06 | 100.07 |
| 2017 - Year | 111.87 | 112.69 | 117.68 | 107.72 |
| - 1(st) half | | 112.40 | 117.68 | 108.40 |
| - July | | 110.38 | 114.20 | 110.38 |
| - August | | 110.06 | 110.80 | 108.89 |
| - September | | 112.64 | 112.76 | 107.72 |
| - October | | 113.63 | 113.92 | 111.72 |
| - November | | 112.30 | 114.25 | 111.00 |
| - December | | 112.69 | 113.62 | 111.88 |
| 2018 - January | | 109.31 | 113.18 | 108.38 |
| - February | | 106.62 | 110.40 | 106.10 |

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

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

D. Risk factors

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

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

Risks Related to Economic Environment*Economic trends in Canon's major markets may adversely affect its operating results.*

Canon's business activities are deployed globally in Japan, the United States, Europe, Asia, and in other regions. Declines in consumption and restrained investment due to economic downturn in these major markets may affect Canon's operating results. The operating results for products such as office, diagnostic equipment and industrial equipment are affected by the financial results of its corporate customers or medical institutions, and deterioration of their financial results has caused and may continue to cause customers to limit capital investments. Demand for Canon's consumer products, such as cameras and inkjet printers, is discretionary. Rapid price declines owing to intensifying competition and declines in levels of consumer spending and corporate investment could adversely affect Canon's operating results and financial position.

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

Canon derives a significant portion of its revenue from its international operations. As a result, Canon's operating results and financial position have been and may continue to be significantly affected by changes in the value of the yen versus foreign currencies. Sales of Canon's products denominated in foreign currencies have been and may continue to be adversely affected by the strength of the yen against foreign currencies. Conversely, a strengthening of foreign currencies against the yen will generally be favorable to Canon's foreign currency sales. Canon's consolidated financial statements are presented in yen. As such, the yen value of Canon's assets and liabilities arising from foreign currency transactions have fluctuated and may continue to fluctuate. Unpredictable fluctuations may have certain effects on Canon's consolidated financial statements. Although Canon strives to mitigate the effects of foreign currency fluctuations arising from its international business activities, Canon's consolidated financial statements have been and may continue to be affected by currency translations from the financial statements of Canon's foreign subsidiaries and affiliates, which are denominated in various foreign currencies. Canon is also exposed to the risk of interest rate fluctuations, which may affect the value of Canon's financial assets and liabilities.

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

Canon's assets include investments in publicly traded securities. As a result, Canon's operating results and general financial position may be affected by price fluctuations in the stock and bond markets. Volatility in financial markets and overall economic uncertainty create the risk that the actual amounts realized in the future on Canon's investments could differ significantly from the fair values currently assigned to them.

High prices of raw materials could negatively impact Canon's profitability.

Increases in prices for raw materials that Canon uses in manufacturing such as steel, non-ferrous metals and petrochemical products may lead to higher production costs and Canon may not be able to pass these increased production costs onto the sales prices of its products. Such increases in prices for raw materials could adversely affect Canon's operating results.

Risks Related to Canon's Industries and Business Operations

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

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

- unfavorable political, diplomatic or economic conditions;
- sharp fluctuations in foreign currency exchange rates;
- unexpected political, legal or regulatory changes;
- inadequate systems of intellectual property protection;
- difficulties in recruiting and retaining qualified personnel; and
- less developed production infrastructure.

Any inability to manage the risks inherent in Canon's international activities could adversely affect its business and operating results.

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Canon has invested and will continue to invest actively in next-generation technologies. If the markets for these technologies do not develop as Canon expects, or if its competitors produce these or competing technologies in a more timely or effective manner, Canon's operating results may be materially adversely affected.

Canon has made and will continue to make investments in next-generation technology research and development initiatives. Canon's competitors may achieve research and development breakthroughs in these technologies more quickly than Canon, or may achieve advances in competing technologies that render products under development by Canon uncompetitive. For several years, Canon has continued its investments in development and manufacturing in order to keep pace with technological evolution. If Canon's business strategies diverge from market demands, Canon may not recover some or all of its investments, or may lose business opportunities, or both, which may have a material adverse effect on Canon's operating results.

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

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

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

Many of the business areas in which Canon competes are characterized by rapid technological advances in hardware performance, software functionality and product features; frequent introduction of new products; short product life cycles; and continued qualitative improvements to current products at stable price levels. Canon has sought to invest substantial resources into introducing appealing, innovative and cost-competitive new products. There are several risks inherent in introduction of new products and services, such as delays in development or manufacturing, unsuitable product quality during the introductory period, variations in manufacturing costs, negative impact on sales of current products, uncertainty in predicting customer demand and difficulty in effectively managing inventory levels. Moreover, if Canon is unable to respond quickly to technological innovations with respect to information systems and networks, Canon's revenue may be significantly affected as a result of delays associated with the incorporation into its products of such new information technologies.

Canon's revenues and gross margins also may suffer adverse effects because of the timing of product or service introductions by its competitors. This risk is exacerbated when a competitor introduces a new product immediately prior to Canon's introduction of a similar product. If any of these risks materialize, future demand for Canon's products and services could be reduced, and its operating results could decline.

Changes in the print environment may affect Canon's business.

In the business machines market for such products as MFDs, copying machines and printers, customers are increasingly looking for ways to cut costs while protecting the environment. From this perspective, Managed Print Services (MPS), which aim to optimize printing efficiencies in the office, have become popular in recent years. This trend could lead to a decrease in business machine print volumes.

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In addition, the digitalization of workflow in office could also lead to a decrease in customer print opportunities. If Canon is unable to supply products and services that respond to these types of market trends, its operating results may be adversely affected.

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

The smartphone market has been growing on a global scale. Smartphones allow users not only to take photos, but also share them instantly on SNSs and it changed people's photo taking behavior. If Canon's digital cameras cannot clearly state their advantages over smartphones' cameras, Canon could suffer from an erosion of the digital camera market, with a resulting adverse effect on operating results.

Canon may not be able to adequately anticipate developments related to its medical device business, including changes to the market environment and developments related to medical device approvals, certifications and health insurance coverage.

Regarding the market for Canon's medical equipment sold to medical institutions, mainly in the area of diagnostic imaging, it takes a long time to design, research, develop and commercialize products, because it is necessary to prove the clinical effectiveness of new technologies and new products, and obtain regulatory approvals and certifications prior to sale in individual countries. The global market for medical devices is expanding due to developing medical infrastructure in emerging countries, but in developed countries issues such as aging populations, rising health insurance costs and pressure to cut medical device costs may adversely affect Canon's medical device business.

Canon invests in research and development of new medical device technologies based on detailed analysis of the potential technical and business prospects for such technologies. However, despite these investments, Canon may become less competitive if it cannot anticipate whether new technologies will have the expected clinical effects or developments in the market or regulatory environment for such technologies. Canon may need to significantly modify its business plans in response to these challenges and it may not be able to generate the expected returns on its investments in research and development of medical devices.

Because the semiconductor lithography equipment and flat-panel-display (FPD) industry is highly cyclical, Canon may be adversely affected by any downturn in demand for semiconductor devices and FPD panels.

The semiconductor lithography equipment and FPD lithography equipment industry is characterized by fluctuating business cycles, the timing, length and volatility of which are difficult to predict. Recurring periods of oversupply of semiconductor devices and FPD panels have at times led to significantly reduced demand for capital equipment, including the semiconductor lithography equipment and FPD lithography equipment that Canon produces. Despite this cyclical nature, Canon must maintain significant levels of research and development expenditures to remain competitive. A future cyclical downturn in the lithography equipment industry and related fluctuations in the demand for capital equipment could cause cash flow from sales to fall below the level necessary to offset Canon's expenditures, including those arising from research and development, and could consequently have a material adverse effect on Canon's operating results and financial condition.

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

Disruptions of relationships with large Canon distributors or acquisitions of those distributors by competitors could adversely affect Canon's ability to meet its sales targets. In addition, the rapid proliferation of Internet-based businesses may render conventional distribution channels obsolete. These, and other changes in Canon's sales environment, could adversely affect Canon's operating results.

In addition, Canon depends on HP Inc. for a significant part of its business. As a result, Canon's business and operating results may be affected by the policies, business and operating results of HP Inc. Any decision by HP Inc. management to limit or reduce the scope of its relationship with Canon would adversely affect Canon's business and operating results.

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Canon depends on specific outside suppliers for certain key components.

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

Canon may be subject to antitrust-related lawsuits, investigations or proceedings, which may adversely affect its operating results or reputation.

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

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

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

Canon's cooperation and alliances with, strategic investments in, and acquisitions of, third parties may not produce the anticipated improvements to its financial results.

Canon makes strategic acquisitions of other companies for the purpose of business expansion and Canon is also engaged in alliances, joint ventures, and strategic investments with other companies. These activities can help Canon to grow its business. However, weak business trends or disappointing performance by partners or acquired companies may adversely affect the success of such activities. The success of such activities may be adversely affected by the inability of Canon and its partners or acquired companies to successfully define and reach common objectives. Even if Canon and its partners or acquired companies succeed in designing a structure that allows for the definition and achievement of common objectives, synergies may not be created between the businesses of Canon and its partners or acquired companies. In addition, integration of operations may take more time than expected. In connection with its acquisitions, Canon recognizes goodwill and other intangible fixed assets on its consolidated balance sheet, and the amounts recognized may be impaired if there is a decline of future cash flow. An unexpected cancellation of a major business alliance may disrupt Canon's overall business plans and may also result in a delayed return on, or reduced recoverability of, the investment, adversely affecting Canon's operating results and financial position.

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

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

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

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

Other Risks

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

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

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

Canon's success depends in part on maintenance and development of the value of its brand name. The main factors which could damage its brand value are defective product quality, circulation of counterfeit and failures of its compliance regime. Although Canon works to minimize risks that may arise from product quality and liability issues, such as those triggered by the individual functionality and also from the combination of hardware and software that make up Canon's products, there can be no assurance that Canon will be able to eliminate or limit these issues and the resulting damages. If such factors adversely affect Canon's operating activities, generate additional expenses such as those related to product recalls, service and compensation, or otherwise hurt its brand image, Canon's operating results or reputation for quality may be adversely affected. Canon has been implementing measures to halt the spread of counterfeit products. However, the continued manufacture and sale of such products could adversely affect Canon's brand image as well as its operating results.

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If Canon fails to maintain its overall compliance regime, especially legal and regulatory compliance, this also could result in damage to Canon's credibility and brand value.

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

Canon is subject to certain Japanese and foreign environmental laws and regulations in areas such as mitigation of climate change, resource conservation including product recycling, reduction of hazardous substances, clean air, clean water and waste disposal. Due to the laws and regulations, Canon may face liability for additional costs and alleged damages. Such costs and damages could adversely affect Canon's business and operating results.

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

Canon is subject to risks relating to legal proceedings.

Canon is involved in various claims and legal actions arising in the ordinary course of its business. Results of actual and potential litigation are inherently uncertain. An unfavorable result in a legal proceeding could adversely affect Canon's reputation, financial condition and operating results.

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

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

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

In relation to third party intellectual property rights, if any third party is adjudicated to have a valid infringement claim against Canon, Canon could be required to: refrain from selling the relevant product in certain markets; pay monetary damages; pursue development of non-infringing technologies, or attempt to acquire licenses to the infringed technology and to make royalty payments, which may not be available on commercially reasonable terms, if at all.

Canon may need to litigate in order to enforce its intellectual property rights or in order to defend against claims of infringement, which can be expensive and time-consuming.

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

With respect to employee inventions, Canon maintains company rules and an evaluation system and has been making adequate payments to employees for the assignment of invention rights based on these rules. However, there can be no assurance that disputes will not arise with respect to the amount of these payments to employees.

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

Canon must attract and retain highly qualified professionals.

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

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

Canon is subject to risks arising from dependency on electronic data.

Canon possesses confidential electronic data relating to manufacturing, research and development, procurement, and production, as well as sensitive information obtained from its customers relating to the customers and to other individuals and parties. This electronic data is used by Canon and third party managed systems and networks. Electronic data is also used for the information service functions in various products.

There are some risks inherent in the use of the electronic data, including vulnerability to hacking and computer viruses, service failures due to unexpected events, and infrastructure issues, such as insufficient power supply and issues arising from damage caused by natural disasters. Although Canon continues to make administrative and managerial improvements in order to alleviate these risks, such events may occur despite Canon's best efforts.

The materialization of such risks could result in interruptions to essential work, leaks of confidential data and damage to the information service functions in products. The occurrence of any of these events has the potential to cause Canon to be subject to claims from affected individuals and parties and to negatively influence Canon's brand image, the social trust it has developed, and its operations and financial conditions.

Canon's financial results may be adversely affected if its deferred tax assets are not recoverable or if it is subject to international double taxation.

Canon currently has deferred tax assets, which are subject to periodic recoverability assessments based on projected future taxable income. The changes of future profitability due to future market conditions and tax reforms including changes in tax rates may require possible recognition of significant valuation allowances to reduce the net carrying value of 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.

Recently, international corporate tax avoidance has developed into a political issue with a focus on aggressive tax planning strategies of certain multinational corporations. The OECD established the BEPS (Base Erosion and Profit Shifting) project for the purpose of increasing cooperation among countries and implementing

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harmonization of taxation. The BEPS action plan was published in July 2013; the OECD then conducted further study based on that plan and published its final report in October 2015. Each country has been revising or amending its domestic taxation system and tax treaties based on the final report.

Canon believes that liability of taxation is a basic and significant responsibility as a corporate citizen and that the revision or amendment will not significantly affect Canon. It is, however, possible that there will be differences in opinion between Canon and tax authorities based on new transfer pricing documentation requirements.

Canon's retirement and severance benefit obligations are subject to certain accounting assumptions.

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, expected return on plan assets, assumed rate of increase in compensation level and mortality rate. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore any such differences would be expected to be linked to increases in actual costs, which may adversely affect net income.

Item 4. Information on the Company

A. History and development of the Company

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

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

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

On March 17, 2016, Canon entered into a Shares and Other Securities Transfer Agreement with Toshiba Corporation and acquired the share options for consideration of cash to acquire all the ordinary shares of Toshiba Medical Systems Corporation (TMSC) (Canon Medical Systems Corporation as of January 4, 2018), which is exercisable upon the clearances of necessary competition regulatory authorities. As such clearances were obtained, Canon exercised the share options and acquired all the ordinary shares of TMSC on December 19, 2016. The acquisition date was December 19, 2016 and the purchase price was ¥665,498 million, which approximates the fair value at that date. Under Phase V of the Excellent Global Corporation Plan, a five-year initiative that Canon has been implementing since 2016, embracing the challenge of new growth through a grand strategic transformation has been set as a basic policy. With regard to strengthening and growing new businesses, and creating future businesses, a particularly important strategy, Canon intends to develop a health care business within the realm of safety and security, as a next-generation pillar of growth.

In 2017, 2016, and 2015, Canon's increases in property, plant and equipment were ¥147,542 million, ¥171,597 million and ¥195,120 million, respectively. In 2017, the increases in property, plant and equipment were mainly used to expand production capabilities in both domestic and overseas regions, and to bolster Canon's production-technology-related infrastructure. In addition, Canon has been continually investing in tools and dies for business machines, in which the amount invested is generally the same each year.

For 2018, Canon projects to invest in property, plant and equipment of approximately ¥200,000 million. This amount is expected to be spent for investments in new production plants and new facilities of Canon. Canon anticipates that the funds needed for this increase will be generated internally through operations.

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B. Business overview

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

Canon sells its products principally under the Canon brand name and through sales subsidiaries. Each of these subsidiaries is responsible for marketing and distribution to retail dealers in an assigned territory. In 2017, 78.3% of consolidated net sales were generated outside Japan, with approximately 27.1%, 25.2% and 26.0% generated in the Americas, Europe and Asia and Oceania, respectively.

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

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

Canon will work to realize the optimized global allocation of its production assets based on changes in local conditions in each country. Canon has manufacturing subsidiaries in a variety of countries, including the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and the Philippines, other than Japan.

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

Products

Canon operates its business in four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business Unit which was newly established in 2017 and the Industry and Others Business Unit .

- Office Business Unit -

Canon manufactures, markets and services a full range of MFDs, printers, copying machines for personal and office use and production print products for print professionals. Canon also delivers added value to customers through software, services and solutions. Canon's offerings cater to a broad market from Small Office Home Office (SOHO), and Small and Midsize Business (SMB) to large enterprises and professional graphic arts companies.

In the industry, customer preference has been shifting from monochrome to color products and from hardware to services and solutions. Especially in the professional print market, customers are increasingly turning to short-run, print-on-demand and variable data printing. The importance of connectivity, mobility, security, integration, workflow and cloud-based web services is growing, and such added value is increasingly delivered together with hardware. Canon seeks to maintain its position as a market leader in these fast-changing markets.

In 2017, Canon expanded our hardware offerings by introducing the new A3 color MFPs; the image RUNNER ADVANCE C3500 series and completed the introduction of our third-generation imageRUNNER ADVANCE products with enhanced operability and productivity. Canon also launched high-speed monochrome production devices; varioPRINT 140 series and VarioPrint 6330 series. The faster output capability of these new product series provides broad coverage for fast delivery and small-lot variable data printing needs of our customers.

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In software, services and solutions, Canon was one of the first vendors to launch its application development platform, the Multifunctional Embedded Application Platform (MEAP) which allows the creation of customized applications for Canon MFDs enabling users to fully take advantage of the power of our MFDs. Canon is reinforcing its solutions capability through offerings such as imageWARE software suite and uniFLOW, business process automation software Enterprise Imaging Platform (EIP) and Canon MDS, a device management solution that reduces total cost of ownership.

To maintain and enhance its competitive edge and to meet increasingly sophisticated customer demands, Canon is committed to the continued reinforcement of Canon s hardware and software offerings and solutions capability.

As for laser printers, Canon has focused on expanding sales of high value-added products from mid to high-end class, especially for MFP, resulted in increased sales and market share in the said products category successfully. Canon, however, is experiencing fierce competition with aggressive competitors in the laser printer market and an eventual decline in sales prices is becoming a major threat, in addition to concerns over lagging growth of the entire market due to a decrease in demand for printing, which has been caused by changes in printing behavior related to the prevalent use of smartphone, cloud computing, etc.

In response, Canon is going to accelerate current momentum to increase sales quantity and market share by enhancing competitiveness in contractual business market by making the most of technical innovation and executing optimum sales strategies created closely for each region/products. Furthermore, Canon aims to maximize business efficiency through making continuous efforts to achieve cost reductions and optimization of its supply chain.

- Imaging System Business Unit -

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

In 2017, Canon strengthened its product lineup by launching six new digital interchangeable-lens cameras, including a compact and lightweight full frame model EOS 6D Mark II for the first time in five years, and an entry level yet high performance mirrorless cameras EOS M100. These new models as well as the current models pushed sales and Canon maintained number one market share in the field of digital interchangeable-lens cameras in volume terms in 2017 in the major regions, such as the United States, Europe, and Japan. Canon aims to expand the imaging domains of EOS, and believes there remains considerable room for future growth through development of new products based on state-of-the-art technology such as higher picture quality, small and light weight body and versatile movie / network functions.

Canon launched seven new lens products for digital SLR. The interchangeable lens lineup currently exceeds 90 products, including Cinema Lenses (EF-Mount). By enhancing its core capability, Canon has been introducing high-quality and high-performance lenses developed by superior optical technology and new elemental technology, which Canon believes allowed it to maintain its advantage over the competition.

As for compact digital cameras, while the overall market has been shrinking, the premium segment with relatively large sensor size has been performing steadily. In such circumstance, in the second half of the year, Canon launched a new flagship model PowerShot G1 X Mark III, featuring APS-C CMOS sensor, the largest sensor ever in a Canon point and shoot camera. Canon aims to strengthen its premium lineup further and strives to improve its profitability. Including those premium models, Canon launched a total of six models, and plans to maintain its full-line up strategy to meet a wide range of customer needs.

In compact photo printer market, along with the increasing demand for photo printing from smart devices, Canon has performed well. With its advantages, such as easy operation, portability, and lab-quality photo print,

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SELPHY has gained a strong market position in each region. The new SELPHY CP1300 with advanced usability launched in the second half of this year has shown high sales performance. Canon plans to tap new customer demand and will seek to maintain its lead in this market.

The market for conventional camcorders has been shrinking, as many other popular devices start adding a movie function. In this environment, Canon aims to expand sales in this market with a product lineup with higher value added based on Canon's distinctive high-definition, high-resolution technologies. In the field of professional camcorders, Canon introduced the new models EOS C200/C200B; digital cinema cameras which are capable of recording 4K video in new format Cinema RAW Light, and XF405/400; compact and lightweight camcorders which are capable of shooting 4K/60P video with newly developed 15x optical zoom lens. Canon aims to solidify its top position in the motion picture production market by introducing new products that suit a wide variety of market requirements.

Canon experienced robust growth in the field of projectors for business applications, and in particular brighter, installation type projectors. In this market, Canon offers a range of products focusing on high resolution projectors of WUXGA and 4K with its advanced optical technologies. In 2017, Canon launched two WUXGA models with LCOS panels and four world smallest and lightest 4K laser projectors*, 4K600STZ and 4K600Z, which meet the various usage requirements of customers such as maintenance-free use and easy installation. Canon plans to expand the projector business with its high-resolution product lineup including 4K and advance Canon's position in the market.

* Among 5000 lumen-class laser projectors that exceed native 4K resolutions as of the end of November, 2017

In the broadcast HDTV lens market, demand remains stable from sports broadcasting in developed countries and from switchover to HD in developing countries, and Canon continues to maintain a large share of the TV lens market with high value-added products. Meanwhile, demand for 2/3" format 4K lenses is increasing especially in Europe and Asia, and Canon will expand the product lineup to meet this demand. On the other hand, Canon launched *CN-E 70-200mm T4.4 L IS KAS S as second edition of COMPACT SERVO EF Cinema zoom lens series, which has excellent operability and mobility that meet various shooting styles, and also has optical performance compatible with both 4K and HD cameras. This lens is getting great reviews in the market.

* Compatible with Super35mm sensor. Equivalent to 107-307mm in 35mm full size calculation.

Inkjet printer technology has been evolving, driving expansion of application from home use to office and commercial use such as poster printing and photo printing that require high-quality.

Canon offers a wide variety of products to meet such needs based on its core technology Full-photolithography Inkjet Nozzle Engineering (FINE), which enables realization of high-speed printing and high image quality at the same time.

For home use, Canon offers such printer solutions as Canon PRINT Inkjet to tighten the connection with cloud computing, smartphones and tablet PCs. Canon also offers more compact body, premium design, convenient front & rear dual paper feeder, a larger and easy to read liquid crystal touchscreen panel. Canon hopes such enhancement of function and service will increase user-friendliness and satisfaction of users.

In 2014, Canon launched the new brand MAXIFY in the business inkjet printer segment, targeting the growing SOHO market. In 2016, Canon also launched new models with network management capability. The MAXIFY printer series features Canon's leading inkjet technologies such as high-quality printing with fast printing, and a low total cost of ownership.

In 2016, Canon launched Refillable Ink Tank Printers that achieved high productivity and cost saving by featuring built-in ink tanks, for business use in emerging market.

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For meeting wide and high quality level requirements of the professional users in photo printing, Canon has completed new large format inkjet printer lineup from imagePROGRAF PRO-1000 for A2 size to the flagship model imagePROGRAF PRO-6000 for 60 inch size, by 2017. The color reproduction and dark expression of those new products are improved by employing 12 color LUCIA PRO ink which features new pigment ink and Chroma Optimizer, and new image processor engine L-COA PRO. Canon launched three new large format professional inkjet printers sequentially from the end of 2015 to 2016 : imagePROGRAF PRO-1000 (17"), imagePROGRAF PRO-2000 (24"), imagePROGRAF PRO-4000 (44") which feature improved color reproduction and dark expression by employing a new image processor engine L-COA PRO and new LUCIA PRO 12 inks with new pigment inks and Chroma Optimizer. In the main body of these products, RED LINE is designed for a printer for the first time. RED LINE is allowed for only the product which can realize the highest photograph quality of the Canon products, producing the same quality as the high class Canon Digital SLR. Canon aims to further expand this business, leveraging its strength in the photo printing and fine art printing market.

In 2012, Canon started to ship the DreamLabo 5000, the first inkjet production photo printer featuring new FINE high-density print head technology.

Canon's lineup also includes CanoScan LiDE, the flatbed scanners which use Contact Image Sensor (CIS), and a scanner with Charge-Coupled Devices (CCD) for high resolution. Canon has maintained high share in the scanner market by achieving stable sales results.

- Medical System Business Unit -

Canon markets diagnostic imaging systems, including Computed tomography (CT), Magnetic resonance imaging (MRI), ultrasound, and X-ray systems, as well as clinical laboratory systems and healthcare ICT solutions, and provides them to customers in more than 140 countries around the world, offering technology that enables fast diagnosis and early stage treatment. Continuing its long tradition of contributing to improvements in healthcare, Canon is making positive contributions toward hospital management and provides a range of patient-friendly healthcare systems and services.

The medical equipment market in Japan this fiscal year remained flat, while in the USA and Europe it was on a recovery trend. In emerging countries, medical needs are rising due to population growth and changes in disease prevalence patterns. Against this background, Canon's CT systems business, which is the mainstay of medical system business units, remained steady.

Canon offers high-resolution imaging that enables more accurate diagnosis. Examples include Aquilion Precision, the world's first ultrahigh-resolution CT scanner, released in Japan in April 2017, which has twice the spatial resolution in both the in-plane direction and the axial direction compared to a conventional CT scanner; and Aplio i-series diagnostic ultrasound systems, which in January 2017 received the Nihon Keizai Shimbun Award for Excellence, the top rank in the 2016 Nikkei Superior Products and Services Awards.

By incorporating various strengths (such as precision mechanical design, processing technology, sensor technology, and image processing technology) during the development, manufacture, and servicing of Canon's medical equipment products, Canon will continue to work hard to provide products with high added value that further contribute to improvements in healthcare.

In the component business market, both the expanding demand in emerging markets and the demand to transition from Computed Radiography (CR) to Digital Radiography (DR) continue to drive steady market growth for X-ray equipment. On the other hand, technological competition with component manufacturers in Europe and the USA has been increasing for high-end products, and price competition with manufacturers in China and Korea has been increasing for the low-end product segment where products are becoming commoditized. Under these market circumstances, Canon released our new flat panel detectors (CXDI-710C

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Wireless series) in April, featuring weight-saving and waterproof performance, and this has contributed to increased sales in the DR product market. In the dynamic X-ray equipment market, where high growth is expected, Canon is continuing its strong efforts to promote sales of fluoroscopy and angiography systems. With regard to our X-ray tube units, X-ray detectors, etc., Canon has developed cost-competitive products for this business based on our highly reliable core technologies (high-voltage vacuum technology, hydrodynamic liquid metal bearing technology, cesium iodide deposition technology, etc.), which has contributed to strong sales.

Regarding ophthalmic equipment, Canon responded to stiffer market competition in the growing Optical Coherence Tomography (OCT) market by releasing a OCT Angiography software series which enables depiction of retinal blood vessels without using fluorescein, a substance that potentially causes strong allergic reactions.

- Industry and Others Business Unit -

In the market for semiconductor lithography equipment, investments for memory devices have been increased due to the demand expansion for 3D-NAND flash memory semiconductors used in data center. In the market for i-line steppers, the demand has increased due to functional diversification of semiconductor for IoT devices, and also investments for the production of automobile electronics, which is expected to become a stable market, have been performing well. In the market for back-end lithography systems, chip makers require higher density integration and thinner chip production due to the trend of miniaturization and power saving in the mobile devices market, and the demand for mass-production of large-capacity memory such as Through-Silicon Via (TSV) is expected to expand.

Responding to diversified semiconductor applications, Canon has been developing a design-in business style, which enables customer needs to be reflected in the early stage of our product development process, and Canon believes steady progress has been made in developing products with high added value. Both of IoT devices and automobile electronics, which are rapidly becoming more widespread, would require the production of Wide variety of small medium production volume by Legacy Process . Canon will meet a wide range of chipmakers needs by expanding our product lineup. As for 200mm wafer tool lineup , in addition to i-line stepper FPA-3030i5+, and KrF stepper FPA-3030EX6 which was introduced last year, Canon released 200mm wafer option for i-line stepper FPA-5550iZ2 and KrF scanner FPA-6300ES6a, which realized high productivity and industry-leading level of overlay. Furthermore, Canon released Nanoimprint Replica Mask Manufacturing Equipment for Mass-Production FPA-1100NR2, which can duplicate masks for semiconductor lithography equipment at low cost.

In the market for FPD lithography equipment, ongoing capital investments by panel makers for small-to-mid-sized panels offering high-definition organic light-emitting diode (OLED) panels in mobile devices led to growth of lithography systems for small-to-mid-sized panel production. More and more electronic makers are expected to use OLED displays for large-screen TVs and monitors in the future. In addition, dimension-based panel market is expected to continue to expand with displays getting larger and higher in resolution.

The demand for OLED is rapidly increasing due to more and more adoption of OLED in the latest smartphones. Under these circumstances, MPAsp-E813 for small-to-mid-sized panel realized not only high productivity and high overlay accuracy but also the world s highest level of resolution by the adoption of newly-designed mirror optical system, which is suitable for high-definition panel production. Canon aims to capture a larger share of the market by taking advantage of the growth of the OLED market. The resolution of large-screen TVs is also enhancing, which leads to the growing demands for OLED TVs. Canon s MPAsp-H803 for large-sized panels, successfully achieved world highest level of resolution, and Canon aims to respond to the increasing demand for production of larger and higher-resolution panels.

Recently network cameras have become widely used for the purpose of security has been well recognized, which led to increasing sales of high resolution models extensively. In addition, the application of network

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camera as preventive security control is expected to increase with improvement of productivity and customer satisfaction is highly expected by combining those cameras with image analysis software beyond the simple recording.

In the first half of 2017, Canon launched 3 new models of network cameras including the VB-S30VE which enables the outdoor installation under the eaves, the box type of VB-S910F mounts 3.5 times of optical zoom lens together with the Q-1659 which Canon and Axis commercialized through the co-development.

In the second half of 2017, Canon launched 12 new models of network cameras including the VB-H45 improving the performance in a low light environment, the VB-H761LVE-H adopting the unique hydrophilic coating, infrared light as well as suitable for outdoor environment. Canon also launched 4 types of image analysis software, like Profile Analyzer Version 1.0 identifying the age group and the gender of the target individual. Canon also announced that it will develop the ME20F-SHN, which enables the viewing of color images in the dark, for launch in 2018.

Canon plans to continue to offer the optimum network video solutions in timely manner to the market through the integration of technologies from group companies and will also continue to strive for a further growth in a network camera market.

NET SALES BY SEGMENT

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

| | 2017 | Years ended December 31 | | 2015 | |
|---------------------|---|-------------------------|-----------|--------|-----------|
| | | change | 2016 | | change |
| | (Millions of yen, except percentage data) | | | | |
| Office | 1,865,928 | 3.2% | 1,807,819 | -14.4% | 2,110,816 |
| Imaging System | 1,136,188 | 3.7 | 1,095,289 | -13.3 | 1,263,835 |
| Medical System | 436,187 | | | | |
| Industry and Others | 731,704 | 25.2 | 584,660 | 11.4 | 524,651 |
| Eliminations | (89,992) | | (86,281) | | (99,031) |
| Total | 4,080,015 | 19.9% | 3,401,487 | -10.5% | 3,800,271 |

Note: Canon newly established Medical System Business Unit effective at the beginning of the second quarter of 2017, and certain businesses included in Industry and Others Business Unit have been reclassified. Net sales for the year ended December 31, 2016 were not restated since they were not material.

NET SALES BY GEOGRAPHIC AREA

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

| | 2017 | Years ended December 31 | | 2015 | |
|------------------|---|-------------------------|-----------|--------|-----------|
| | | change | 2016 | | change |
| | (Millions of yen, except percentage data) | | | | |
| Japan | 884,828 | 25.2% | 706,979 | -1.0% | 714,280 |
| Americas | 1,107,515 | 14.9 | 963,544 | -15.8 | 1,144,422 |
| Europe | 1,028,415 | 12.6 | 913,523 | -15.0 | 1,074,366 |
| Asia and Oceania | 1,059,257 | 29.6 | 817,441 | -5.7 | 867,203 |
| Total | 4,080,015 | 19.9% | 3,401,487 | -10.5% | 3,800,271 |

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Seasonality

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

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

Sources of supply

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

Prices of some raw materials fluctuate according to market trends. Although Canon is currently focusing on globalizing supplies and improving raw material resource management strategies, and believes that it will be able to continue procuring sufficient quantities of raw materials to meet its needs, there can be no assurance that supply shortages will not occur or that raw materials, such as crude oil, will be available at competitive prices, or at all, in the future.

Marketing and distribution

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

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

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

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

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

For medical business, TMSC sells its products directly or through regional marketing subsidiaries and distributors.

Canon also sells laser printers on an OEM basis to HP Inc.. HP Inc. resells these printers under the HP LaserJet Printers name. During 2017 and 2016, OEM sales to HP Inc. constituted 13.1% and 14.8%, respectively, of Canon's consolidated net sales.

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

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Service

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

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

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

For diagnostic imaging systems, including CT, MRI, ultrasound, and X-ray systems, Canon provides comprehensive repairs, service, and maintenance to ensure that customers are able to use these products to their full potential at all times. Canon maintains support contracts with customers and has technical call centers. In addition, to help ensure customer satisfaction, Canon offers service training programs for engineers working in overseas medical institutions.

Patents and licenses

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

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

Companies to which Canon has granted licenses include:

| | |
|---------------------------------|---|
| Ricoh Company, Ltd. | Electrophotography |
| HP Inc. | Laser printers, multifunction printers and facsimile machines |
| Kyocera Document Solutions Inc. | Electrophotography |
| Oki Electric Industry Co., Ltd. | LED printers, multifunction printers and facsimile machines |
| Sharp Corporation | Electrophotography |
| Brother Industries, Ltd. | Electrophotography and facsimile machines |

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

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

| | |
|---|---|
| HP Inc. | Bubble jet printers |
| Ricoh Company, Ltd. | Electrophotography products, facsimile machines and word processors |
| Xerox Corporation | Business machines |
| International Business Machines Corporation | Information handling systems |
| Eastman Kodak Company | Electrophotography and image processing technology |
| Seiko Epson Corporation | Information-related instruments |

Canon has placed a high priority on the management of its intellectual property. Some products that are material to Canon's operating results incorporate patented technology. Patented technology is critical to the

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continued success of Canon's products, which typically incorporate technology from dozens of different patents. However, Canon does not believe that its business, as a whole, is dependent on, or that its profitability would be materially affected by the revocation, termination, expiration or infringement upon, any particular patent, copyright, license or intellectual property rights or group thereof.

Competition

Canon encounters intense global competition in all areas of its business. Canon's competitors range from some of the world's major multinational corporations to smaller, highly specialized companies. Canon competes in a number of different business areas, whereas many of its competitors focus on one or more individual areas. Consequently, Canon may face significant competition from entities that apply greater financial, technological, sales and marketing or other resources than Canon to their activities in a particular market segment.

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

- Office Business Unit -

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

- Imaging System Business Unit

Canon has continued to invest aggressively in competitive new products and intends to maintain its position in this market.

Canon's primary competitors in the interchangeable-lens digital camera market are Nikon Corporation and Sony Corporation.

Average prices for compact digital cameras in the industry increased in 2017 from the previous year. Market contraction is having a major impact, resulting in severe conditions in the digital camera market. Despite these difficulties, Canon will seek to take advantage of its status as the major brand in the industry, along with its economies of scale, in order to maintain profitability.

Canon's primary competitors in the compact digital camera market are Sony Corporation and Nikon Corporation. Canon's primary competitors in the digital video camcorder market are Sony Corporation; Panasonic Corporation; and JVC Kenwood Corporation. Canon's primary competitors in the inkjet printer market are HP Inc., Seiko Epson Corporation and Brother Industries, Ltd.

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Canon's primary competitors in the diagnostic medical imaging market are General Electric Company, Siemens AG, Koninklijke Philips N.V., Hitachi, Ltd., and Fujifilm Corporation.

The markets for this segment are highly competitive. Canon has been consistently involved in the medical care business, from development to manufacturing, sales, and service. Canon believes that it provides high-resolution images that enable more accurate diagnosis. For example, we have developed several world's-first technologies, such as an ultrahigh-resolution CT scanner with twice the spatial resolution in both the in-plane direction and the axial direction compared to a conventional CT scanner, and ultrasound technology that can perform imaging of very fine, slow-flowing bloodstreams that previously could not be visualized. We will continue to bring the latest diagnostic imaging systems to the market.

- Industry and Others Business Unit -

Very stiff competition continues in the markets for lithography equipment used in the production of semiconductor devices and flat panel display (FPD). In order to produce lithography equipment that can provide ultra-fine processing, an integration of advanced optical, control and system technologies is required, along with continuous investment in technology development. The main competitors in these markets are Nikon Corporation, in the markets for semiconductor and FPD lithography equipment, and ASML Holding N.V., in the market for semiconductor lithography equipment only.

Canon believes that it has helped its customers improve their productivity by continuously improving the cost performance of semiconductor lithography equipment using the i-line and KrF laser light sources. In particular, equipment using i-line has captured a large share of the global market, satisfying the needs by quickly providing products which correspond to the diversification of devices associated with the trend of IoT.

Canon believes its FPD lithography equipment with a common platform offers excellent productivity and reliability that has helped it capture market share of the industry-leading South Korean market. Canon's sales and service support systems have also received high accolades from the customers in these markets. In the trend of demand expansion for 4K displays and OLED displays, Canon believes it has also been meeting the needs of panel makers by continuously offering new products with high productivity and high resolution.

As for network cameras, the market is competitive in higher functional requirement and price pressure from customers. Canon's primary competitors are Hikvision Digital Technology Co., Ltd. and Panasonic Corporation. Canon is developing the innovative technology to continue to be a global market leader in this industry.

Environmental regulations

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

1. UN Frameworks to Address Global Issues, which are related to the Environment including Climate Changes

The United Nations adopted the 2030 Agenda for Sustainable Development Goals (SDGs) on September 25, 2015, under the UN Sustainable Development Summit. SDGs cover global issues to be addressed for transforming the world toward sustainable development over the next 15 years, which are composed of 17 goals and 169 targets. The goals and targets cover a wide-range global issues, including the environmental areas such as climate change, sustainable energy, efficient use of natural resources and reduction of waste. Based upon the SDGs, member states will introduce national policies and initiatives to tackle such global environmental issues, and Canon may need to implement further actions to respond to potential national initiatives.

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The Paris Agreement on climate change adopted in 2015 and entered into force in 2016. The Agreement relates to a common future framework beyond 2020 to address climate change. In the Agreement, all member states of UNFCCC agreed to take countermeasures to hold Global temperature rise to well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature rise to 1.5 degrees Celsius.

Upon the Agreement, Canon is further striving to reduce CO2 emissions toward the low-carbon society. Canon has established 2017-2019 Mid-Term Environmental Goals and monitors its progress on a yearly basis. Canon is implementing initiatives to achieve these goals, which focus on Lifecycle CO2 emissions improvement index per product by 3 percent improvement (compared to the previous year) , Raw materials and usage CO2 emissions improvement index per product by 3 percent improvement (compared to the previous year) , Improve energy consumption basic unit at operational sites by 1.2 percent (compared to the previous year) . Canon has successfully reduced its Life Cycle CO2 emission per product by approximately 34 percent between 2008 and 2016. Also, total lifecycle CO2 emissions in 2016 were 6.212 million tons, which were verified by a third party in April 2017.

Canon continues to pursue CO2 emission reductions both locally and globally through energy-efficient product design and improvement of logistics and factory operations.

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

Under RoHS Directive, from July 1, 2006, companies have been required to ensure that electrical and electronic equipment (EEE) sold in the European Union does not contain lead, cadmium, hexavalent chromium, mercury, polybrominated biphenyls or polybrominated diphenyl ethers. The scope of products covered was expanded to include medical and measurement equipment starting in July 2014. New subsidiary directive of RoHS Directive restricting an additional four substances was published in June 2015, and these substances will be restricted starting in 2019. In parallel with these developments, all the RoHS exempted applications for which the restricted substances can be used are now under review. If these exemptions expire, additional design changes may be required for Canon products, and cost of changing designs may increase total compliance costs.

The WEEE Directive requires that companies selling EEE bearing their trade names in the European Union must arrange and pay for collection, treatment, recycling, recovery and disposal of their equipment. Canon has become a member company of collective compliance schemes in each member state of the European Union and has achieved the required recycling levels for waste EEE. The WEEE recast Directive was published on July 24, 2012 and was applied from February 2014. Due to a change in official interpretation, the scope of products covered is to be expanded to include consumables.

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

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

The REACH Regulation was implemented in 2007. This regulation covers almost all chemicals (products in gaseous, liquid, paste or powder form) and articles (products in solid state) manufactured in or imported into the European Union. All chemicals manufactured in or imported into the European Union that exceed specific content thresholds must be registered. If certain substances of very high concern are contained in an article, the substances must be communicated to the recipient or consumer of the article. Furthermore, additional restrictions on the use of certain substances can be proposed at any time by the ECHA (European Chemical Agency) or member states, and, some of them have been already adopted and others are now under discussion, manufacturers such as Canon must take steps to address such new restrictions.

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Canon keeps meeting these existing and newly-added requirements under the REACH Regulation, and their implementation could increase Canon's management costs and have adverse effects on its operating results and financial condition.

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

The ErP Directive applies in Europe to all energy-using products, and implementing measures with respect to off-mode and standby mode and external power supplies were adopted in and have been applied since 2010. This measure was expanded in 2013 to include requirements for energy modes with networked standby. The requirements for networked standby were applied from 2015. For imaging equipment, the industry made a public commitment to attain certain targets on environmentally conscious designs from 2012 by an industrial voluntary agreement (VA) and began implementation in 2011. By the regular revisions of the VA, commitments become tighter than ever because the European authorities and NGOs are expected to require a stricter VA. In addition, many new or revised implementing measures (expanded both in scope and requirements) are now considered, and some of them will cover Canon's products. Canon is continuing to comply with requirement under the ErP Directive. However, the requirements are expected to be challenging, and achieving compliance will likely increase Canon's costs, especially by required design changes.

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

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

6. Chinese Administrative Measures on the Control of Pollution Caused by Electrical and Electronic Products

The Chinese Ministry of Information Industry revised Administrative Measures on the Control of Pollution Caused by Electrical and Electronic Products in January 2016, and regulates the same six substances covered by the EU RoHS in electrical and electronic products. The measures establish two stages of implementation. Stage 1 is in effect and covers all Canon products. To comply with Stage 1 requirements, a China-specific label must be placed on any covered product if any of the six regulated substances are contained therein, and use of the six regulated substances must be disclosed in each product manual. Stage 2 requires that the contents of six regulated substances in specific (as specified by the Chinese Government in the Compliance catalog) be restricted by limitations similar to the EU RoHS Directive. Standards to implement these measures and the Compliance catalog are proposed, including with regard to printers, copying machines and facsimile machines.

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

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

The Regulation for the Management of the Recycling and Disposal of Waste Electrical and Electronic Products was issued by the Chinese government in 2009 and implemented on January 1, 2011. Producers and importers are required to pay a fee to a government fund. The list of products falling under the waste electrical and electronic products catalogue issued on February 9, 2015 includes printers, copying machines and facsimile machines. Those payment fees are under discussion by the Chinese government.

These requirements will likely increase Canon's costs and could adversely affect its operating results and financial condition.

Table of Contents**8. *Soil Pollution Prevention Law of Japan***

A 2010 amendment to the Soil Pollution Prevention Law of Japan tightens certain requirements to survey soil to measure certain pollution levels. If soil pollution exceeds specified limits, a prefecture governor may designate the land as a Measure required area if effects to human health due to soil pollution are foreseen, and the prefecture governor may order removal of pollutants. The substances designated as pollutants consist of twenty-six chemical groups, including lead, arsenic and trichloroethylene. If an investigation shows that soil contamination may affect human health, the prefecture governor may issue an order to the landowner to take designated remedial actions and may restrict the changes of the land character. Canon has commenced a detailed survey and measurement of soil and groundwater to check for pollution at all of Canon's operational sites in Japan, and necessary procedures are being carrying out. Additional costs may arise if these investigations reveal that additional remedial measures are necessary. These factors could adversely affect Canon's operating results and financial condition.

9. *Other Environmental Regulations*

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

Other regulations

Disclosure under Section 13(r) of the Securities Exchange Act of 1934

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) added Section 13(r) to the Securities Exchange Act of 1934, as amended (the Exchange Act). Section 13(r) requires an issuer to disclose in its annual or quarterly reports, as applicable, whether, during the reporting period, it or any of its affiliates knowingly engaged in certain activities, transactions or dealings relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction. Disclosure is required even where the activities, transactions or dealings are conducted outside the U.S. by non-U.S. affiliates in compliance with applicable law, and whether or not the activities are sanctionable under U.S. law.

During the year ended December 31, 2017, the following Canon affiliates engaged in the transactions described below that are required to be disclosed pursuant to Section 13(r) of the Exchange Act. These transactions were conducted in compliance with applicable law in the respective countries.

Toshiba Medical Systems Corporation (TMSC) (Canon Medical Systems Corporation as of January 4, 2018), a wholly-owned Japanese subsidiary of Canon Inc., had indirect sales transactions through independent distributors in Sharjah, United Arab Emirates and Tehran, Iran for computed tomography, diagnostic ultrasound systems and service parts for those products with hospitals in Iran. It is our understanding that Iranian hospitals are owned or controlled by the Government of Iran (central or local government) and that their purchases are controlled through an agency of the Iranian Ministry of Health and Medical Education. Total gross sales under these contracts during the year 2017 were approximately ¥327,655 thousand. The net profit was substantially less than that.

Canon Europe N.V. (CENV), a wholly-owned Dutch subsidiary of Canon Finance Netherlands B.V., which is wholly-owned by Canon Inc., had indirect sales transactions through independent distributors in Dubai, United Arab Emirates, Tehran, Iran and Algete, Spain for medical products such as digital radiography systems and ophthalmic equipment with hospitals in Iran. It is our understanding that Iranian hospitals are owned or controlled by the Government of Iran (central or local government) and that their purchases are controlled through an agency of the Iranian Ministry of Health and Medical Education. Total gross sales under these contracts during the year 2017 were in foreign currency of approximately ¥30,748 thousand. The net profit was substantially less than that.

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Canon Marketing Japan (CMJ), our 58.5% owned Japanese subsidiary as of December 31, 2017 and Canon Danmark A/S, a wholly-owned Danish subsidiary of CENV, had service contracts for copier machines with the Iranian embassies in Tokyo, Japan, and Copenhagen, Denmark, which were expired during the year 2017. Canon Marketing (Thailand) Co. Ltd, a wholly-owned Thai subsidiary of Canon Singapore Pte. Ltd. (CSPL), which is wholly-owned by Canon Inc., performed a spot repair on three copier machines and three printers with the Iranian embassy in Bangkok, Thailand. Additionally, Canon India Pvt. Ltd., a wholly-owned Indian subsidiary of CSPL, has service contracts for two copier machines with the Iranian embassy in New Delhi. Total gross sales under these contracts and activities above during the year 2017 were in Japanese yen and foreign currency of approximately ¥82 thousand. The net profit was substantially less than that.

As of the date of this report, Canon is not aware of any other activity, transaction or dealing by us or any of our affiliates during the year ended December 31, 2017 that requires disclosure in this report under Section 13(r) of the Exchange Act. After considering recent changes in the international situation and economic sanctions relating to Iran, Canon has restarted business with certain Iranian counterparties. Canon maintains policies and procedures designed to ensure that transactions, including transactions with Iranian counterparties, are conducted in accordance with applicable economic sanction laws and regulations.

C. Organizational structure

Canon Inc. and its subsidiaries and affiliates form a group of which Canon Inc. is the parent company. As of December 31, 2017, Canon Inc. had 376 consolidated subsidiaries and 7 affiliated companies accounted for by the equity method.

The following table lists the significant subsidiaries owned by Canon, all of which are consolidated as of December 31, 2017.

| Name of company | Head office location | Proportion of ownership interest owned | Proportion of voting power held |
|-------------------------------------|-----------------------------|---|--|
| Canon Marketing Japan Inc. | Tokyo, Japan | 50.1% | 58.5% |
| Canon U.S.A., Inc. | New York, U.S.A. | 100.0% | 100.0% |
| Canon Europa N.V. | Amstelveen, The Netherlands | 100.0% | 100.0% |
| Toshiba Medical Systems Corporation | Tochigi, Japan | 100.0% | 100.0% |

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Canon's manufacturing is conducted primarily at 30 plants in Japan and 18 plants in other countries. Canon owns all of the buildings and the land on which its plants are located, with the exception of certain immaterial leases of land and floor space of certain of its subsidiaries. The names and locations of Canon's plants and other facilities, their approximate floor space and the principal activities and products manufactured therein as of December 31, 2017 are as follows:

| Name and location Domestic | Floor space (including leased space) (Thousands of square feet) | Principal activities and products manufactured |
|---|--|---|
| Headquarters, Tokyo | 2,416 | R&D, corporate administration and other functions |
| Canon Global Management Institute, Tokyo | 164 | Training and administration |
| Kawasaki Office, Kanagawa | 1,973 | R&D and manufacturing of production equipment and semiconductor devices; R&D of laser printers and toner cartridges |
| Kosugi Office, Kanagawa | 374 | Development of software for office imaging products |
| Fuji-Susono Research Park, Shizuoka | 1,035 | R&D in electrophotographic technologies |
| Ayase Office, Kanagawa | 393 | R&D and manufacturing of semiconductor devices |
| Hiratsuka Plant, Kanagawa | 949 | R&D of display products and manufacturing of semiconductor devices |
| Tamagawa Office, Kanagawa | 383 | Quality engineering |
| Oita Plant, Oita | 284 | Manufacturing of semiconductor devices |
| Yako Office, Kanagawa | 905 | Development of inkjet printers, inkjet chemical products |
| Utsunomiya Office, Tochigi | 2,762 | Manufacturing of lenses for cameras and other applications, R&D in optical technologies, development and sales of broadcasting equipment, R&D, manufacturing, sales and servicing of semiconductor production equipment |
| Toride Plant, Ibaraki | 3,133 | R&D in electrophotographic technologies, mass-production trials and supports; manufacturing of office imaging products, chemical products; training of manufacturing |
| Ami Plant, Ibaraki | 972 | Manufacturing of FPD production equipment |
| Canon Electronics Inc., Tokyo, Saitama and Gunma | 1,309 | Components, magnetic heads, document scanners and laser printers |
| Canon Finetech Nisca Inc., Saitama, Ibaraki and Yamanashi | 1,100 | Label printer, Card printer, Optical equipment, Motor |
| Canon Precision Inc., Aomori | 1,493 | Toner cartridges, sensors and micromotors |

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| Name and location Domestic | Floor space (including leased space) (Thousands of square feet) | Principal activities and products manufactured |
|---|--|---|
| Canon Optron Inc., Ibaraki | 143 | Optical crystals (for lithography equipments, cameras, telescopes) and vapor deposition materials |
| Canon Chemicals Inc., Ibaraki | 1,825 | Toner cartridges and rubber functional components |
| Canon Components, Inc., Saitama | 681 | Contact image sensors, inkjet cartridges and medical equipment |
| Oita Canon Inc., Oita | 1,387 | Digital cameras, lenses and digital video camcorders |
| Nagahama Canon Inc., Shiga | 1,093 | Laser printers, toner cartridges and A-Si drums |
| Oita Canon Materials Inc., Oita | 2,647 | Chemical products for copying machines and printers, and inkjet cartridges |
| Ueno Canon Materials Inc., Mie | 654 | Chemical products for copying machines and printers |
| Fukushima Canon Inc., Fukushima | 1,310 | Inkjet printers and inkjet cartridges |
| Canon Semiconductor Equipment Inc., Ibaraki | 232 | Development and production of semiconductor production-related equipment |
| Canon Ecology Industry Inc., Ibaraki | 901 | Recycling of toner cartridges, repair and recycling of business machines |
| Fukui Canon Materials Inc., Fukui | 194 | OPC raw stock, material for optics, High water-repellent material |
| Miyazaki Canon Inc., Miyazaki | 179 | Digital cameras |
| Canon Mold Co., Ltd., Ibaraki | 219 | Molds |
| Canon ANELVA Corporation, Kanagawa and Yamanashi | 729 | Production equipment for electron devices, flat panel display and semiconductors |
| Canon Machinery Inc., Shiga | 666 | Automated production equipment and semiconductor production-related equipment |
| Canon Tokki Corporation, Niigata, Kanagawa and Tokyo | 360 | Vacuum technology-related equipment |
| Nagasaki Canon Inc., Nagasaki | 469 | Digital cameras |
| Hita Canon Materials Inc., Oita | 369 | Rubber functional components |
| Toshiba Medical Systems Corporation, Tochigi | 1,753 | R&D, manufacturing and sales of medical equipment |
| Toshiba Electron Tubes & Devices Corporation, Tochigi | 329 | R&D, manufacturing and sales of electron tubes and its application products |

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| Name and location | Floor space (including leased space) (Thousands of square feet) | Principal activities and products manufactured |
|---|--|--|
| Overseas | | |
| <i>Europe</i> | | |
| Canon Giessen GmbH, Giessen, Germany | 336 | Remanufacturing of copying machines and semiconductor production equipment |
| Canon Bretagne S.A.S., Liffre, France | 505 | Manufacturing and recycling of toner cartridges |
| Océ-Technologies B.V., Venlo, the Netherlands | 2,190 | Document management, high speed digital production printing systems and wide format printers |
| Océ Printing Systems GmbH & Co. KG, Poing, Germany | 1,256 | High speed digital production printing systems |
| <i>Americas</i> | | |
| Canon Virginia, Inc., Virginia, U.S. | 1,662 | Toner cartridges, molds and remanufacturing of copying machines |
| Canon Environmental Technologies, Inc., Virginia, U.S. | 185 | Recycling of toner cartridges |
| <i>Asia</i> | | |
| Canon Inc., Taiwan, Taiwan | 1,593 | Lenses and digital cameras |
| Canon Opto (Malaysia) Sdn. Bhd., Selangor, Malaysia | 611 | Lenses and optical lens parts |
| Canon Dalian Business Machines, Inc., Dalian, China | 1,732 | Production and recycling of toner cartridges, production of laser printers |
| Canon Zhuhai, Inc., Zhuhai, China | 1,157 | Digital cameras, digital video camcorders and contact image sensors |
| Canon Prachinburi (Thailand) Ltd., Prachinburi, Thailand | 1,268 | Copying machines |
| Canon Hi-Tech (Thailand) Ltd., Ayutthaya and Nakohon Ratchasima, Thailand | 3,274 | Inkjet printers, MFDs, scanners, molds and plastic injection molded parts |
| Canon Zhongshan Business Machines Co., Ltd., Zhongshan, China | 1,387 | Laser printers |
| Canon Vietnam Co., Ltd., Hanoi, Vietnam | 3,278 | Inkjet printers, laser printers, MFDs, scanners and contact image sensors |
| Canon (Suzhou) Inc., Suzhou, China | 1,524 | Copying machines |
| Canon Finetech Nisca (Shenzhen) Inc., Shenzhen, China | 721 | Copying machines and laser printer peripherals |
| Canon Electronics Vietnam Co., Ltd., Hung Yen Province, Vietnam | 308 | Components |
| Canon Business Machines (Philippines), Inc., Batangas, Philippines | 898 | Laser printers |

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

Main facilities under construction for establishment/expansion

| Name and location | Principal activities and products manufactured |
|--------------------------------|--|
| Domestic | |
| Canon Inc., Shimomaruko | New training and administration center (Headquarters Operations) |
| Miyazaki Canon, Inc., Miyazaki | New production base (Imaging System Business Unit) |

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

A. Operating Results

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

Overview

Canon is one of the world's leading manufacturers of plain paper copying machines, office multifunction devices (MFDs), laser printers, cameras, inkjet printers, medical equipment, semiconductor lithography equipment and FPD (Flat panel display) 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 four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business Unit which was newly established in 2017, and the Industry and Others Business Unit.

Economic environment

Looking back at the global economy in 2017, the U.S. economy continued to grow steadily as employment conditions and corporate earnings improved. In Europe, the economy remained stable as unemployment rates decreased and capital investment increased due to strong exports. The Chinese economy rallied due to public investments while the economies of emerging countries realized moderate recovery as the economies of Russia and Brazil bottomed out owing to the rising price of natural resources. In Japan, corporate earnings improved and consumer spending showed signs of recovery. As a result, the global economy overall continued to recover more robustly than was expected at the beginning of the year.

Market environment

As for the markets in which Canon operates amid these conditions, demand for office multifunction devices (MFDs) and laser printers remained at around the same level as the previous year. While demand for cameras shrank moderately, demand for inkjet printers increased from the previous year with the economies recovering in

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emerging countries. Additionally, there was solid demand for medical equipment, mainly outside of Japan. Within the Industry and Others sector, demand for FPD (Flat panel display) lithography equipment and manufacturing equipment for organic LED (OLED) panels enjoyed strong growth and the demand for network camera also enjoyed solid growth.

The average value of the yen during the year was ¥112.13 against the U.S. dollar, a year-on-year depreciation of approximately ¥4, and ¥126.69 against the euro, a year-on-year depreciation of approximately ¥6.

Summary of operations

During 2017, unit sales of office MFDs increased compared with the previous year due to the expanded sales of color models. Additionally, unit sales of laser printers increased compared with the previous year, supported by the steady sales of newly launched models, as demand recovered in emerging countries. While unit sales of interchangeable-lens digital cameras decreased compared with the previous year, unit sales of digital compact cameras remained at around the same level amid the shrinking market, owing to increased sales of high-value-added models. Looking at inkjet printers, unit sales increased compared with the previous year, thanks to such factors as strong sales of newly launched home-use models and refillable ink tank models for emerging countries. Additionally, sales of semiconductor lithography equipment, FPD lithography equipment, and manufacturing equipment for OLED panels exceeded those of the previous year, thanks to favorable market conditions, and sales of network cameras increased steadily in response to the growing market. Under these conditions, along with the impact of acquiring TMSC, net sales for the year increased by 19.9% year on year to ¥4,080,015 million. Although the gross profit ratio decreased by 0.4 points to 48.8% due to the effect of the product mix, gross profit increased by 19.0% year on year to ¥1,992,691 million, thanks to such factors as the increase in sales and continuous cost reduction efforts. Operating expenses increased by 15.0% year on year, mainly due to impairment loss on goodwill of commercial printing business in Office Business Unit and the impact of acquiring TMSC. As a result, operating profit increased by 44.8% to ¥331,479 million. Other income (deductions) increased by ¥6,620 million mainly due to gain on securities contributed to retirement benefit trust and foreign currency exchange losses while income before income taxes increased by 44.6% year on year to ¥353,884 million and net income attributable to Canon Inc. increased by 60.6% to ¥241,923 million.

Key performance indicators

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

KEY PERFORMANCE INDICATORS

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|-----------|-----------|-----------|-----------|-----------|
| Net sales (Millions of yen) | 4,080,015 | 3,401,487 | 3,800,271 | 3,727,252 | 3,731,380 |
| Gross profit to net sales ratio | 48.8% | 49.2% | 50.9% | 49.9% | 48.2% |
| R&D expense to net sales ratio | 8.1% | 8.9% | 8.6% | 8.3% | 8.2% |
| Operating profit to net sales ratio | 8.1% | 6.7% | 9.3% | 9.8% | 9.0% |
| Inventory turnover measured in days | 49 days | 59 days | 47 days | 50 days | 52 days |
| Debt to total assets ratio | 10.2% | 11.9% | 0.0% | 0.0% | 0.1% |
| Canon Inc. shareholders' equity to total assets ratio | 55.2% | 54.2% | 67.0% | 66.8% | 68.6% |

Note: Inventory turnover measured in days is determined by: Inventory divided by net sales for the previous six months, multiplied by 182.5. The increase of inventory turnover in 2016 was primarily due to the acquisition of TMSC on December 19, 2016. If this factor were excluded, the inventory turnover would show 50 days.

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Net sales and profit ratio

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 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 of production costs.

Operating profit ratio (ratio of operating profit to net sales) and 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 adequate spending in core technology to sustain Canon's leading position in its current business areas and to exploit opportunities 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 relating to cash flow management that Canon's management believes to be important.

Inventory turnover measured in days is a KPI because it measures the efficiency 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 work-in-process inventories by decreasing production lead times in order to promptly recover related product expenses, while balancing risks of supply chain disruptions by optimizing finished goods inventories in order to avoid losing potential sales opportunities.

The debt to total assets ratio is also one of the KPIs. For a manufacturing company like Canon, it generally takes considerable time to realize profit from a business due to lead times required for R&D, manufacturing and sales has to be followed for success. Therefore, management believes that it is important to have sufficient financial strength. Canon will continue to reduce its dependency on external funds for capital investments in favor of generating the necessary funds from its own operations.

Canon Inc. shareholders' equity to total assets ratio is another KPI for Canon. Canon believes that its shareholders' equity to total assets ratio measures its long-term sustainability. Canon also believes that achieving a high or rising shareholders' 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's management believes a high shareholders' equity ratio will enable the company 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 shareholders' equity to total assets ratio.

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Critical accounting policies and estimates

The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and based on the selection and application of significant accounting policies which require management to make significant 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. 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 office, imaging system and medical system 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 MFDs and laser printers, and imaging system products, such as digital cameras and inkjet printers, is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

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 allocated based upon the estimated relative fair value of the lease and non-lease deliverables. Lease deliverables generally include equipment, financing and executory costs, while non-lease deliverables generally consist of product maintenance contracts and supplies.

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

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 to 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.

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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, due for example to 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 are further adjusted.

Valuation of inventories

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

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.

Business combinations

The acquisition is accounted for using the acquisition method of accounting. The acquisition method of accounting requires the identification and measurement of all acquired tangible and intangible assets and assumed liabilities at their respective fair values, as of the acquisition date. The determination of the fair value of net assets acquired involves significant judgment and estimates, such as future cash flow projections, appropriate discount and capitalization rates and other estimates based on available market information. Estimates of future cash flows are based on a number of factors including operating results, known and anticipated trends, as well as market and economic conditions.

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

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exist. 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 recognizes an impairment charge in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on Canon's forecast of future growth rates. Estimates of discount rates are determined based on the weighted average cost of capital, which considers primarily market and industry data as well as specific risk factors. Canon has completed its impairment test in the fourth quarter of 2017 and recognized an impairment charge for the commercial printing business included in Office Business Unit for the amount by which the carrying amount exceeded the reporting unit's fair value. For further information, please refer to Notes 8 and 20 of the Notes to Consolidated Financial Statements. The fair values of remaining reporting units exceeded its respective carrying amount, and thus no other impairment charges were recognized as a result of 2017 impairment test. However, since goodwill attributed to Medical System Business Unit and network camera business included in Industry and Others Business Unit were resulted from recent acquisitions, fair values in excess of reported carrying values as a percentage are relatively low. As a result, a future reduction more than expected in cash flows of the related business, could trigger an impairment. The goodwill related to these reporting units are ¥499,915 million and ¥235,172 million, respectively. Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 6 years, trademarks are 15 years, patents and developed technology are from 7 years to 17 years, license fees are 7 years, and customer relationships are from 11 years to 15 years, respectively.

Income tax uncertainties

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 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.

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In preparing its financial statements for 2017, Canon estimated a weighted-average discount rate used to determine benefit obligations of 0.6% for Japanese plans and 2.2% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.1% for Japanese plans and 4.2% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income government 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. For 2017, a decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately ¥101,964 million. 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 2017, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥4,948 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.

Recently Issued Accounting Guidance

Please refer to Note 1 of the Notes to Consolidated Financial Statements.

Consolidated results of operations**2017 compared with 2016**

Summarized results of operations for 2017 and 2016 are as follows:

| | 2017 | Change | 2016 |
|--|--|---------------|-------------|
| | (Millions of yen, except per share amounts and percentage data) | | |
| Net sales | 4,080,015 | +19.9% | 3,401,487 |
| Operating profit | 331,479 | +44.8 | 228,866 |
| Income before income taxes | 353,884 | +44.6 | 244,651 |
| Net income attributable to Canon Inc. | 241,923 | +60.6 | 150,650 |
| Net income attributable to Canon Inc. shareholders per share: | | | |
| Basic | 222.88 | +61.6 | 137.95 |
| Diluted | 222.88 | +61.6 | 137.95 |

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

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In the current business term, the world economy as a whole continued to recover more robustly than was expected at the beginning of the year. In such an environment, due to efforts to promote sales of newly launched models and high-value-added models, along with the impact of acquiring TMSC, Canon's consolidated net sales in 2017 totaled ¥4,080,015 million, an increase of 19.9% from the previous year.

Overseas operations are significant to Canon's operating results and generated 78.3% of total net sales in 2017. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative 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 during the year was ¥112.13 against the U.S. dollar, a year-on-year depreciation of approximately ¥4, and ¥126.69 against the euro, a year-on-year depreciation of approximately ¥6. The effects of foreign exchange rate fluctuations positively affected net sales by approximately ¥96,224 million in 2017. This favorable impact consisted of approximately ¥42,467 million of favorable impact for the U.S. dollar denominated sales and favorable impact of ¥42,950 million for the euro denominated sales, and ¥10,807 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 foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratios of cost of sales to net sales for 2017 and 2016 were 51.2% and 50.8%, respectively.

Gross profit

Canon's gross profit in 2017 increased by 19.0% to ¥1,992,691 million from 2016. The gross profit ratio also decreased by 0.4 points year on year to 48.8%. The decrease in the gross profit ratio is primarily due to the effect of product mix.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Operating expenses increased 15.0% year on year to ¥1,661,212 million owing to such factors as the increase in foreign-currency-denominated operating expenses after conversion into yen due to the depreciation of the yen, the impact of acquiring TMSC, and the impact of recognizing impairment losses on goodwill.

Operating profit

Operating profit in 2017 increased 44.8% from 2016 to a total of ¥331,479 million. The ratio of operating profit to net sales increased 1.4 points to 8.1% from 2016.

Other income (deductions)

Other income (deductions) for 2017 was ¥22,405 million, an increase of ¥6,620 million from 2016 mainly due to gain on securities contributed to retirement benefit trust which was partially offset by foreign currency exchange losses.

Table of Contents*Income before income taxes*

Income before income taxes in 2017 was ¥353,884 million, an increase of 44.6% from 2016, and constituted 8.7% of net sales.

Income taxes

Income taxes in 2017 increased by ¥15,343 million from 2016. The effective tax rate for 2017 was 27.7%, which was lower than the statutory tax rate in Japan. This was mainly due to the effect of reversal of deferred tax liabilities derived from US tax reform in 2017 and the tax credit for R&D expenses which were partially offset by the impact of impairment losses on goodwill.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in 2017 increased by 60.6% to ¥241,923 million, which represents 5.9% of net sales.

Segment information

Canon divides its businesses into four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System Business Unit which was newly established in 2017, and the Industry and Others Business Unit.

The Office Business Unit mainly includes office multifunction devices (MFDs), laser multifunction printers (MFPs), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions.

The Imaging System Business Unit mainly includes interchangeable-lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, Compact photo printers, inkjet printers, large format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators.

The Medical System Business Unit mainly includes digital radiography systems, diagnostic X-ray systems, computed tomography, magnetic resonance imaging, diagnostic ultrasound systems, clinical chemistry analyzers and ophthalmic equipment.

The Industry and Others Business Unit mainly includes semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, digital radiography systems, vacuum thin-film deposition equipment, organic LED (OLED) panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners.

Sales by segment

Please refer to the table of sales by segment in Note 21 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

| | 2017 | Change | 2016 |
|---------------------|---|--------|-----------|
| | (Millions of yen, except percentage data) | | |
| Office | 1,865,928 | +3.2% | 1,807,819 |
| Imaging System | 1,136,188 | +3.7 | 1,095,289 |
| Medical System | 436,187 | | |
| Industry and Others | 731,704 | +25.2 | 584,660 |
| Eliminations | (89,992) | | (86,281) |
| Total | 4,080,015 | +19.9% | 3,401,487 |

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Within the Office Business Unit, unit sales of office MFDs increased from the previous year and achieved higher growth than the market average, supported by steady sales of next-generation color models designed to strengthen the product lineup such as the newly launched color A3 (12 x18) imageRUNNER ADVANCE C3500 series for small- and medium-size offices. Among high-speed continuous-feed printers, unit sales of the Océ-produced VarioPrint i300, a high-speed sheet-fed color inkjet press that offers superior low-running-cost performance, increased. As for laser printers, sales of both hardware and consumables increased from the previous year, supported by steady sales of new models that achieve low power consumption and compact body designs. These factors resulted in total sales for the business unit of ¥1,865,928 million, a year-on-year increase of 3.2%, while operating profit totaled ¥180,648 million, a year-on-year increase of 6.6%.

Within the Imaging System Business Unit, while the pace of decline in demand for interchangeable-lens digital cameras is gradually decelerating, the sales of the advanced-amateur-models including the EOS 6D Mark II enjoyed solid demand, allowing Canon to maintain the top share, mainly in the United States, Europe, and Japan. As for compact-system cameras, the advanced-amateur-model EOS M6 and the entry-level EOS M100 enjoyed strong demand. As for digital compact cameras, amid the shrinking market, unit sales remained at the same level as the previous year, supported by the increased sales of such high-value-added models as the newly launched G9 X Mark II part of the high-image-quality PowerShot G-series lineup. As for inkjet printers, the newly designed home-use TS-series, refillable ink tank models targeting emerging countries and the imagePROGRAF PRO series of large format inkjet printer targeting the professional photo and graphic art markets enjoyed strong demand, resulting in unit sales increasing from the previous year. As a result, sales for the business unit increased by 3.7% year on year to ¥1,136,188 million, while operating profit totaled ¥175,913 million, a year-on-year increase of 21.8%.

Within the Medical System Business Unit, TMSC's computed tomography (CT) products increased the sales and maintained the top share in the Japanese market thanks to the solid sales of the newly launched Aquilion Precision CT scanner, which delivers the industry's highest level of high-resolution imaging. As for diagnostic ultrasound systems, sale of the Aplio i-series, which delivers proprietary high-resolution imaging technology, remained firm. As a result, sales for the business unit totaled ¥436,187 million, while operating profit totaled ¥22,505 million.

In the Industry and Others Business Unit, unit sales of semiconductor lithography equipment increased from the previous year as a result of increasing demand for memory devices used in data centers. Additionally, sales of FPD lithography equipment and manufacturing equipment for OLED panels increased significantly in response to continued growing demand for high-definition OLED displays used in mobile devices. As for network cameras, amid increasing market demand, Axis enjoyed solid sales, resulting in a considerable sales increase compared with the previous year. Consequently, sales for the business unit increased by 25.2% year on year to ¥731,704 million, while operating profit grew by ¥49,340 million from the previous year to ¥56,788 million.

Intersegment sales of ¥89,992 million, representing 2.2% of total sales, are eliminated from total sales for the four segments, and are described as Eliminations .

Table of Contents***Sales by geographic area***

Please refer to the table of sales by geographic area in Note 21 of the Notes to Consolidated Financial Statements.

A summary of net sales by geographic area in 2017 and 2016 is provided below:

| | 2017 | Change | 2016 |
|------------------|---|---------------|------------------|
| | (Millions of yen, except percentage data) | | |
| Japan | 884,828 | +25.2% | 706,979 |
| Americas | 1,107,515 | +14.9 | 963,544 |
| Europe | 1,028,415 | +12.6 | 913,523 |
| Asia and Oceania | 1,059,257 | +29.6 | 817,441 |
| Total | 4,080,015 | +19.9% | 3,401,487 |

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customers. A geographical analysis indicates that net sales in 2017 are summarized as follows.

In Japan, net sales increased 25.2% from the previous year mainly due to the impact of acquiring TMSC.

In the Americas, net sales increased 14.9% from the previous year due to the impact of acquiring TMSC, solid sales of network cameras and the positive effects of favorable currency exchange rates.

In Europe, net sales increased 12.6% from the previous year due to the impact of acquiring TMSC, solid sales of network cameras and the positive effects of favorable currency exchange rates.

In Asia and Oceania, net sales increased by 29.6% from the previous year due to the impact of acquiring TMSC and strong sales of manufacturing equipment for OLED displays which is sold by Canon Tokki and manufacturing equipment for FPD (Flat panel display).

Operating profit by segment

Please refer to the table of segment information in Note 21 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in 2017 increased by 6.6% from the previous year to ¥180,648 million, owing to the positive effects of favorable currency exchange rates.

Operating profit for the Imaging System Business Unit in 2017 increased by 21.8% from the previous year to ¥175,913 million, owing to the improvement in profitability from the sales shift to high-added-value models in cameras, along with the positive effects of favorable currency exchange rates.

Operating profit for the Medical System Business Unit, which was newly established from this year, was ¥22,505 million in 2017.

Operating profit for the Industry and Others Business Unit in 2017 grew by ¥49,340 million to ¥56,788 million thanks to strong sales of manufacturing equipment for OLED displays and network cameras.

Table of Contents**2016 compared with 2015**

Summarized results of operations for 2016 and 2015 are as follows:

| | 2016 | Change (Millions of yen, except per share amounts and percentage data) | 2015 |
|--|-----------|--|-----------|
| Net sales | 3,401,487 | -10.5% | 3,800,271 |
| Operating profit | 228,866 | -35.6 | 355,210 |
| Income before income taxes | 244,651 | -29.6 | 347,438 |
| Net income attributable to Canon Inc. | 150,650 | -31.6 | 220,209 |
| Net income attributable to Canon Inc. shareholders per share: | | | |
| Basic | 137.95 | -31.6 | 201.65 |
| Diluted | 137.95 | -31.6 | 201.65 |

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

Sales

In the current business term, the world economy as a whole experienced only a moderate recovery due to, among others, the slowdown in emerging economies. In such an environment, despite efforts to promote sales of highly-competitive products, due to the effect of significant appreciation of the yen, Canon's consolidated net sales in 2016 totaled ¥3,401,487 million, a decrease of 10.5% from the previous year.

Overseas operations are significant to Canon's operating results and generated 79.2% of total net sales in 2016. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative 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 during the year was ¥108.58 against the U.S. dollar, a year-on-year appreciation of approximately ¥13, and ¥120.25 against the euro, a year-on-year appreciation of approximately ¥14. The effects of foreign exchange rate fluctuations negatively affected net sales by approximately ¥280,434 million in 2016. This unfavorable impact consisted of approximately ¥144,206 million of unfavorable impact for the U.S. dollar denominated sales and unfavorable impact of ¥90,308 million for the euro denominated sales, and ¥45,920 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 foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratios of cost of sales to net sales for 2016 and 2015 were 50.8% and 49.1%, respectively.

Gross profit

Canon's gross profit in 2016 decreased by 13.5% to ¥1,673,833 million from 2015. The gross profit ratio also decreased by 1.7 points year on year to 49.2%. The decrease in the gross profit ratio primarily reflects the negative effect of appreciation of the yen against other foreign currencies such as the U.S. dollar and the euro.

Table of Contents*Operating expenses*

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Operating expenses decreased 8.5% year on year to ¥1,444,967 million owing to such factors as the decrease in foreign-currency-denominated operating expenses after conversion into yen due to the appreciation of the yen, and a decrease in advertising and other marketing expenses and R&D expenses.

Operating profit

Operating profit in 2016 decreased 35.6% from 2015 to a total of ¥228,866 million. The ratio of operating profit to net sales decreased 2.6 points to 6.7% from 2015.

Other income (deductions)

Other income (deductions) for 2016 was ¥15,785 million, an increase of ¥23,557 million from 2015 mainly due to a decrease in foreign currency exchange loss.

Income before income taxes

Income before income taxes in 2016 was ¥244,651 million, a decrease of 29.6% from 2015, and constituted 7.2% of net sales.

Income taxes

Provision for income taxes in 2016 decreased by ¥33,424 million from 2015. The effective tax rate for 2016 was 33.8%, which was higher than the statutory tax rate in Japan. This was mainly due to the effect of reversal of deferred tax assets derived from changes in tax laws and Japanese tax rates that took effect in 2016.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in 2016 decreased by 31.6% to ¥150,650 million, which represents 4.4% of net sales.

Segment information

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

The Office Business Unit mainly includes office multifunction devices (MFDs), laser multifunction printers (MFPs), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions.

The Imaging System Business Unit mainly includes interchangeable-lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, Compact photo printers, inkjet printers, large format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators.

The Industry and Others Business Unit mainly includes semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, digital radiography systems, diagnostic X-ray systems, computed tomography, magnetic resonance imaging, diagnostic ultrasound systems, clinical chemistry analyzers, ophthalmic equipment, vacuum thin-film deposition equipment, organic LED (OLED) panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners.

Table of Contents**Sales by segment**

Please refer to the table of sales by segment in Note 21 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

| | 2016 (Millions of yen, except percentage data) | Change | 2015 |
|---------------------|---|---------------|------------------|
| Office | 1,807,819 | -14.4% | 2,110,816 |
| Imaging System | 1,095,289 | -13.3 | 1,263,835 |
| Industry and Others | 584,660 | +11.4 | 524,651 |
| Eliminations | (86,281) | | (99,031) |
| Total | 3,401,487 | -10.5% | 3,800,271 |

Within the Office Business Unit, unit sales of office MFDs increased overall from the previous year thanks to strong sales of color models, even with the continued decrease in sales of monochrome models. This growth was supported by steady sales of the color A3 (12 x18) imageRUNNER ADVANCE C5500-series models, which were released this year, and the small-office/home-office color A3 (12 x18) imageRUNNER C3300-series models, which were launched in the previous year, along with expanded sales of imagePRESS C1000VP-series models, which target the production printing market. Among high-speed continuous-feed printers, unit sales of the Océ-produced VarioPrint i300, a high-speed sheet-fed color inkjet press, increased year on year. Although the unit sales of laser printers had been below level against the same period of the previous year until the third quarter, due to the sluggish economic conditions in the emerging countries, unit sales exceeded the same period of the year at fourth quarter along with a smooth transition to new models as planned. These factors, coupled with the negative effect of unfavorable currency exchange rates, resulted in total sales for the business unit of ¥1,807,819 million, a year-on-year decline of 14.4%, while operating profit totaled ¥169,486 million, a year-on-year decline of 41.7%.

Within the Imaging System Business Unit, sales volume for interchangeable-lens digital cameras grew compared with the previous year owing to healthy demand for the EOS-1D X mark II and the EOS 5D mark IV, which were launched this year, and the launch of a new addition to the Company's strengthening compact-system camera lineup, the EOS M5, which features a built-in EVF. As for digital compact cameras, along with the ongoing contraction of the market, sales volume declined amid difficulties in procuring components due to the earthquake in Kumamoto earlier in the year, with much of the profitability generated by sales of high-added-value models that deliver high image quality and zoom capabilities. As for inkjet printers, although sales volume declined compared with the previous year due to a shrinking market for consumer products, sales of models equipped with large-capacity ink tanks that were launched in the fourth quarter of 2015 experienced healthy demand mainly in emerging countries, while demand was high mainly in Japan for newly designed models for home use that were launched in 2016. Additionally, wide format inkjet printers, new imagePROGRAF PRO-series models, which target the professional photo and graphic art market, saw an increase in unit sales. As a result of these factors, along with the negative effect of unfavorable currency exchange rates, sales for the business unit decreased by 13.3% to ¥1,095,289 million while operating profit totaled ¥144,413 million, a year-on-year decline of 21.3%.

In the Industry and Others Business Unit, unit sales of semiconductor lithography equipment decreased from the previous year amid the postponement of some capital investments by customers. As for FPD lithography equipment, unit sales of lithography systems employed in the fabrication of mid- and small-size panels increased in response to growing demand for high-definition OLED displays used in mobile devices. Also, sales of manufacturing equipment for OLED displays, which is sold by Canon Tokki, increased amid brisk capital investment by panel manufacturers. In addition, sales of network cameras increased compared with the previous year thanks to efforts to strengthen the product lineup. Consequently, sales for the business unit increased 11.4% year-on-year to ¥584,660 million while operating profit grew by ¥20,527 million to ¥7,448 million.

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Intersegment sales of ¥86,281 million, representing 2.5% of total sales, are eliminated from total sales for the three segments, and are described as Eliminations .

Sales by geographic area

Please refer to the table of sales by geographic area in Note 21 of the Notes to Consolidated Financial Statements.

A summary of net sales by geographic area in 2016 and 2015 is provided below:

| | 2016 | Change | 2015 |
|------------------|---|---------------|------------------|
| | (Millions of yen, except percentage data) | | |
| Japan | 706,979 | -1.0% | 714,280 |
| Americas | 963,544 | -15.8 | 1,144,422 |
| Europe | 913,523 | -15.0 | 1,074,366 |
| Asia and Oceania | 817,441 | -5.7 | 867,203 |
| Total | 3,401,487 | -10.5% | 3,800,271 |

Note: This summary of net sales by geographic area is determined by the location where the product is shipped to the customers. A geographical analysis indicates that net sales in 2016 are summarized as follows.

In Japan, net sales decreased 1.0% from the previous year due to the ongoing contraction of the digital camera market, especially for digital compact cameras, which reflected a slow recovery in consumer spending.

In the Americas, net sales decreased 15.8% from the previous year owing to the negative effect of the yen's appreciation and the decline in sales of laser printers, interchangeable-lens digital cameras and digital compact cameras.

In Europe, net sales decreased 15.0% from the previous year owing to the negative effect of the yen's appreciation and the decline in sales of laser printers.

In Asia and Oceania, despite strong sales of manufacturing equipment for OLED displays which is sold by Canon Tokki, net sales decreased by 5.7% from the previous year mainly due to the negative effect of the yen's appreciation.

Operating profit by segment

Please refer to the table of segment information in Note 21 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in 2016 decreased by 41.7% from the previous year to ¥169,486 million, owing to the negative effect of the yen's appreciation along with the decrease in sales of laser printers.

Operating profit for the Imaging System Business Unit in 2016 decreased by 21.3% from the previous year to ¥144,413 million, owing to the negative effect of the yen's appreciation along with the decrease in sales of compact digital cameras.

Operating profit for the Industry and Others Business Unit in 2016 grew by ¥20,527 million to ¥7,448 million thanks to strong sales of manufacturing equipment for OLED displays and network cameras, despite the negative impact of the yen's appreciation

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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 21 of the Notes to Consolidated Financial Statements.

B. Liquidity and capital resources

Cash and cash equivalents increased by ¥91,621 million to ¥721,814 million in fiscal 2017 compared to the previous year. Canon's cash and cash equivalents are primarily denominated in Japanese yen and in U.S. dollars, with the remainder denominated in other currencies.

Net cash provided by operating activities increased by ¥90,274 million to ¥590,557 million in fiscal 2017 compared to the previous year thanks to the increase in net income. 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, R&D expenses and income taxes.

For fiscal 2017, cash inflow from cash received from customers increased thanks to sales growth. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials, selling, general and administrative expenses and R&D expenses increased mainly due to sales growth. Cash outflow for payments for income taxes decreased thanks to a decrease in taxable income in fiscal 2016.

Net cash used in investing activities decreased by ¥672,115 million to ¥165,010 million in fiscal 2017. This mainly reflects the acquisition of TMSC in fiscal 2016.

Canon defines "free cash flow" as cash flows from operating activities less cash flows from investing activities. For fiscal 2017, free cash flow increased by ¥762,389 million to positive ¥425,547 million as compared with negative ¥336,842 million for fiscal 2016.

Note: "Free cash flow" is non-GAAP measure. Refer to "Non-GAAP Financial Measures" section for the explanation and the reconciliation to the reported GAAP measure.

Canon's management places importance on cash flow management and frequently monitors this indicator. 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 and believes that such indicator is beneficial to an investor's understanding. 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 provided in financing activities totaled negative ¥340,464 million in fiscal 2017, mainly resulting from the dividend payout of ¥162,887 million, the repayment for long-term loans of ¥126,578 million and the acquisition of own shares in ¥50,036 million. The Company paid dividends in fiscal 2017 of ¥160.00 per share.

To the extent Canon relies on external funding for its liquidity and capital requirements, it generally has access to various funding sources, including the issuance of additional share capital, issuance of corporate bond

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or 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) increased to ¥39,328 million at December 31, 2017 compared with ¥1,850 million at December 31, 2016, which was mainly due to a new consolidation of subsidiary. Long-term debt (excluding the current portion) amounted to ¥493,238 million at December 31, 2017 compared with ¥611,289 million at December 31, 2016 thanks to the repayment for long-term loans.

Canon's long-term debt mainly consists of bank borrowings and 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 9, 2018, Canon's debt ratings are: Moody's: Aa3 (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.

Canon's management policy in recent periods to optimize inventory levels is intended to maintain an appropriate balance among relevant imperatives, including minimizing working capital, avoiding undue exposure to the risk of inventory obsolescence, and maintaining the ability to sustain sales despite the occurrence of unexpected disasters.

Reflecting the foregoing circumstances, Canon's total inventory turnover ratios were 49, 59, and 47 days at the end of the fiscal years 2017, 2016, and 2015, respectively. The increase of inventory turnover in 2016 was primarily due to the acquisition of TMSC on December 19, 2016. If this factor were excluded, the inventory turnover would show 50 days.

Increase in property, plant and equipment on an accrual basis in 2017 amounted to ¥147,542 million compared with ¥171,597 million in 2016 and ¥195,120 million in 2015. For 2018, Canon projects its increase in property, plant and equipment will be approximately ¥200,000 million.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥50,628 million in 2017, ¥14,575 million in 2016 and ¥19,565 million in 2015. Employer contributions to Canon's worldwide defined contribution pension plans were ¥18,979 million in 2017, ¥17,603 million in 2016, and ¥17,277 million in 2015. In addition, employer contributions to the multiemployer pension plan of certain subsidiaries were ¥4,165 million in 2017, ¥3,482 million in 2016 and ¥3,864 million in 2015.

Working capital in 2017 increased by ¥6,790 million to ¥1,123,169 million, compared with ¥1,116,379 million in 2016 and ¥1,241,850 million in 2015. 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 2017 was 2.01 compared to 2.14 for 2016 and to 2.52 for 2015.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 4.7% in 2017, compared to 3.1% in 2016 and 5.0% in 2015.

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Return on Canon Inc. shareholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. shareholders' equity) was 8.6% in 2017 compared with 5.2% in 2016 and 7.4% in 2015.

The debt to total assets ratios were 10.2%, 11.9% and 0.0% as of December 31, 2017, 2016 and 2015, respectively. Canon had short-term loans and long-term debt of ¥532,566 million as of December 31, 2017, ¥613,139 million as of December 31, 2016 and ¥1,569 million as of December 31, 2015.

Non-GAAP Financial Measures

We have reported our financial results in accordance with U.S. generally accepted accounting principles (U.S. GAAP). In addition, we have discussed our results using the combination of two GAAP cash flow measures, Net cash provided by operating activities and Net cash used for investing activities, which we refer to as Free Cash Flow which is non-GAAP measure. We believe this measure is beneficial to an investor's understanding on Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities.

A reconciliation of these non-GAAP financial measures and the most directly comparable measures calculated and presented in accordance with GAAP are set forth on the following table.

Free Cash Flow

| | December 31 | |
|---|--------------------------|-------------|
| | 2017 | 2016 |
| | <i>(Millions of yen)</i> | |
| Net cash provided by operating activities | 590,557 | 500,283 |
| Net cash used in investing activities | (165,010) | (837,125) |
| Free cash flow | 425,547 | (336,842) |

C. Research and development, patents and licenses

Canon has started its 5-year management plan, the Excellent Global Corporation Plan Phase V (Phase V) from the year 2016. In Phase V, our slogan is "Embrace the challenge of new growth through a grand strategic transformation" and there are three key strategies related to R&D:

- Establish a new production system to achieve a cost-of-sales ratio of 45%;
- Reinforce and expand new businesses while creating future businesses; and
- Enhance R&D capabilities through open innovation.

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

Establish a new production system to achieve a cost-of-sales ratio of 45%:

Strengthen domestic mother factories by integrating design, procurement, production engineering and manufacturing technology operations while pursuing total cost reduction by advancing production engineering capabilities with more sophisticated robots and next-generation technologies such as the IoT, big data and artificial intelligence.

Reinforce and expand new businesses while creating future businesses:

Create and expand new businesses by accelerating the horizontal expansion of existing business with the exploration of new application possibility of Canon's technologies into new fields. Also, invest intensively on the R&D of promising businesses areas such as commercial

printing, network cameras and life sciences while actively taking advantage of M&A to accelerate the early expansion of these businesses.

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Enhance R&D capabilities through open innovation:

Construct a more open R&D system that proactively leverages external technologies and knowledge to accelerate and improve efficiency of the R&D. Especially in our fundamental research and development, Canon is promoting joint and contract research with various partners including universities, research institutes, and startups around the world.

In the ImPACT (Impulsing Paradigm Change through Disruptive Technologies) program led by the Japanese government, Canon's Innovative Visualization Technology to Lead to Creation of a New Growth Industry was selected as one of the R&D programs in the year 2014, and we are aiming to develop medical inspection equipment with the physically-noninvasive and -nondestructive imaging technology. Additionally, Canon is currently working on collaborative research with Massachusetts General Hospital (MGH) and Brigham and Women's Hospital (BWH) to develop biomedical optical imaging and medical robotics technologies at the Healthcare Optics Research Laboratory in Cambridge, Massachusetts, founded in 2013. Also, TMSC and the University of Bordeaux has started a joint research on ultra-high-resolution MRI technologies.

Canon has developed simulation systems covering comprehensive image processing including optical design, mechanical noise analysis, and thermal air flow analysis. With these simulation systems, Canon has succeeded in further reducing the need for prototypes, lowering costs and shortening product development lead times.

Canon's consolidated R&D expenses were ¥330,053 million in 2017, ¥302,376 million in 2016 and ¥328,500 million in 2015. The ratios of R&D expenses to the consolidated total net sales for 2017, 2016 and 2015 were 8.1%, 8.9% and 8.6%, respectively.

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

Canon obtained the third greatest number of private sector patents in 2017, according to the United States patent annual list, released by IFI CLAIMS® Patent Services.

D. Trend information

Under the corporate philosophy of kyosei living and working together for the common good 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 corporation targeting continued growth and development.

Based on this basic management policy, Canon launched the Excellent Global Corporation Plan in 1996 and, from Phase I through to Phase IV, has worked to strengthen its management base and improve corporate value. In 2016, under the slogan Embracing the challenge of new growth through a grand strategic transformation, Canon embarked on a new five-year initiative: Phase V of the Excellent Global Corporation Plan. Under this plan, Canon aims to facilitate growth through structural transformation by reinforcing existing businesses and taking steps to cultivate and strengthen new businesses.

Despite the growing concerns about geopolitical risks, the world economy is expected to continue achieving moderate growth in 2018.

In the businesses in which Canon is involved, for office MFDs, demand for color models is expected to grow moderately and make up for the contraction of the market for monochrome models, leading to the same level of demand overall compared with the previous year. Looking at the laser printer market, although the demand in developed countries is expected to decrease, demand in emerging countries continues to recover, resulting in overall demand remaining at the same level as the previous year. For interchangeable-lens digital

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cameras, demand is expected to decrease moderately. Projections for digital compact cameras indicate continued market contraction, centered mainly on low-priced models, despite solid demand for high-value-added models. With regard to inkjet printers, demand is expected to continue to exceed that of the previous year. As for the medical equipment market, demand is expected to remain firm in response to replacement demand for medical equipment in developed countries, increasing medical needs associated with population growth in emerging countries and changes in the prevalence of diseases. Looking at industrial equipment, within the semiconductor lithography equipment segment, the market is expected to enjoy healthy growth due to the increase in demand for memory devices used in data centers and mobile devices. The outlook for FPD lithography equipment and OLED panel manufacturing equipment points to continued active capital investment by panel manufacturers, which is expected to increase demand. The network camera market is also expected to grow in response to the increasing use of network cameras for diverse applications in such areas as marketing support in addition to disaster monitoring and crime prevention applications.

Amid these conditions, 2018 marks the year of accelerated progress toward the target to achieve net sales of 5.0 trillion yen under Phase V (2016-2020) of Excellent Global Corporation Plan with the new business portfolio including the four new business areas (commercial printing, network cameras, healthcare, and industrial equipment), and will work to address the following key challenges under the theme of Pursue total optimization and prioritize profits to complete our grand strategic transformation. Canon will once again return to the slogans of total optimization and focus on profit, which Canon have upheld since 1996, and review everything from scratch based on them aiming to raise the level of the overall management one step higher.

Strengthen capability to research leading-edge technology

Strengthen research and analysis functions that contribute to the expansion of strategic initiatives that respond to changing times and rapid and constant innovation. Comprehensively strengthen capability to research not only global leading-edge technology, but also political, economic, industrial, social and other areas.

Strengthen product development capability

Focus resources in areas that hold future promise, promoting even more strictly the selection and concentration of development themes. Efficiently accelerate technological development through collaboration and the use of external research institutes, and start-up enterprises. Further improve quality, cost, and delivery, promoting such initiatives as elimination of prototypes by improving simulation technology, optimal designs for robot assembly, and the sharing of product platforms. Enhance software development capability and work to obtain the optimal balance between outsourcing and in-house production.

Comprehensively strengthen manufacturing prowess

Accelerate reduction in the production cost ratio of new businesses. Establish an advanced and efficient production system that brings together, development, production engineering, and manufacturing, and strongly promote the expansion of this via the mother factory concept. Thoroughly pursue cost reduction, expanding the in-house production of production equipment and parts that are shared among various products in addition to key components. Construct a globally optimized manufacturing system, which enables monitoring of costs in real time by country and region. Eradicate waste in product development stage, having product development and quality organizations work in unison.

Comprehensively strengthen strategic procurement function

Further strengthen and accelerate cooperation with worldwide suppliers in the global procurement network developed so far. Promote in-house production of parts and materials and realize cost reduction by promoting standardization of parts and adoption of general-purpose components.

Table of Contents*Reform sales organizations to correspond to market changes*

Cultivate global sales engineers essential for B2B businesses such as commercial printing and network camera, and while striving to enhance the capabilities of these sales engineers, work to strengthen local service support systems with a focus on sales companies. Carry out the optimization of sales channels to correspond to changes in product and market landscapes, such as adapting to e-commerce.

Establish a human resource management system that adapts to the changing times

Build a human resource development system, a personnel system that enables a wide range of career paths that are in step with changes in the business environment and times.

For a discussion of the trend by business segments, see Item 4 B. Business overview and Item 5 A. Operating Results .

E. Off-balance sheet arrangements

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

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

Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract terms. The contract terms are 1 year to 30 years in case of employees with housing loans, and 1 year to 7 years in case of affiliates and other companies with lease obligations and bank loans. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥6,059 million at December 31, 2017. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2017 were not significant.

F. Contractual obligations

The following summarizes Canon's contractual obligations at December 31, 2017.

| | Total | Payments Due By Period | | | More than 5 years |
|---|----------------|------------------------|---------------|----------------|----------------------|
| | | Less than 1 year | 1-3 years | 3-5 years | |
| (Millions of yen) | | | | | |
| Contractual obligations: | | | | | |
| Long-Term Debt: | | | | | |
| Loan from the banks | 490,000 | | | 490,000 | |
| Other debt | 9,168 | 5,930 | 2,776 | 390 | 72 |
| Operating Lease Obligations | 111,502 | 28,414 | 37,622 | 22,495 | 22,971 |
| Purchase commitments for: | | | | | |
| Property, Plant and Equipment | 36,199 | 36,199 | | | |
| Parts and Raw Materials | 135,649 | 135,649 | | | |
| Other long-term liabilities | | | | | |
| Contribution to Defined Benefit Pension Plans | 36,750 | 36,750 | | | |
| Total | 819,268 | 242,942 | 40,398 | 512,885 | 23,043 |

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Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 12, Income Taxes in the Notes to Consolidated Financial Statements for further details.

Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2017 accrued product warranty costs amounted to ¥17,452 million.

At December 31, 2017, commitments outstanding for the purchase of property, plant and equipment were approximately ¥36,199 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥135,649 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 2018, Canon expects to contribute ¥14,447 million to its Japanese defined benefit pension plans and ¥22,303 million to its foreign defined benefit pension plans.

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

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

Directors and Audit & Supervisory Board Members of the Company as of March 29, 2018 and their respective business experience are listed below.

| Name (Date of birth) | Position (Group executive/function) | Date of commencement | Business experience (*current position/function) |
|----------------------------------|--|-------------------------|--|
| Fujio Mitarai (Sep. 23, 1935) | Chairman & CEO | 4/1961 | Entered the Company |
| | | 1/1979 | President of Canon U.S.A., Inc. |
| | | 3/1981 | Director |
| | | 3/1985 | Managing Director |
| | | 1/1989 | In charge of HQ administration |
| | | 3/1989 | Senior Managing Director |
| | | 3/1993 | Executive Vice President |
| | | 9/1995 | President & CEO |
| | | 3/2006 | Chairman of the Board & President & CEO |
| | | 5/2006 | Chairman & CEO* |
| Masaya Maeda (Oct. 17, 1952) | President & COO | 4/1975 | Entered the Company |
| | | 1/2006 | Group Executive of Digital Imaging Business Group |
| | | 3/2007 | Director |
| | | 4/2007 | Chief Executive of Image Communication Products Operations |
| | | 3/2010 | Managing Director |
| | | 3/2014 | Senior Managing Director |
| | | 3/2016 | President & COO* |
| Toshizo Tanaka (Oct. 8, 1940) | Executive Vice President & CFO (Group Executive of Human Resources Management & Organization HQ, Group Executive of Facilities Management HQ, Group Executive of Public Affairs HQ) | 4/1964 | Entered the Company |
| | | 1/1992 | Deputy Group Executive of Finance & Accounting HQ |
| | | 3/1995 | Director |
| | | 4/1995 | Group Executive of Finance & Accounting HQ |
| | | 3/1997 | Managing Director |
| | | 3/2001 | Senior Managing Director |
| | | 1/2007 | Group Executive of Policy and Economy Research HQ |
| | | 3/2007 | Executive Vice President & Director |
| | | 3/2008 | Executive Vice President & CFO* |
| | | 1/2010 | Group Executive of General Affairs HQ |
| | | 3/2010 | Group Executive of External Relations HQ |
| | | 4/2011 | Group Executive of Finance & Accounting HQ |
| | | 4/2012 | Group Executive of Facilities Management HQ |
| 3/2014 | Group Executive of Human Resources Management & Organization HQ* | | |

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| Name (Date of birth) | Position (Group executive/function) | Date of commencement | Business experience | |
|--|---|-------------------------|--|--|
| | | | (*current position/function) | |
| | | 4/2017 | Group Executive of Facilities Management HQ* | |
| | | 3/2018 | Group Executive of Public Affairs HQ* | |
| Toshio Homma (Mar. 10, 1949) | Executive Vice President in charge of Office Business | 4/1972 | Entered the Company | |
| | | 4/2001 | Deputy Chief Executive of i Printer Products Operations | |
| | (Chief Executive of Office Imaging Products Operations) | 3/2003 | Director | |
| | | 4/2003 | Group Executive of Business Promotion HQ | |
| | | 7/2003 | Group Executive of L Printer Business Promotion HQ | |
| | | 1/2007 | Chief Executive of L Printer Products Operations | |
| | | 3/2008 | Managing Director | |
| | | 3/2012 | Senior Managing Director | |
| | | | 3/2016 | Group Executive of Procurement HQ Executive Vice President |
| | | | 4/2016 | Chief Executive of Office Imaging Products Operations* |
| | | 3/2017 | Executive Vice President in charge of Office Business* | |
| Shigeyuki Matsumoto (Nov. 15, 1950) | Executive Vice President & CTO (Group Executive of R&D HQ) | 4/1977 | Entered the Company | |
| | | 1/2002 | Group Executive of Device Technology Development HQ | |
| | | 3/2004 | Director | |
| | | 3/2007 | Managing Director | |
| | | 3/2011 | Senior Managing Director | |
| | | 3/2015 | Group Executive of Corporate R&D | |
| | | 7/2015 | Group Executive of R&D HQ* | |
| | | 3/2016 | CTO* | |
| 3/2017 | Executive Vice President* | | | |
| Kunitaro Saida (May 4, 1943) | Director | 5/2006 | Qualified for attorney* Ginza Seiwa Law Office* | |
| | | 6/2007 | Audit & Supervisory Board Member of NICHIREI CORPORATION* | |
| | | 6/2008 | Director of Sumitomo Osaka Cement Co., Ltd.* | |
| | | 6/2010 | Director of HEIWA REAL ESTATE CO., LTD.* | |
| | | 3/2014 | Director* | |
| Haruhiko Kato (Jul. 21, 1952) | Director | 7/2009 | Commissioner of National Tax Agency | |
| | | 1/2011 | Senior Managing Director of Japan Securities Depository Center, Incorporated | |
| | | 6/2011 | President & CEO of Japan Securities Depository Center, Incorporated* | |

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| Name (Date of birth) | Position (Group executive/function) | Date of commencement | Business experience |
|-------------------------------------|--|-------------------------|--|
| | | | (*current position/function) |
| | | 6/2013 | Director of Toyota Motor Corporation* |
| | | 3/2014 | Director* |
| Kazuto Ono (Jul. 20, 1957) | Audit & Supervisory Board Member | 4/1980 | Entered the Company |
| | | 3/2012 | Group Executive of Human Resources Management & Organization HQ |
| | | 4/2012 | Executive Officer |
| | | 3/2013 | Director |
| | | 3/2014 | Group Executive of Corporate Planning Development HQ |
| | | 3/2015 | Audit & Supervisory Board Member* |
| Masaaki Nakamura (Jul. 28, 1957) | Audit & Supervisory Board Member | 4/1980 | Entered the Company |
| | | 1/2013 | Deputy Group Executive of Facilities Management HQ |
| | | 3/2014 | Deputy Group Executive of Human Resources Management & Organization HQ |
| | | 4/2014 | Executive Officer |
| | | 3/2015 | Director |
| | | 3/2016 | Managing Executive Officer |
| | | 4/2016 | Group Executive of Facilities Management HQ |
| | | 2/2017 | Group Executive of Public Affairs HQ |
| | | 3/2018 | Audit & Supervisory Board Member* |
| Tadashi Ohe (May 20, 1944) | Audit & Supervisory Board Member | 4/1969 | Qualified for attorney* |
| | | 4/1989 | Instructor of Judicial Research and Training Institute |
| | | 3/1994 | Audit & Supervisory Board Member* |
| | | 6/2004 | Audit & Supervisory Board Member of Marui Group Co., Ltd.* |
| | | 6/2011 | Director of Jeco Corporation* |
| | | 6/2015 | Director of Nissan Chemical Industries, Ltd.* |
| Hiroshi Yoshida (Sep. 5, 1954) | Audit & Supervisory Board Member | 10/1980 | Joined Tohmatsu Awoki & Co. |
| | | 4/1984 | Registered as Certified Public Accountant* |
| | | 7/1993 | Partner of Tohmatsu & Co. |
| | | 6/2000 | Representative Partner of Tohmatsu & Co. |
| | | 5/2007 | Managing Partner, Finance & Administration of Deloitte Touche Tohmatsu |
| | | | The Board Member of Deloitte Touche Tohmatsu |

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| Name (Date of birth) | Position (Group executive/function) | Date of commencement | Business experience |
|--|--|-------------------------|--|
| | | | (*current position/function) |
| | | 11/2011 | CFO of Deloitte Touche Tohmatsu LLC |
| | | 3/2017 | Audit & Supervisory Board Member* |
| Koichi Kashimoto (Jul. 2, 1961) | Audit & Supervisory Board Member | 4/1984 | Entered The Dai-ichi Life Insurance Company, Limited (formerly The Dai-ichi Mutual Life Insurance Co.) |
| | | 4/1997 | Manager of Government Relations Department of The Dai-ichi Life Insurance Company, Limited |
| | | 4/2005 | General Manager of Corporate Administration Center of The Dai-ichi Life Insurance Company, Limited |
| | | 4/2009 | Managing Director of Dai-ichi Life International (Europe), Limited |
| | | 4/2012 | General Manager of Secretarial Department of The Dai-ichi Life Insurance Company, Limited |
| | | 4/2016 | Senior General Manager of Secretarial Department (in charge of Secretarial Department and General Affairs Department), and Senior General Manager of Group General Affairs Unit of The Dai-ichi Life Insurance Company, Limited |
| | | 10/2016 | Senior General Manager of Secretarial Department (in charge of Secretarial Department and General Affairs Department) of The Dai-ichi Life Insurance Company, Limited, and Senior General Manager and Chief of General Affairs Unit of Dai-ichi Life Holdings, Inc. |
| | | 3/2018 | Audit & Supervisory Board Member* |

Term

All directors and Audit & Supervisory Board Members are elected by the shareholders at their general meeting.

Tadashi Ohe, Hiroshi Yoshida and Koichi Kashimoto, are outside Audit & Supervisory Board Members as stipulated in Item 16, Article 2 of the Corporation Law of Japan. Kunitaro Saida and Haruhiko Kato are outside directors. The term of office of directors is one year. The current term of all directors expires in March 2018. The term of office of Audit & Supervisory Board Members is four years. The current term for Kazuto Ono and Tadashi Ohe who were elected in the general meeting of shareholders in March 2015, expires in March 2019, the

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current term for Hiroshi Yoshida who was elected in the general meeting of shareholders in March 2017, expires in March 2021, and the current term for Masaaki Nakamura and Koichi Kashimoto who were elected in the general meeting of shareholders in March 2018, expires in March 2022.

Board members and Audit & Supervisory Board Members may serve any number of consecutive terms.

There is no arrangement or understanding between any director or Audit & Supervisory Board Member and any major shareholder, customer, supplier or other material stakeholders in connection with the selection of such director or Audit & Supervisory Board Member.

Board of Directors and Audit & Supervisory Board Members

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

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

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

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

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

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

The amount of remuneration payable to the Company's board members as a group and that of the Company's Audit & Supervisory Board Members as a group in respect of a fiscal year is subject to approval by a

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general meeting of shareholders. Within those authorized amounts, the compensation for each board member and Audit & Supervisory Board Member is determined by the board of directors and a consultation with the Audit & Supervisory Board Members, respectively. The Company does not have a remuneration committee.

Under the Corporation Law of Japan and the Company's articles of incorporation, the board of directors may, by resolution, release current and former directors and Audit & Supervisory Board Members from liability for damages resulting from negligence in the fulfillment of their respective duties to the extent permitted by law. In addition, the Company may enter into contracts with outside directors limiting their liability for damages resulting from negligence in the fulfillment of their respective duties in an amount consistent with the limitation stipulated by law. Furthermore, the Company may enter into contracts with outside Audit & Supervisory Board Members limiting their liability for damages resulting from negligence in the fulfillment of their respective duties in an amount consistent with the limitation stipulated by law.

Canon established a standing committee, the Internal Control Committee in 2004, with the president appointed as chairman of the group. The Internal Control Committee has built a highly effective internal control system unique to Canon, which not only serves to ensure the reliability of the Company's financial reporting, but also aims to ensure the effectiveness and efficiency of its business operations, as well as compliance with related laws, regulations and internal controls. In 2015, with the aim of managing financial, compliance, and business risks from a comprehensive perspective, the Internal Control Committee was reorganized and renamed the Risk Management Committee which is tasked with performing this duty. Established under the Risk Management Committee are the following three subcommittees: the Financial Risk Management Subcommittee, which is in charge of improving systems to ensure the reliability of financial reporting, the Compliance Subcommittee, which is in charge of improving systems to ensure compliance of corporate ethics and major laws and regulations, and the Business Risk Management Subcommittee, which is in charge of improving systems to manage quality risks, information leakage risks and other significant business risks. The Risk Management Committee shall develop various measures with regard to improving the risk management system. These measures include the system for grasping any significant risks (violation of laws and regulations, inappropriate financial reporting, quality issues, work-related injuries, disasters, etc.) that the Canon Group may face in the course of business. Additionally, in accordance with any action plan that is approved by the Board of Directors, the Risk Management Committee shall evaluate the status of improvement and implementation of the risk management system and report its findings to the CEO and the Board of Directors.

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

Executive Officer System

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

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Executive Officers of the Company appointed by the Board of Directors meeting held on January 30, 2018, whom are expected to take the assignment on April 1, 2018, are listed below.

| Name | Position | (Group executive/function) |
|--------------------|-----------------------------------|---|
| Yoroku Adachi | Executive Vice President | Chairman of Canon U.S.A., Inc. |
| Hideki Ozawa | Executive Vice President | President of Canon (China) Co., Ltd. |
| Seymour Liebman | Senior Managing Executive Officer | Executive Vice President of Canon U.S.A., Inc. |
| Naoji Otsuka | Senior Managing Executive Officer | Chief Executive of Inkjet Products Operations |
| Toshio Takiguchi | Senior Managing Executive Officer | Chief Executive of Medical Systems Operations, President of Toshiba Medical Systems Corporation |
| Kenichi Nagasawa | Managing Executive Officer | Group Executive of Corporate Intellectual Property & Legal HQ |
| Masanori Yamada | Managing Executive Officer | Group Executive of Network Visual Solution Business Promotion HQ, Chief of Rugby World Cup/Olympic and Paralympic Project |
| Aitake Wakiya | Managing Executive Officer | Group Executive of Finance & Accounting HQ |
| Eiji Osanai | Managing Executive Officer | Group Executive of Production Engineering HQ |
| Ryuichi Ebinuma | Managing Executive Officer | Deputy Group Executive of R&D HQ |
| Yuichi Ishizuka | Managing Executive Officer | President of Canon U.S.A., Inc. |
| Kazuto Ogawa | Managing Executive Officer | Executive Vice President of Canon (China) Co., Ltd. |
| Shunsuke Inoue | Managing Executive Officer | Group Executive of Device Technology Development HQ |
| Takayuki Miyamoto | Managing Executive Officer | Chief Executive of Peripheral Products Operations |
| Katsumi Iijima | Managing Executive Officer | Group Executive of Information & Communication Systems HQ |
| Hiroaki Takeishi | Managing Executive Officer | Chief Executive of Optical Products Operations |
| Soichi Hiramatsu | Executive Officer | Group Executive of Procurement HQ |
| Nobutoshi Mizusawa | Executive Officer | Deputy Chief Executive of Medical Systems Operations, Deputy Group Executive of R&D HQ |
| Yoichi Iwabuchi | Executive Officer | Deputy Group Executive of Digital System Technology Development HQ |
| Takashi Takeya | Executive Officer | Senior General Manager of Global Logistics Management Center |
| Nobuyuki Tainaka | Executive Officer | Senior General Manager of Global Legal Administration Center |
| Takanobu Nakamasu | Executive Officer | Executive Vice President of Canon Europe Ltd. |
| Toshihiko Kusumoto | Executive Officer | Deputy Chief Executive of Office Imaging Products Operations |
| Akiko Tanaka | Executive Officer | President of Canon BioMedical, Inc. |
| Go Tokura | Executive Officer | Chief Executive of Image Communication Business Operations |
| Ritsuo Mashiko | Executive Officer | President of Oita Canon Inc. |
| Hisahiro Minokawa | Executive Officer | Deputy Group Executive of Human Resources Management & Organization HQ |
| Noriko Gunji | Executive Officer | President of Canon Singapore Pte. Ltd. |
| Hideki Sanatake | Executive Officer | Deputy Group Executive of Corporate Intellectual Property and Legal HQ |
| Tamaki Hashimoto | Executive Officer | Group Executive of Consumer Inkjet Products Group |
| Hideto Kohtani | Executive Officer | Group Executive of Office Imaging Products Digital Solution Group |
| Minoru Asada | Executive Officer | Senior General Manager of Group Management Center |
| Kazuhiko Nagashima | Executive Officer | Senior General Manager of Finance Accounting Center |
| Katsuhiko Shinjo | Executive Officer | Deputy Group Executive of R&D HQ |
| Katsuyoshi Soma | Executive Officer | President of Fukushima Canon Inc. |
| Masaki Omori | Executive Officer | Senior General Manager of Production Engineering Research Laboratory |

Table of Contents**B. Compensation**

In the fiscal year ended December 31, 2017, Canon pays an aggregate of approximately ¥1,021 million to its directors and Audit & Supervisory Board Members. This amount includes bonuses.

Beginning from the fiscal year ended December 31, 2010, the Company is required to disclose the compensation of any director who receives total aggregate annual compensation exceeding ¥100 million in accordance with the Financial Instruments and Exchange Act of Japan and related ordinances. The following table sets forth the amount of compensation paid or planned to be paid directors whose aggregate compensation exceeded ¥100 million in 2017.

| Name (Position) | Company | Category of remuneration | | Total |
|--------------------------------|------------|--------------------------|----------------------------|-------|
| | | Basic Compensation | Bonus (Millions of yen) | |
| Fujio Mitarai (Director) | Canon Inc. | 293 | 39 | 332 |
| Masaya Maeda (Director) | Canon Inc. | 135 | 22 | 157 |
| Toshizo Tanaka (Director) | Canon Inc. | 130 | 22 | 152 |
| Shigeyuki Matsumoto (Director) | Canon Inc. | 103 | 14 | 117 |

Notes:

(1) Bonus amounts represent the increased portion of accrued directors' bonuses in fiscal year 2017. The following two elements comprise remuneration to directors:

Basic Compensation: compensation for executing of business operations

Bonus: bonus links to business results of current fiscal year

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

The determination methods of remuneration are as follows:

Basic Compensation

Each maximum amount of total compensation to directors and Audit & Supervisory Board Members is determined by the Ordinary General Meeting of Shareholders. The remuneration to each director is determined by the meeting of the Board of Directors based on criteria set by the Company, and the remuneration to each Audit & Supervisory Board Member is determined by the meeting of Audit & Supervisory Board Members.

Bonus

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

Stock Options

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

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The Company has a stock option (share option) plan. This plan was approved at the meeting of the Board of Directors in accordance with the Ordinary General Meeting of Shareholders for the 117th Business Term of the Company, pursuant to Articles 236, 238 and 239 of the Corporation Law of Japan, held on March 29, 2018. Under and pursuant to this plan, share options will be issued as stock options to the Company's directors and executive officers.

The description of this stock option plan is below.

*The Stock Option Plan Approved on March 29, 2018***1. Purpose of Introduction of Stock-Type Compensation Stock Options**

The Company have allotted stock options to its directors (excluding outside directors) and executive officers, as the remuneration of directors and executive officers for the purpose of providing an incentive for directors and executive officers to further contribute to the improvement of medium- and long-term operating results and higher corporate value through sharing the benefits and risks of share price fluctuations with the Company's shareholders.

The stock options are the stock-type compensation stock options, which entitle individual directors and executive officers to acquire shares upon exercise of the stock acquisition rights at an exercise price of one (1) yen per share. The remuneration (the Remuneration), the amount of which shall be equal to the price to be paid in exchange for stock acquisition rights (the Allotment Price), which shall be determined based on the fair value thereof, will be paid by the Company to each director and executive officer, and the obligation of each director and executive officer to pay the Allotment Price shall be offset by the rights of such director and executive officer to receive the Remuneration.

2. Details of the Stock-Type Compensation Stock Options**(1) Class and number of shares to be acquired upon exercise of stock acquisition rights**

The class of shares to be acquired upon exercise of the stock acquisition rights shall be shares of common stock of the Company, and the number of shares to be acquired upon exercise of each stock acquisition right (the Number of Shares Acquired) shall be 100 shares; provided, however, that in the case that the Company conducts a share split (including an allotment without consideration (musho-wariate) of shares of common stock of the Company; the same shall apply to all references to the share split herein) or share consolidation on and after the date of shareholders resolution adopting the proposal at the above-mentioned General Meeting of Shareholders (the Resolution Date), the Number of Shares Acquired shall be adjusted in accordance with the following formula, rounding down any fraction of less than one (1) share resulting from such adjustment.

$$\begin{array}{rcccl} \text{Number of Shares} & & \text{Number of Shares} & & \text{Ratio of share Split} \\ \\ \text{Acquired after} & = & \text{Acquired before} & \times & \text{or} \\ \\ \text{Adjustment} & & \text{Adjustment} & & \text{share consolidation} \end{array}$$

In addition to the above, in any event that makes it necessary to adjust the Number of Shares Acquired, including a merger and company split, on and after the Resolution Date, the Company may make appropriate adjustment to the Number of Shares Acquired within a reasonable range.

(2) Grantees of Share Options

The Company's 5 directors (excluding outside directors) and 28 executive officers.

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(3) Maximum number of stock acquisition rights

The maximum number of stock acquisition rights to be allotted to all directors (excluding outside directors) and executive officers within one (1) year from the date of the Ordinary General Meeting of Shareholders for each fiscal year is seven hundred forty (740).

(4) Allotment Price

The Allotment Price for each stock acquisition right shall be determined by the Board of Directors based on the fair value of a stock acquisition right at the time of its allotment as calculated through a fair calculation method, such as the Black-Scholes model.

(5) The value of assets to be contributed upon exercise of each stock acquisition right

The value of assets to be contributed upon exercise of each stock acquisition right shall be one (1) yen per share to be acquired upon exercise of each stock acquisition right, multiplied by the Number of Shares Acquired.

(6) Exercise period of stock acquisition rights

The exercise period of stock acquisition rights shall be determined by the Board of Directors, but shall not exceed thirty (30) years from the day immediately following the allotment date of stock acquisition rights.

(7) Restrictions on acquisition of stock acquisition rights by transfer

The stock acquisition rights cannot be acquired through transfer, unless such acquisition is expressly approved by a resolution of the Board of Directors.

(8) Conditions for exercise of stock acquisition rights

Any conditions for the exercise of stock acquisition rights shall be determined by a resolution of the Board of Directors. Such conditions include the condition that (i) those to whom stock acquisition rights are allotted (the Holder(s)) shall, unless otherwise resolved by the Board of Directors, be entitled to exercise all the stock acquisition rights together within 10 days (in case the last day is not a business day, the following business day) from the day immediately following the day when they cease to hold any position as a director or an executive officer of the Company, (ii) in the event that the Company recognizes any violation of laws and regulations, misconduct of the duties, act conflicting with the duty of due care or duty of loyalty, or any other act equivalent thereto of the Holder, the Company may limit, subject to a resolution by the Board of Directors of the Company, the number of offered stock acquisition rights that may be exercised by such Holder.

C. Board practices

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

Table of Contents**D. Employees**

The following table shows the numbers of Canon's employees as of December 31, 2017, 2016 and 2015.

| | Total | Japan | Americas | Europe | Asia and Oceania |
|---------------------|----------------|---------------|---------------|---------------|------------------|
| December 31, 2017 | | | | | |
| Office | 103,380 | 32,407 | 13,263 | 18,972 | 38,738 |
| Imaging System | 55,909 | 16,732 | 2,416 | 1,841 | 34,920 |
| Medical System | 10,851 | 5,942 | 1,834 | 1,577 | 1,498 |
| Industry and Others | 18,476 | 9,573 | 935 | 3,176 | 4,792 |
| Corporate | 9,160 | 9,011 | | 57 | 92 |
| Total | 197,776 | 73,665 | 18,448 | 25,623 | 80,040 |
| December 31, 2016 | | | | | |
| Office | 105,480 | 33,056 | 14,108 | 19,103 | 39,213 |
| Imaging System | 55,263 | 15,845 | 2,353 | 1,914 | 35,151 |
| Industry and Others | 27,790 | 15,042 | 2,699 | 4,434 | 5,615 |
| Corporate | 9,140 | 8,970 | | 60 | 110 |
| Total | 197,673 | 72,913 | 19,160 | 25,511 | 80,089 |
| December 31, 2015 | | | | | |
| Office | 106,895 | 32,557 | 14,381 | 20,399 | 39,558 |
| Imaging System | 55,238 | 16,394 | 2,357 | 1,684 | 34,803 |
| Industry and Others | 17,708 | 9,828 | 897 | 2,682 | 4,301 |
| Corporate | 9,730 | 9,546 | | 61 | 123 |
| Total | 189,571 | 68,325 | 17,635 | 24,826 | 78,785 |

Basically, the Company and its subsidiaries have their own independent labor union. The Company believes that the relationship between Canon and its labor union is good.

E. Share ownership

The following table shows the numbers of shares owned by the directors and Audit & Supervisory Board Members of the Company as of March 29, 2018. The total is 306,116 shares, constituting 0.02% of all outstanding shares.

| Name | Position | Number of shares |
|---------------------|----------------------------------|------------------|
| Fujio Mitarai | Chairman & CEO | 126,923 |
| Masaya Maeda | President & COO | 15,200 |
| Toshizo Tanaka | Executive Vice President & CFO | 22,810 |
| Toshio Homma | Executive Vice President | 51,452 |
| Shigeyuki Matsumoto | Executive Vice President & CTO | 29,652 |
| Kunitaro Saida | Director | 4,200 |
| Haruhiko Kato | Director | |
| Kazuto Ono | Audit & Supervisory Board Member | 4,700 |
| Masaaki Nakamura | Audit & Supervisory Board Member | 2,179 |
| Tadashi Ohe | Audit & Supervisory Board Member | 48,100 |
| Hiroshi Yoshida | Audit & Supervisory Board Member | 600 |
| Koichi Kashimoto | Audit & Supervisory Board Member | 300 |

Total

306,116

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

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

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

The table below shows the numbers of the Company's shares held by the top ten holders of the Company's shares and their ownership percentage as of December 31, 2017:

| Name of major shareholder | Shares owned | Percentage Number of shares owned / Number of shares issued |
|--|--------------|---|
| The Master Trust Bank of Japan, Ltd. (Trust Account) | 77,949,000 | 5.8% |
| Japan Trustee Services Bank, Ltd. (Trust Account) | 57,046,450 | 4.3% |
| The Dai-ichi Life Insurance Company, Limited | 33,051,180 | 2.5% |
| Barclays Securities Japan Limited | 26,000,000 | 2.0% |
| Mizuho Bank, Ltd. | 22,558,173 | 1.7% |
| State Street Bank West Client Treaty 505234 | 22,122,387 | 1.7% |
| Japan Trustee Services Bank, Ltd. (Trust Account 5) | 20,528,200 | 1.5% |
| Moxley and Co. LLC | 19,648,132 | 1.5% |
| Sompo Japan Nipponkoa Insurance Inc. | 17,439,987 | 1.3% |
| OBAYASHI CORPORATION | 16,527,607 | 1.2% |

Notes:

- 1: Apart from the above shares, The Dai-ichi Life Insurance Company, Limited held 6,180,000 shares contributed to a trust fund for its retirement and severance plans.
 - 2: Apart from the above shares, Mizuho Bank, Ltd. held 9,057,000 shares contributed to a trust fund for its retirement and severance plans.
 - 3: Moxley and Co. LLC is a nominee of JPMorgan Chase Bank, which is the depository of Canon's ADRs (American Depositary Receipts).
 - 4: Apart from the above shares, the Company owns 254,007,681 shares (19.0% of total issued shares) of treasury stock.
- Canon's major shareholders do not have different voting rights from other shareholders.

As of December 31, 2017, 11.2% of the issued shares of common stock, including the Company's treasury stock, were held of record by 280 residents of the United States of America.

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

B. Related party transactions

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

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enterprise in which Canon has a significant influence or which has significant influence over Canon. Significant influence over an enterprise is the power to participate in the financial and operating policy decisions of the enterprise but is less than control over those policies. Shareholders beneficially owning a 10% interest in the voting power of the Company are presumed to have a significant influence on Canon.

To the Company's knowledge, no person owned a 10% interest in the voting power of the Company as of March 29, 2018.

In the ordinary course of business on an arm's length basis, Canon purchases and sells materials, supplies and services from and to its affiliates accounted for by the equity method. There are 7 affiliates which are accounted for by the equity method. Canon does not consider the amounts of the transactions with the above affiliates to be material to its business.

C. Interests of experts and counsel

Not applicable.

Item 8. Financial Information

A. Consolidated financial statements and other financial information

Consolidated financial statements

This Annual Report contains consolidated financial statements as of December 31, 2017 and 2016 and for each of the three years in the period ended December 31, 2017 prepared in accordance with U.S. generally accepted accounting principles and audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) by an Independent Registered Public Accounting Firm. The financial statements as of and for the years ended December 31, 2017, 2016, and 2015 have been audited by Ernst & Young ShinNihon LLC, and their audit report covering each of the periods is included in Item 18 of this report.

Refer to Item 18 Financial Statements.

Legal proceedings

There are no outstanding legal or other proceedings which could reasonably be expected to have a material adverse effect on Canon's consolidated financial position, results of operations or cash flows.

Dividend policy

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

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

In 2017, Canon made steady progress in business structure transformation. This is due to the improved ability of existing businesses to generate profits and the expansion of new businesses. In addition to this, management efficiency has improved thanks to comprehensive cash flow management. Reflecting this situation, to provide a stable and active return to shareholders, Canon has decided to distribute a full-year dividend of

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¥160 per share, (interim dividend of ¥75 per share that was already distributed and year-end dividend of ¥85 including the commemorative dividend of ¥10), which represents a ¥10 increase from the previous year's dividend.

B. Significant changes

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

Item 9. The Offer and Listing**A. Offer and listing details****Trading in domestic markets**

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

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

| Period | TSE (Canon Inc.) (Japanese yen) | | TOPIX (Reference data) (Points) | | Nikkei Stock Average (Reference data) (Japanese yen) | |
|--------------------|---------------------------------------|-------|---------------------------------------|----------|--|-----------|
| | High | Low | High | Low | High | Low |
| | 2013 Year | 4,115 | 2,913 | 1,302.87 | 862.62 | 16,320.22 |
| 2014 Year | 4,045 | 2,889 | 1,454.22 | 1,121.50 | 18,030.83 | 13,885.11 |
| 2015 Year | 4,539 | 3,402 | 1,702.83 | 1,343.29 | 20,952.71 | 16,592.57 |
| 2016 1(st) quarter | 3,656 | 2,978 | 1,544.73 | 1,193.85 | 18,951.12 | 14,865.77 |
| 2(nd) quarter | 3,412 | 2,780 | 1,412.98 | 1,192.80 | 17,613.56 | 14,864.01 |
| 3(rd) quarter | 3,053 | 2,797 | 1,357.41 | 1,209.88 | 17,156.36 | 15,106.52 |
| 4(th) quarter | 3,468 | 2,850 | 1,558.75 | 1,287.39 | 19,592.90 | 16,111.81 |
| 2016 Year | 3,656 | 2,780 | 1,558.75 | 1,192.80 | 19,592.90 | 14,864.01 |
| 2017 1(st) quarter | 3,549 | 3,218 | 1,578.51 | 1,495.03 | 19,668.01 | 18,650.33 |
| 2(nd) quarter | 3,967 | 3,357 | 1,627.54 | 1,452.15 | 20,318.11 | 18,224.68 |
| 3(rd) quarter | 3,890 | 3,623 | 1,679.83 | 1,578.66 | 20,481.27 | 19,239.52 |
| 4(th) quarter | 4,472 | 3,817 | 1,844.05 | 1,671.05 | 23,382.15 | 20,363.28 |
| 2017 Year | 4,472 | 3,218 | 1,844.05 | 1,452.15 | 23,382.15 | 18,224.68 |

| Period | TSE (Canon Inc.) (Japanese yen) | | TOPIX (Reference data) (Points) | | Nikkei Stock Average (Reference data) (Japanese yen) | |
|--------------|---------------------------------------|-------|---------------------------------------|----------|--|-----------|
| | High | Low | High | Low | High | Low |
| | 2017 July | 3,873 | 3,623 | 1,636.53 | 1,602.47 | 20,200.88 |
| August | 3,890 | 3,760 | 1,642.34 | 1,589.05 | 20,113.73 | 19,280.02 |
| September | 3,853 | 3,707 | 1,679.83 | 1,578.66 | 20,481.27 | 19,239.52 |
| October | 4,253 | 3,817 | 1,772.59 | 1,671.05 | 22,086.88 | 20,363.28 |
| November | 4,472 | 4,217 | 1,844.05 | 1,737.72 | 23,382.15 | 21,972.34 |
| December | 4,422 | 4,200 | 1,833.28 | 1,761.18 | 22,994.33 | 22,119.21 |
| 2018 January | 4,378 | 4,221 | 1,911.31 | 1,836.68 | 24,129.34 | 23,065.20 |
| February | 4,395 | 3,888 | 1,870.94 | 1,691.65 | 23,492.77 | 20,950.15 |

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

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

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

| Period | NYSE (Canon Inc.) (U.S. dollars) | |
|--------------------|--|--------|
| | High | Low |
| 2013 Year | 40.430 | 29.820 |
| 2014 Year | 33.960 | 28.670 |
| 2015 Year | 38.020 | 28.520 |
| 2016 1(st) quarter | 30.320 | 26.600 |
| 2(nd) quarter | 30.930 | 27.670 |
| 3(rd) quarter | 29.750 | 27.180 |
| 4(th) quarter | 29.980 | 27.760 |
| 2016 Year | 30.930 | 26.600 |
| 2017 1(st) quarter | 31.680 | 28.150 |
| 2(nd) quarter | 35.910 | 30.790 |
| 3(rd) quarter | 35.360 | 32.200 |
| 4(th) quarter | 39.150 | 34.010 |
| 2017 Year | 39.150 | 28.150 |

| Period | (Canon Inc.) (U.S. dollars) | |
|--------------|--------------------------------|--------|
| | High | Low |
| 2017 July | 35.110 | 32.200 |
| August | 35.360 | 34.440 |
| September | 35.000 | 33.740 |
| October | 37.790 | 34.010 |
| November | 39.150 | 37.480 |
| December | 38.740 | 37.220 |
| 2018 January | 40.190 | 37.380 |
| February | 39.900 | 35.610 |

The depository and agent of the ADRs is JPMorgan Chase Bank, N.A., located at 4 New York Plaza Floor 12, New York, N.Y. 10004, U.S.A.

B. Plan of distribution

Not applicable.

C. Markets

See Item 9A Offer and listing details .

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D. Selling shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the issue

Not applicable.

Item 10. Additional Information

A. Share capital

Not applicable.

B. Memorandum and articles of association

Objects and Purposes in the Company's Articles of Incorporation

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

- (1) Manufacture and sale of optical machineries and instruments of various kinds.
- (2) Manufacture and sale of acoustic, electrical and electronic machineries and instruments of various kinds.
- (3) Manufacture and sale of precision machineries and instruments of various kinds.
- (4) Manufacture and sale of medical machineries and instruments of various kinds.
- (5) Manufacture and sale of general machineries, instruments and equipments of various kinds.
- (6) Manufacture and sale of parts, materials, etc. relative to the products mentioned in each of the preceding items.
- (7) Production and sale of software products.
- (8) Manufacture and sale of pharmaceutical products.
- (9)

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Telecommunications business, and information service business such as information processing service business, information providing service business, etc.

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

Provisions Regarding Directors

There is no provision in the Company's Articles of Incorporation as to a Director's power to vote on a proposal, arrangement or contract in which the Director is materially interested, but, under the Corporation Law

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of Japan, the law relating to joint stock corporations (known in Japanese as *kabushiki kaisha*) which came into effect on May 1, 2006, a director is required to refrain from voting on such matters at meetings of the board of directors.

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

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

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

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

Holding of Shares by Foreign Investors

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

Rights of Shareholders

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

General

The Company's authorized share capital is 3,000,000,000 shares, of which 1,333,763,464 shares were issued, including the Company's treasury stock, as of December 31, 2017. In accordance with the Law Concerning Book-Entry Transfer of Corporate Bonds, Shares, etc. (including regulations promulgated thereunder; the "Book-Entry Law"), the Japan Securities Depository Center, Inc. ("JASDEC") is the only institution that is designated by the relevant authorities as a clearing house which is permitted to engage in the clearing operations of shares of Japanese listed companies under the Book-Entry Law. Under the new clearing system, in order for any person to hold, sell or otherwise dispose of shares of Japanese listed companies, it must have an account at an account management institution unless such person has an account at JASDEC.

Account management institutions are financial instruments traders (i.e., securities companies), banks, trust companies and certain other financial institutions which meet the requirements prescribed by the Book-Entry Law.

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

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

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

Distributions of Surplus

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

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

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

Restriction on Distributions of Surplus

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Stock Splits

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

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

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Japanese Unit Share System

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

Transferability of Shares Representing Less than One Unit

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

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

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

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

The Articles of Incorporation of the Company provide that a holder of shares representing less than one unit may require the Company to sell its shares to such holder so that the holder can raise its fractional ownership to a whole unit; provided, however, that the Company is not obliged to do so if the Company does not own its own shares in the number which it is requested to sell. Such a request shall be made through the account management institutions and JASDEC. These shares will be sold at (a) the closing price of the shares reported by the TSE on the day when the request to sell becomes effective or (b) if no sale has taken place on the TSE on that day, then the price at which sale of shares is effected on such stock exchange immediately thereafter.

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

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

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

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

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

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Ordinary and Extraordinary General Meeting of Shareholders

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

Voting Rights

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

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

- a reduction of stated capital,
- amendment of the Articles of Incorporation (except amendments which the Board of Directors are authorized to make under the Corporation Law of Japan as described in Stock Splits and Japanese Unit Share System above),
- the removal of an Audit & Supervisory Board Member,
- establishment of a 100% parent-subsidiary relationship by way of share exchange or share transfer,
- a dissolution, merger or consolidation,
- a corporate separation,
- the transfer of the whole or an important part of the Company's business,
- the transfer of the whole or a part of the Company's equity interests in any of the Company's significant subsidiaries which meets certain requirements,
- the taking over of the whole of the business of any other corporation,
- any issuance of new shares at a specially favorable price, stock acquisition rights (*shinkabu yoyakuken*) with specially favorable conditions or bonds with stock acquisition rights (*shinkabu yoyakuken-tsuki shasai*) with specially favorable conditions to persons other than shareholders,
- distribution of Surplus in kind with respect to which shareholders are not granted the right to require the Company to make such distribution in cash instead of in kind,
- purchase of shares by the Company from a specific shareholder other than its subsidiaries,
- consolidation of shares, and
- discharge of a portion of liabilities of Directors, Audit & Supervisory Board Members or independent auditors that are owed to the Company.

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

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

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Subscription Rights

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

Stock Acquisition Rights

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

Liquidation Rights

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

Liability to Further Calls or Assessments

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

Share Registrar

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

Record Date

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

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

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

Repurchase by the Company of Shares

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

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

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

Right of Controlling Shareholder Representing 90 Per Cent or More of Shares to Request Other Shareholders to Sell All Shares

A shareholder holding, directly or indirectly, 90 per cent or more of the voting rights of the Company's shares has the right to request, subject to approval by the Company's Board of Directors, that the other shareholders and (if the controlling shareholder so determines) all holders of stock acquisition rights of the Company sell to the controlling shareholder all shares and all stock acquisition rights, as the case may be, held by them. In the above case, the Company will be required to give public notice thereof to all holders and registered pledgees of shares (and stock acquisition rights, as the case may be) not later than 20 days prior to the effective date of such sales.

C. Material contracts

On March 15, 2016, Canon entered into a provisional borrowing agreement with The Bank of Tokyo-Mitsubishi UFJ, Ltd. which matures in 2017 for acquiring TMSC. This borrowing was refinanced on January 31, 2017. For further information, please refer to Note 9 of the Notes to Consolidated Financial Statements.

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

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D. Exchange controls

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

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

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

Issuance of Securities by the Company

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

Acquisition of Shares

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

In the case where a foreign investor intends to acquire listed shares (whether from a resident or a non-resident of Japan, from another foreign investor or from or through a designated securities company) and as a result of such acquisition the number of shares held, directly or indirectly, by such foreign investor (if there are other foreign investors with whom the foreign investor has a special relationship, the shares held by such other foreign investors will be included in the number) would become 10% or more of the total outstanding shares of the company, the foreign investor must generally report such acquisition to the Minister of Finance and other Ministers having jurisdiction over the business of the subject company by the 15th day of the immediately following month in the date of acquisition falls. In certain exceptional cases, a prior notification is required in respect of such acquisition.

Acquisition of Shares upon Exercise of Rights for Subscription of Shares

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

Dividends and Proceeds of Sales

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

Table of Contents**(b) Reporting of Substantial Shareholdings:**

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

E. Taxation**1. Taxation in Japan**

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

Pursuant to the Convention Between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Treaty), dividend payments made by a Japanese corporation to a U.S. resident or corporation, unless the recipient of the dividend has a permanent establishment in Japan and the shares or ADSs with respect to which such dividends are paid are effectively connected with such permanent establishment, are generally subject to a withholding tax at rate of: (1) 10% for portfolio investors who are qualified U.S. residents eligible for benefits of the Treaty; and (2) 0% (*i.e.*, no withholding) for pension funds which are qualified U.S. residents eligible for benefits of the Treaty, provided that the dividends are not derived from the carrying on of a business, directly or indirectly, by such pension funds. Japan is a party to a number of income tax treaties, conventions and agreements, (collectively Tax Treaties), whereby the maximum withholding tax rate for dividend payments is set at, in most cases, 15% for portfolio investors who are Non-Resident Holders. Specific countries with which such Tax Treaties have been entered into include Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, Luxembourg, New Zealand, Norway, Singapore and Spain. Japan's income tax treaties with Australia, France, The Netherlands, Sweden, Switzerland and the United Kingdom have been amended to generally reduce the maximum withholding tax rate to 10%.

On the other hand, unless one of the applicable Tax Treaties reducing the maximum rate of withholding tax applies, the standard tax rate applicable to dividends paid with respect to listed shares, such as those paid by the Company on shares or ADSs, to Non-Resident Holders is 15% under the Japanese Income Tax Law, except for dividends paid to any individual shareholder who holds 3% or more of the issued shares, in which case the applicable rate is 20% (Article 182(2) of the Japanese Income Tax Law and Article 9-3(1)(i) of the Japanese Special Tax Measures Law, including its relevant temporary provision for these withholding rates). On December 2, 2011, the Special measures act to secure the financial resources required to implement policy on restoration of the East Japan Earthquake (Act No. 117 of 2011) was promulgated and special surtax measures on income tax and withholding tax were introduced thereafter to fund the restoration effort for the earthquake. Income tax and withholding tax payers need to pay a surtax, calculated by multiplying the standard tax rate by 2.1% for 25 years starting from January 1, 2013 (Surtax). As a result, the withholding tax rate applicable to dividends paid with respect to listed shares to Non-Resident Holders increased to 15.315% (Withholding Tax Rate) which is applicable for the period from January 1, 2014 until December 31, 2037.

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Taking this Withholding Tax Rate into account, the treaty rates such as the 15% rate (or 10% for eligible U.S. residents subject to the Treaty and/or eligible residents subject to other similarly renewed treaties mentioned above) apply, in general, except for dividends paid to any individual holder who holds 3% or more of the total issued shares, in which case the applicable rate is 20.42% (standard tax rate of 20% imposed by Surtax). The treaty rate normally overrides the domestic rate, but due to the so-called preservation doctrine under Article 1(2) of the Treaty, and/or due to Article 3-2 of the Special Measures Law for the Income Tax Law, Corporation Tax Law and Local Taxes Law with respect to the Implementation of Tax Treaties, if the tax rate under the domestic tax law is lower than that promulgated under the applicable income tax treaty, then the domestic tax rate is still applicable. Currently, the tax rate under the applicable tax treaty is lower than that under the domestic tax law and thus the treaty override treatment applies. As such, the tax rate under the Treaty applies for most holders of shares or ADSs who are U.S. residents or corporations. In the case where the treaty rate is applicable, no Surtax is imposed, but in order to enjoy the lower treaty rate, the taxpayer must file a treaty application in advance with the Company. Gains derived from the sale outside Japan of Japanese corporations' shares or ADSs by Non-Resident Holders, or from the sale of Japanese corporations' shares or ADSs within Japan by a non-resident of Japan as an occasional transaction or by a non-Japanese corporation not having a permanent establishment in Japan, are generally not subject to Japanese income or corporation taxes, provided that the seller is a portfolio investor. Japanese inheritance and gift taxes at progressive rates may apply to an individual who has acquired Japanese corporations' shares or ADSs as a distributee, legatee or donee.

2. Taxation in the United States

The following is a discussion of the material U.S. federal income tax consequences of owning and disposing of the Company shares or ADSs to the U.S. holders described below, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular person's decision to acquire, hold or dispose of such securities. The discussion does not address the potential application of the provisions of the Internal Revenue Code of 1986, as amended (the Code) known as the Medicare contribution tax. The discussion applies only if a U.S. holder holds the Company shares or ADSs as capital assets for U.S. federal income tax purposes and it does not address special classes of holders, such as:

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

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

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

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

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

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

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

This discussion assumes that the Company was not a passive foreign investment company for 2017, as described below.

Taxation of Distributions

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

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

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

Sale or Other Disposition of the Company Shares or ADSs

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

Passive Foreign Investment Company Rules

The Company believes that it was not a passive foreign investment company (PFIC) for U.S. federal income tax purposes for its 2016 fiscal year. However, since PFIC status depends upon the composition of the Company's income and assets and the market value of its assets (including, among others, goodwill and equity investments in less than 25% owned entities) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. holder owned the Company shares or ADSs, certain adverse tax consequences could apply to such U.S. holder.

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

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

If the Company were a PFIC for any taxable year during which a U.S. holder owned the Company shares or ADSs, the U.S. holder would generally be required to file IRS Form 8621 with its annual U.S. federal income tax return, subject to certain exceptions.

Information Reporting and Backup Withholding

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

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

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

F. Dividends and paying agents

Not applicable.

G. Statement by experts

Not applicable.

H. Documents on display

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

Securities Exchange Commission (Public Reference Room):

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

New York Stock Exchange, Inc.:

11 Wall Street, New York, New York 10005

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

Securities Exchange Commission Home Page:

<http://www.sec.gov>

I. Subsidiary information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk

Market risk exposures

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

Equity price risk

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

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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, 2017.

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Available-for-sale securities

| | 2017 | |
|---------------------------------------|-------------------|------------|
| | Cost | Fair value |
| | (Millions of yen) | |
| Debt securities | | |
| Due within one year | 1,222 | 1,222 |
| Due after one year through five years | 605 | 605 |
| Due after five years | 340 | 506 |
| Fund trusts | 122 | 124 |
| Equity securities | 10,965 | 20,901 |
| | 13,254 | 23,358 |

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, 2017. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2018.

| | U.S.\$ | Euro | Others | Total |
|--------------------------------------|-------------------|---------|--------|---------|
| | (Millions of yen) | | | |
| Forwards to sell foreign currencies: | | | | |
| Contract amounts | 119,128 | 127,449 | 25,986 | 272,563 |
| Estimated fair value | 61 | (1,720) | (426) | (2,085) |
| Forwards to buy foreign currencies: | | | | |
| Contract amounts | 38,775 | 2,399 | 4,994 | 46,168 |
| Estimated fair value | (448) | (187) | 5 | (630) |

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

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign currency exchange contracts associated with forecasted intercompany sales, are reported in accumulated

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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 currency 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, 2017, 2016 and 2015. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) were ¥332 million, ¥311 million and ¥131 million for the years ended December 31, 2017, 2016 and 2015, 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.

Item 12. Description of Securities Other than Equity Securities

A. Debt securities

Not applicable.

B. Warrants and rights

Not applicable.

C. Other securities

Not applicable.

D. American Depositary Shares

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

(b) Receiving or distributing dividends
Not applicable.

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

(d) Withdrawing an underlying security
Not applicable.

(e) Transferring, splitting or grouping receipts

Not applicable.

(f) General depositary services, particularly those charged on an annual basis
Not applicable.

(g) Expenses of the depositary
Not applicable.

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PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Canon's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and Canon's chief executive officer and chief financial officer concluded that Canon's disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, are effective at the reasonable assurance level as of December 31, 2017.

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, 2017. In making this assessment, management used the criteria established in internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria).

Based on its assessment, management concluded that, as of December 31, 2017, Canon's internal control over financial reporting was effective based on the COSO criteria.

Canon's independent registered public accounting firm, Ernst & Young ShinNihon LLC, has issued an audit report on the effectiveness of Canon's internal control over financial reporting. This report appears in Item 18.

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During 2017, Toshiba Medical Systems Corporation (TMSC) (Canon Medical Systems Corporation as of January 4, 2018) which Canon acquired in 2016 was integrated into the Canon s internal control over financial reporting. Canon assessed the effectiveness of internal control over financial reporting of TMSC as of December 31, 2017. There are no other changes in Canon s internal control over financial reporting that occurred during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

Item 16A. Audit Committee Financial Expert

Canon s Audit & Supervisory Board has determined that Hiroshi Yoshida is an audit committee financial expert as defined by the rules of the SEC. Hiroshi Yoshida has considerable experience and advanced expert knowledge in corporate accounting gained through his longstanding practice as a certified public accountant. Hiroshi Yoshida was elected as one of Canon s Outside Audit & Supervisory Board Members at an ordinary general meeting of shareholders held in March 2017. Hiroshi Yoshida met the independence requirements imposed on Audit & Supervisory Board Members as set forth by Japanese legal provisions.

Item 16B. Code of Ethics

Canon maintains a Canon Group Code of Conduct or Code of Conduct, applicable to all executives and employees. The Code of Conduct sets forth provisions relating to honest and ethical conduct (including the handling of conflicts of interest), compliance with applicable laws, rules and regulations and accountability for adherence to the provisions of the Code of Conduct. The Board of Directors maintains a Code of Ethics as a supplement to the Code of Conduct. This Code of Ethics applies to Canon s President and Chief Executive Officer, each member of the Board of Directors (which includes the Chief Financial Officer) and general managers belonging to Canon s accounting headquarters. The Code of Ethics requires full, fair, accurate, timely and understandable disclosure in reports and documents that Canon files with or submits to the SEC and in Canon s other communications with the public, prompt internal reporting of violations of the Code of Conduct or Code of Ethics, and accountability for adherence to their provisions. Both the Code of Conduct and the Code of Ethics have been filed as exhibits.

Item 16C. Principal Accountant Fees and Services*Policy on Pre-Approval of Audit and Non-Audit Services of Independent Auditors*

Canon s Audit & Supervisory Board consisting of five members, including three outside auditors, is responsible for the oversight of the services of its independent registered public accounting firm. The Audit & Supervisory Board has established Pre-Approval Policies and Procedures for Audit and Non-Audit Services. These policies and procedures govern the Audit & Supervisory Board s review and approval of the board of director s engagement of Canon s independent registered public accounting firm to render audit or non-audit services. Non-audit services include audit-related services, tax services and other services, as described in greater detail below under Fees and Services. Canon and any affiliate controlled by Canon directly, indirectly or through one or more intermediaries must follow these policies and procedures before any engagement of Canon s independent registered public accounting firm for U.S. securities law reporting purposes.

The policies and procedures stipulate three means by which audit and non-audit services may be pre-approved, depending on the content of and the fee for the services.

All services provided to Canon necessary to perform an annual audit or review to comply with the standards of the Public Company Accounting Oversight Board (United States), in any jurisdiction, including tax services and accounting consultation necessary to comply with the standards of the Public Company Accounting Oversight Board (United States) in those jurisdictions, and any engagement of

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an Independent Registered Public Accounting Firm for any audit or non-audit service involving estimated fees exceeding ¥10,000,000 per single engagement must be pre-approved by the majority of Audit & Supervisory Board.

Certain other services may be pre-approved under detailed categories of audit and non-audit services established annually by the Audit & Supervisory Board, as long as those services do not exceed specified maximum yen limits for aggregate fees relating to each of those categories. Any engagement of an Independent Registered Public Accounting Firm by this means must be reported to the Audit & Supervisory Board at its next regularly scheduled meeting.

For services that are not covered by the above two means of pre-approval, the Audit & Supervisory Board has delegated pre-approval authority to any of the standing Audit & Supervisory Board Members of the board. Any engagement of an Independent Registered Public Accounting Firm pre-approved by one of the standing Audit & Supervisory Board Members is required to be reported to the Audit & Supervisory Board at its next regularly scheduled meeting.

Additional services may be pre-approved by the Audit & Supervisory Board on an individual basis.

No services were provided for which pre-approval was waived pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

Fees and services

The following table discloses the aggregate fees accrued or paid to Canon's principal accountant and member firms of Ernst & Young for each of the last two fiscal years and briefly describes the services performed:

| | Year ended December 31, 2017 | Year ended December 31, 2016 |
|--------------------|---------------------------------|---------------------------------|
| | (Millions of yen) | |
| Audit fees | 3,028 | 2,582 |
| Audit-related fees | 27 | 60 |
| Tax fees | 119 | 122 |
| All other fees | 10 | 19 |
| Total | 3,184 | 2,783 |

Audit fees include fees billed for professional services rendered for audits of Canon's annual consolidated financial statements, reviews of consolidated quarterly financial information and statutory audits of the Company and its subsidiaries.

Audit-related fees include fees billed for assurance and related services such as due diligence, accounting consultations and audits in connection with mergers and acquisitions, employee benefit plan audits, internal control reviews, and consultations concerning financial accounting and reporting standards.

Tax fees include fees billed for services related to tax compliance, including the preparation of tax returns and claims for refund, tax planning and tax advice, including assistance with tax audits and appeals, advice related to mergers and acquisitions, tax services for employee benefit plans and assistance with respect to requests for rulings from tax authorities.

All other fees include fees billed primarily for services rendered with respect to advisory and training services.

Ernst & Young ShinNihon LLC served as Canon's principal accountant for 2017 and 2016.

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Item 16D. Exemptions from the Listing Standards for Audit Committees

Canon is relying on the general exemption contained in Rule 10A-3(c)(3) under the Exchange Act. Because of such reliance, Canon does not have an audit committee which can act independently and satisfy the other requirements of Rule 10A-3 under the Exchange Act.

According to Rule 10A-3 under the Exchange Act and NYSE listing standards, Canon's Audit & Supervisory Board has been identified to act in place of an audit committee. The Audit & Supervisory Board meets the following requirements of the general exemption contained in Rule 10A-3(c)(3):

the Audit & Supervisory Board is established pursuant to applicable Japanese law and Canon's Articles of Incorporation; under Japanese legal requirements, the Audit & Supervisory Board is separate from the board of directors; the Audit & Supervisory Board is not elected by the management of Canon and no executive officer of Canon is a member of the Audit & Supervisory Board; all of the members of the Audit & Supervisory Board meet specific independence requirements from the Company and Canon, the management and the auditing firm, as set forth by Japanese legal provisions; the Audit & Supervisory Board, in accordance with and to the extent permitted by Japanese law, is responsible for the appointment, retention and oversight of the work of Canon's external auditors engaged for the purpose of issuing audit reports on Canon's annual financial statements; the Audit & Supervisory Board maintains a complaints procedure in accordance with Rule 10A-3(b)(3) of the Exchange Act; the Audit & Supervisory Board is authorized to engage independent counsel and other advisers, as it deems appropriate; and the Audit & Supervisory Board is provided with appropriate funding for payment of (i) compensation to Canon's independent registered public accounting firm engaged for the purpose of issuing audit reports on Canon's annual financial statements, (ii) compensation to independent counsel and other advisers engaged by the Audit & Supervisory Board, and (iii) ordinary administrative expenses of the Audit & Supervisory Board in carrying out its duties.

Canon's reliance on Rule 10A-3(c)(3) does not, in its opinion, materially adversely affect the ability of its Audit & Supervisory Board to act independently and to satisfy the other requirements of Rule 10A-3.

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The following table sets forth, for each of the months indicated, the total number of shares purchased by Canon, or on Canon's behalf or by any affiliated purchaser, the average price paid per share, the number of shares purchased pursuant to the applicable shareholder resolution or board resolution, which are publicly announced, and the maximum number of shares that may yet be purchased pursuant to these shareholder resolutions or board resolutions.

| Period | (a) Total number of shares purchased | (b) Average price paid per share | (c) Total number of shares purchased as part of publicly announced plans or programs | (d) Maximum number of shares that may yet be purchased under the plans or programs |
|----------------------------|--------------------------------------|----------------------------------|--|--|
| 2017 | (Shares) | (Yen) | | |
| January 1 - January 31 | 320 | 3,329 | | |
| February 1 - February 28 | 486 | 3,298 | | |
| March 1 - March 31 | 658 | 3,402 | | |
| April 1 - April 30 | 575 | 3,483 | | |
| May 1 - May 31 | 987 | 3,720 | | |
| June 1 - June 30 | 12,776,836 | 3,914 | 12,776,100 | |
| July 1 - July 31 | 845 | 3,799 | | |
| August 1 - August 31 | 813 | 3,858 | | |
| September 1 - September 30 | 758 | 3,796 | | |
| October 1 - October 31 | 1,547 | 3,962 | | |
| November 1 - November 30 | 711 | 4,308 | | |
| December 1 - December 31 | 995 | 4,342 | | |

Notes:

(1) On May 31, a resolution approved at the meeting of our board directors authorized the Company to acquire up to 14 million shares with an aggregate purchase price of ¥50 billion during the period from June 1, 2017 through July 14, 2017. Column (a) represents the total number of shares purchased as fractional shares from fractional shareowners in accordance with the Corporation Law of Japan, and the purchase of shares from publicly announced plans which is shown in column (c). During 2017, the Company purchased 9,431 shares for a total purchase price of 36,178,693 yen upon requests from holders of shares consisting less than one full unit.

Item 16F. Change in Registrant's Certifying Accountant

Not applicable.

Item 16G. Corporate Governance***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

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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

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NYSE Corporate Governance Rules, the Corporation Law of Japan (the Corporation Law) does not require Japanese companies with the Audit & Supervisory Board 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 does not have such internal corporate organ or committee.

The Company currently has two outside directors under the Corporation Law. Under the Corporation Law, an outside director is defined as a person who meets the prescribed conditions, such as, that the person is not currently, and has not been in the ten years prior to his or her assumption of office as outside director, an executive director (which means a director concurrently performing an executive role) (*gyomu shikko torishimariyaku*), a corporate executive officer, a manager (*shihainin*), or any other type of employee of the company or any of its subsidiaries. Such qualifications for an outside director are different from the director independence requirements under the NYSE Corporate Governance Rules.

In addition, pursuant to the regulations of the Japanese stock exchanges, the Company is required to have one or more independent director(s)/audit & supervisory board member(s), defined under the relevant regulations of the Japanese stock exchanges as outside directors or outside audit & supervisory board members (as defined under the Corporation Law), who are unlikely to have any conflicts of interests with the Company's general shareholders. Each of the outside directors of the Company satisfies the independent director/audit & supervisory board member requirements under the regulations of the Japanese stock exchanges. The definition of independent director/audit & supervisory board member is different from that of the definition of independent director under the NYSE Corporate Governance Rules.

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 the Audit & Supervisory Board Members; (ii) have an audit and supervisory committee and abolish the post of the Audit & Supervisory Board Members; or (iii) have the Audit & Supervisory Board. The Company has elected to have the Audit & Supervisory Board, whose duties include monitoring and reviewing the management and reporting the results of these activities to the shareholders or board of directors of the Company. While the NYSE Corporate Governance Rules provide that U.S. listed companies must have an audit committee, nominating committee and compensation committee, each composed entirely of independent directors, the Corporation Law does not require companies to have specified committees, including those that are responsible for director nomination, corporate governance and executive compensation.

The Company's board of directors nominates candidates for directorships and submits a proposal at the general meeting of shareholders for shareholder approval. Pursuant to the Corporation Law, the shareholders then vote to elect directors at the meeting. The Corporation Law requires that the total amount or calculation method of compensation for directors and Audit & Supervisory Board Members be determined by a resolution of the general meeting of shareholders respectively, unless the amount or calculation method is provided under the Articles of Incorporation. As the Articles of Incorporation of the Company do not provide an amount or calculation method, the amount of compensation for the directors and the Audit & Supervisory Board Members 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 Audit & Supervisory Board Member is determined by consultation among the Company's Audit & Supervisory Board Members.

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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 the Audit & Supervisory Board shall be exempt from the audit committee requirements, subject to certain requirements which continue to be applicable under Rule 10A-3. Pursuant to the requirements of the Corporation Law, the shareholders elect the Audit & Supervisory Board Members by resolution of a general meeting of shareholders. The Company currently has five Audit & Supervisory Board Members, although the minimum number of Audit & Supervisory Board Members 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 the Audit & Supervisory Board Members to be experts in accounting or to have any other area of expertise. Under the Corporation Law, the Audit & Supervisory Board 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 Audit & Supervisory Board Member's duties. The Audit & Supervisory Board prepares auditors' reports, determines a proposal for the nomination or removal of the accounting auditors to be submitted to the general meeting of shareholders, and may veto a proposal for the nomination of the Audit & Supervisory Board Members, 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 Audit & Supervisory Board Members must be outside Audit & Supervisory Board Members. An outside Audit & Supervisory Board Member is defined as a person who meets the prescribed conditions, such as, that the person has not been in the ten years prior to his or her assumption of office as outside Audit & Supervisory Board Member, a director, an accounting adviser (*kaikai sanyo*), a corporate executive officer, a manager (*shihainin*), or any other type of employee of the company or any of its subsidiaries. The Company's current Audit & Supervisory Board Member 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 Audit & Supervisory Board Member(s) which terms are defined under the relevant regulations of the Japanese stock exchanges as outside directors or outside Audit & Supervisory Board Members (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 Audit & Supervisory Board Members. In addition, all such three outside Audit & Supervisory Board Members are also qualified as independent Audit & Supervisory Board Members under the regulations of the Japanese stock exchanges. The qualifications for an outside or independent Audit & Supervisory Board Member under the Corporation Law or the regulations of the Japanese stock exchanges are different from the audit committee independence requirement under the NYSE Corporate Governance Rules.

4. Shareholder Approval of Equity Compensation Plans

The NYSE Corporate Governance Rules require that shareholders be given the opportunity to vote on all equity compensation plans and any material revisions of such plans, with certain limited exceptions. Under the Corporation Law, a Company is required to obtain shareholder approval regarding the stock options to be issued to directors and Audit & Supervisory Board Members as part of remuneration of directors and Audit & Supervisory Board Member.

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PART III

Item 17. Financial Statements

Not applicable.

Item 18. Financial Statements

| | Page number |
|---|--------------------|
| Consolidated financial statements of Canon Inc. and Subsidiaries: <u>Reports of Ernst & Young ShinNihon LLC, Independent Registered Public Accounting Firm</u> | 90 |
| <u>Consolidated Balance Sheets as of December 31, 2017 and 2016</u> | 92 |
| <u>Consolidated Statements of Income for the years ended December 31, 2017, 2016 and 2015</u> | 93 |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2017, 2016 and 2015</u> | 94 |
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| Schedule: | |
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| All other schedules are omitted as permitted by the rules and regulations of the Securities and Exchange Commission as not applicable. | |

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of

Canon Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries (the Company) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and financial statement schedule listed in the Index at Item 18 (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, 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) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 29, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young ShinNihon LLC

We have served as the Company's auditor for SEC reporting purposes since 2004, and as its Japanese statutory auditor since 1978.

Tokyo, Japan

March 29, 2018

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of

Canon Inc.

Opinion on Internal Control over Financial Reporting

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Canon Inc. and subsidiaries (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and financial statement schedule listed in the Index at Item 18 and our report dated March 29, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's 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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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.

Definition and Limitations of Internal Control Over Financial Reporting

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.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan

March 29, 2018

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Canon Inc. and Subsidiaries

Consolidated Balance Sheets

| | December 31 | |
|--|-------------------|------------------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents <i>(Note 1)</i> | 721,814 | 630,193 |
| Short-term investments <i>(Note 2)</i> | 1,965 | 3,206 |
| Trade receivables, net <i>(Note 3)</i> | 650,872 | 641,458 |
| Inventories <i>(Note 4)</i> | 570,033 | 560,736 |
| Prepaid expenses and other current assets <i>(Notes 6 and 17)</i> | 287,965 | 264,155 |
| Total current assets | 2,232,649 | 2,099,748 |
| Noncurrent receivables <i>(Note 18)</i> | 35,444 | 29,297 |
| Investments <i>(Note 2)</i> | 48,320 | 73,680 |
| Property, plant and equipment, net <i>(Notes 5 and 6)</i> | 1,126,620 | 1,194,976 |
| Intangible assets, net <i>(Notes 7 and 8)</i> | 420,972 | 446,268 |
| Goodwill <i>(Notes 7 and 8)</i> | 936,722 | 936,424 |
| Other assets <i>(Notes 6, 11 and 12)</i> | 397,564 | 358,136 |
| Total assets | 5,198,291 | 5,138,529 |
| Liabilities and equity | | |
| Current liabilities: | | |
| Short-term loans and current portion of long-term debt <i>(Note 9)</i> | 39,328 | 1,850 |
| Trade payables <i>(Note 10)</i> | 380,654 | 372,269 |
| Accrued income taxes <i>(Note 12)</i> | 77,501 | 30,514 |
| Accrued expenses <i>(Notes 11 and 18)</i> | 330,188 | 304,901 |
| Other current liabilities <i>(Notes 1, 5, and 17)</i> | 281,809 | 273,835 |
| Total current liabilities | 1,109,480 | 983,369 |
| Long-term debt, excluding current installments <i>(Notes 9 and 19)</i> | 493,238 | 611,289 |
| Accrued pension and severance cost <i>(Note 11)</i> | 365,582 | 407,200 |
| Other noncurrent liabilities <i>(Note 12)</i> | 133,816 | 142,049 |
| Total liabilities | 2,102,116 | 2,143,907 |
| Commitments and contingent liabilities <i>(Note 18)</i> | | |
| Equity: | | |
| Canon Inc. shareholders' equity: | | |
| Common stock | | |
| Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2017 and 2016 | 174,762 | 174,762 |
| Additional paid-in capital | 401,386 | 401,385 |
| Legal reserve <i>(Note 13)</i> | 66,879 | 66,558 |
| Retained earnings <i>(Note 13)</i> | 3,429,312 | 3,350,728 |
| Accumulated other comprehensive income (loss) <i>(Note 14)</i> | (143,228) | (199,881) |
| Treasury stock, at cost; 254,007,681 shares in 2017 and 241,695,310 shares in 2016 | (1,058,481) | (1,010,423) |
| Total Canon Inc. shareholders' equity | 2,870,630 | 2,783,129 |
| Noncontrolling interests | 225,545 | 211,493 |

| | | |
|------------------------------|------------------|-----------|
| Total equity | 3,096,175 | 2,994,622 |
| Total liabilities and equity | 5,198,291 | 5,138,529 |

See accompanying Notes to Consolidated Financial Statements.

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Canon Inc. and Subsidiaries

Consolidated Statements of Income

| | Years ended December 31 | | |
|--|-------------------------|-----------|-----------|
| | 2017 | 2016 | 2015 |
| | (Millions of yen) | | |
| Net sales | 4,080,015 | 3,401,487 | 3,800,271 |
| Cost of sales (<i>Notes 5, 8, 11 and 18</i>) | 2,087,324 | 1,727,654 | 1,865,887 |
| Gross profit | 1,992,691 | 1,673,833 | 1,934,384 |
| Operating expenses (<i>Notes 1, 5, 8, 11, 18 and 20</i>): | | | |
| Selling, general and administrative expenses | 1,297,247 | 1,142,591 | 1,250,674 |
| Research and development expenses | 330,053 | 302,376 | 328,500 |
| Impairment losses on goodwill | 33,912 | | |
| | 1,661,212 | 1,444,967 | 1,579,174 |
| Operating profit | 331,479 | 228,866 | 355,210 |
| Other income (deductions): | | | |
| Interest and dividend income | 6,012 | 4,762 | 5,501 |
| Interest expense | (818) | (1,061) | (584) |
| Other, net (<i>Notes 1, 2 and 17</i>) | 17,211 | 12,084 | (12,689) |
| | 22,405 | 15,785 | (7,772) |
| Income before income taxes | 353,884 | 244,651 | 347,438 |
| Income taxes (<i>Note 12</i>) | 98,024 | 82,681 | 116,105 |
| Consolidated net income | 255,860 | 161,970 | 231,333 |
| Less: Net income attributable to noncontrolling interests | 13,937 | 11,320 | 11,124 |
| Net income attributable to Canon Inc. | 241,923 | 150,650 | 220,209 |
| | (Yen) | | |
| Net income attributable to Canon Inc. shareholders per share (<i>Note 16</i>): | | | |
| Basic | 222.88 | 137.95 | 201.65 |
| Diluted | 222.88 | 137.95 | 201.65 |
| Cash dividends per share | 160.00 | 150.00 | 150.00 |

See accompanying Notes to Consolidated Financial Statements.

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Canon Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

| | Years ended December 31 | | |
|---|-------------------------|-----------|----------|
| | 2017 | 2016 | 2015 |
| | (Millions of yen) | | |
| Consolidated net income | 255,860 | 161,970 | 231,333 |
| Other comprehensive income (loss), net of tax <i>(Note 14)</i> : | | | |
| Foreign currency translation adjustments | 47,090 | (107,666) | (55,504) |
| Net unrealized gains and losses on securities | (9,362) | 997 | 2,010 |
| Net gains and losses on derivative instruments | 2,588 | (2,948) | 2,785 |
| Pension liability adjustments | 21,207 | (70,355) | (6,543) |
| | 61,523 | (179,972) | (57,252) |
| Comprehensive income (loss) | 317,383 | (18,002) | 174,081 |
| Less: Comprehensive income attributable to noncontrolling interests | 18,807 | 1,745 | 11,973 |
| Comprehensive income (loss) attributable to Canon Inc. | 298,576 | (19,747) | 162,108 |

See accompanying Notes to Consolidated Financial Statements.

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Canon Inc. and Subsidiaries

Consolidated Statements of Equity

| | Common stock | Additional paid-in capital | Legal reserve | Retained earnings | Accumulated other comprehensive income (loss) (Millions of yen) | Treasury stock | Total Canon Inc. shareholders equity | Non- controlling interests | Total equity |
|--|-----------------|----------------------------------|------------------|----------------------|--|-------------------|---|----------------------------------|-----------------|
| Balance at December 31, 2014 | 174,762 | 401,563 | 64,599 | 3,320,392 | 28,286 | (1,011,418) | 2,978,184 | 162,574 | 3,140,758 |
| Equity transactions with noncontrolling interests and other | | (29) | | | 73 | | 44 | (29,627) | (29,583) |
| Dividends to Canon Inc. shareholders | | | | (174,711) | | | (174,711) | | (174,711) |
| Dividends to noncontrolling interests | | | | | | | | (3,958) | (3,958) |
| Acquisition of subsidiaries | | | | | | | | 77,086 | 77,086 |
| Transfer to legal reserve | | | 690 | (690) | | | | | |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | 220,209 | | | 220,209 | 11,124 | 231,333 |
| Other comprehensive income (loss), net of tax (<i>Note 14</i>): | | | | | | | | | |
| Foreign currency translation adjustments | | | | | (57,592) | | (57,592) | 2,088 | (55,504) |
| Net unrealized gains and losses on securities | | | | | 1,509 | | 1,509 | 501 | 2,010 |
| Net gains and losses on derivative instruments | | | | | 2,785 | | 2,785 | | 2,785 |
| Pension liability adjustments | | | | | (4,803) | | (4,803) | (1,740) | (6,543) |
| Total comprehensive income | | | | | | | 162,108 | 11,973 | 174,081 |
| Repurchases and reissuance of treasury stock | | (176) | | (42) | | 1,008 | 790 | | 790 |
| Balance at December 31, 2015 | 174,762 | 401,358 | 65,289 | 3,365,158 | (29,742) | (1,010,410) | 2,966,415 | 218,048 | 3,184,463 |
| Equity transactions with noncontrolling interests and other | | 27 | | | 258 | | 285 | (5,270) | (4,985) |
| Dividends to Canon Inc. shareholders | | | | (163,810) | | | (163,810) | | (163,810) |
| Dividends to noncontrolling interests | | | | | | | | (4,077) | (4,077) |
| Acquisition of subsidiaries | | | | | | | | 1,047 | 1,047 |
| Transfer to legal reserve | | | 1,269 | (1,269) | | | | | |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | 150,650 | | | 150,650 | 11,320 | 161,970 |
| Other comprehensive income (loss), net of tax (<i>Note 14</i>): | | | | | | | | | |
| Foreign currency translation adjustments | | | | | (101,257) | | (101,257) | (6,409) | (107,666) |
| Net unrealized gains and losses on securities | | | | | 1,196 | | 1,196 | (199) | 997 |
| Net gains and losses on derivative instruments | | | | | (2,924) | | (2,924) | (24) | (2,948) |
| Pension liability adjustments | | | | | (67,412) | | (67,412) | (2,943) | (70,355) |
| Total comprehensive income (loss) | | | | | | | (19,747) | 1,745 | (18,002) |

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| | | | | | | | | | |
|--|----------------|----------------|---------------|------------------|------------------|--------------------|------------------|----------------|------------------|
| Repurchases and reissuance of treasury stock | | | | (1) | | (13) | (14) | | (14) |
| Balance at December 31, 2016 | 174,762 | 401,385 | 66,558 | 3,350,728 | (199,881) | (1,010,423) | 2,783,129 | 211,493 | 2,994,622 |

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Canon Inc. and Subsidiaries

Consolidated Statements of Equity (continued)

| | Common stock | Additional paid-in capital | Legal reserve | Retained earnings | Accumulated other comprehensive income (loss) (Millions of yen) | Treasury stock | Total Canon Inc. shareholders equity | Non- controlling interests | Total equity |
|--|-----------------|----------------------------------|------------------|----------------------|--|--------------------|---|----------------------------------|------------------|
| Balance at December 31, 2016 | 174,762 | 401,385 | 66,558 | 3,350,728 | (199,881) | (1,010,423) | 2,783,129 | 211,493 | 2,994,622 |
| Equity transactions with noncontrolling interests and other | | 1 | | | | | 1 | (1) | |
| Dividends to Canon Inc. shareholders | | | | (162,887) | | | (162,887) | | (162,887) |
| Dividends to noncontrolling interests | | | | | | | | (4,814) | (4,814) |
| Acquisition of subsidiaries | | | | | | | | 60 | 60 |
| Transfer to legal reserve | | | 321 | (321) | | | | | |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | 241,923 | | | 241,923 | 13,937 | 255,860 |
| Other comprehensive income (loss), net of tax (<i>Note 14</i>): | | | | | | | | | |
| Foreign currency translation adjustments | | | | | 44,168 | | 44,168 | 2,922 | 47,090 |
| Net unrealized gains and losses on securities | | | | | (9,767) | | (9,767) | 405 | (9,362) |
| Net gains and losses on derivative instruments | | | | | 2,562 | | 2,562 | 26 | 2,588 |
| Pension liability adjustments | | | | | 19,690 | | 19,690 | 1,517 | 21,207 |
| Total comprehensive income (loss) | | | | | | | 298,576 | 18,807 | 317,383 |
| Repurchases of treasury stock | | | | | | (50,036) | (50,036) | | (50,036) |
| Reissuance of treasury stock | | | | (131) | | 1,978 | 1,847 | | 1,847 |
| Balance at December 31, 2017 | 174,762 | 401,386 | 66,879 | 3,429,312 | (143,228) | (1,058,481) | 2,870,630 | 225,545 | 3,096,175 |

See accompanying Notes to Consolidated Financial Statements.

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Canon Inc. and Subsidiaries

Consolidated Statements of Cash Flows

| | Years ended December 31 | | |
|--|-------------------------|-----------|-----------|
| | 2017 | 2016 | 2015 |
| | (Millions of yen) | | |
| Cash flows from operating activities: | | | |
| Consolidated net income | 255,860 | 161,970 | 231,333 |
| Adjustments to reconcile consolidated net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 261,881 | 250,096 | 273,327 |
| Loss on disposal of fixed assets | 6,935 | 5,203 | 7,975 |
| Equity in earnings of affiliated companies | (1,196) | (890) | (447) |
| Impairment losses on goodwill <i>(Notes 8 and 20)</i> | 33,912 | | |
| Gain on securities contributed to retirement benefit trust <i>(Note 2)</i> | (17,836) | | |
| Deferred income taxes | (17,603) | 7,188 | 4,672 |
| (Increase) decrease in trade receivables | 3,563 | (4,155) | 22,720 |
| Decrease in inventories | 2,967 | 6,156 | 14,249 |
| Increase (decrease) in trade payables | 4,951 | 56,844 | (17,288) |
| Increase (decrease) in accrued income taxes | 46,296 | (16,456) | (8,731) |
| Increase (decrease) in accrued expenses | 18,503 | (5,256) | (25,529) |
| Increase in accrued (prepaid) pension and severance cost | 522 | 5,489 | 4,622 |
| Other, net | (8,198) | 34,094 | (32,179) |
| Net cash provided by operating activities | 590,557 | 500,283 | 474,724 |
| Cash flows from investing activities: | | | |
| Purchases of fixed assets <i>(Note 5)</i> | (189,484) | (206,971) | (252,948) |
| Proceeds from sale of fixed assets <i>(Note 5)</i> | 26,444 | 6,177 | 3,824 |
| Purchases of available-for-sale securities | (2,220) | (84) | (98) |
| Proceeds from sale and maturity of available-for-sale securities | 970 | 1,181 | 804 |
| Decrease in time deposits, net | 3,373 | 15,414 | 47,665 |
| Acquisitions of businesses, net of cash acquired <i>(Note 7)</i> | (6,557) | (649,570) | (251,534) |
| Purchases of other investments | (928) | (4,460) | (1,220) |
| Other, net | 3,392 | 1,188 | (112) |
| Net cash used in investing activities | (165,010) | (837,125) | (453,619) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of long-term debt <i>(Note 9)</i> | 1,570 | 610,552 | 717 |
| Repayments of long-term debt <i>(Note 9)</i> | (126,578) | (856) | (1,350) |
| Increase (decrease) in short-term loans, net <i>(Note 9)</i> | 5,628 | (80,580) | |
| Purchases of noncontrolling interests | | (4,993) | (29,570) |
| Dividends paid | (162,887) | (163,810) | (174,711) |
| Repurchases and reissuance of treasury stock | (50,034) | (14) | 790 |
| Other, net | (8,163) | (4,607) | (6,078) |
| Net cash provided by (used in) financing activities | (340,464) | 355,692 | (210,202) |
| Effect of exchange rate changes on cash and cash equivalents | 6,538 | (22,270) | (21,870) |
| Net change in cash and cash equivalents | 91,621 | (3,420) | (210,967) |
| Cash and cash equivalents at beginning of year | 630,193 | 633,613 | 844,580 |
| Cash and cash equivalents at end of year | 721,814 | 630,193 | 633,613 |

Supplemental disclosure for cash flow information:

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Cash paid during the year for:

| | | | |
|--------------|---------------|--------|---------|
| Interest | 1,026 | 738 | 653 |
| Income taxes | 71,473 | 76,714 | 117,643 |

See accompanying Notes to Consolidated Financial Statements.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements

1. Basis of Presentation and Significant Accounting Policies

(a) Description of Business

Canon Inc. (the Company) and subsidiaries (collectively Canon) is one of the world's leading manufacturers in such fields as office products, imaging system products, medical system products and industry and other products. Office products consist mainly of office multifunction devices (MFDs), laser multifunction printers (MFPs), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions. Imaging system products consist mainly of interchangeable-lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, compact photo printers, inkjet printers, large format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators. Medical system products consist mainly of digital radiography systems, diagnostic X-ray systems, computed tomography, magnetic resonance imaging, diagnostic ultrasound systems, clinical chemistry analyzers and ophthalmic equipment. Industry and other products consist mainly of semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, vacuum thin-film deposition equipment, organic LED (OLED) panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners. 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. Further segment information is described in Note 21.

Canon sells laser printers on an OEM basis to HP Inc.; such sales constituted 13.1%, 14.8% and 17.8% of consolidated net sales for the years ended December 31, 2017, 2016 and 2015, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 30 plants in Japan and 18 overseas plants which are located in countries or regions such as the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and Philippines.

(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 (U.S. 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

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(d) Use of Estimates (continued)

reflected in valuation and disclosure of accounts including: revenue recognition, allowance for doubtful receivables, inventories, long-lived assets, goodwill and other intangible assets with indefinite useful lives, environmental liabilities, 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 were net losses of ¥9,775 million, ¥2 million and ¥22,149 million for the years ended December 31, 2017, 2016 and 2015, 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 ¥70,500 million and ¥30,500 million at December 31, 2017 and 2016, respectively, are included in cash and cash equivalents in the consolidated balance sheets.

(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 securities. Canon does not hold any trading securities which are bought and held primarily for the purpose of sale in the near term, or any held-to-maturity securities.

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 accumulated other comprehensive income (loss) until realized.

Available-for-sale 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

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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,

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(g) Investments (continued)

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 net realizable 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 intangible assets 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

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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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(k) Property, Plant and Equipment (continued)

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. 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 recognizes an impairment charge in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.

Intangible assets with finite useful lives consist primarily of software, trademarks, patents and developed technology, license fees and customer relationships, which are amortized using the straight-line method. The estimated useful lives of software are from 3 years to 6 years, trademarks are 15 years, patents and developed technology are from 7 years to 17 years, license fees are 7 years, and customer relationships are from 11 years to 15 years, respectively. 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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(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. Shareholders per Share

Basic net income attributable to Canon Inc. shareholders 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. shareholders 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, imaging system and medical system 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 MFDs and laser printers, and imaging system products, such as digital cameras and inkjet printers, is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

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 allocated based upon the estimated relative fair value of the lease and non-lease deliverables. Lease deliverables generally include equipment, financing and executory costs, while non-lease deliverables generally consist of product maintenance contracts and supplies.

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

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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(q) Revenue Recognition (continued)

Canon records amounts received in advance from customers in excess of revenue recognized primarily for sales of optical equipment and product maintenance contracts as deferred revenue until the revenue recognition criteria are satisfied. Deferred revenue were ¥125,965 million and ¥102,298 million at December 31, 2017 and 2016, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets.

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 to sales are based upon historical trends and other known factors at the time of sale. Canon regularly adjusts its estimates each period in the ordinary course of establishing sales incentive program accruals based on current information. Canon also 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 ¥61,207 million, ¥58,707 million and ¥80,907 million for the years ended December 31, 2017, 2016 and 2015, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥52,953 million, ¥44,296 million and ¥52,504 million for the years ended December 31, 2017, 2016 and 2015, 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.

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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

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(u) Derivative Financial Instruments (continued)

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 January 2017, the Financial Accounting Standards Board (FASB) issued an amendment which eliminates the second step from the impairment test of goodwill. This amendment requires the entity to recognize an impairment charge for the amount by which the carrying amount exceeds the fair value of reporting unit; however, the impairment charge is limited to the amount of goodwill allocated to that reporting unit. Canon early adopted this amended guidance from the impairment test performed after January 1, 2017.

In May 2014, the FASB issued a new accounting standard related to revenue from contracts with customers, as amended. This standard requires an entity to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard is effective for Canon from the quarter beginning January 1, 2018. Canon will apply the modified retrospective method of adoption to contracts that are not completed as of the adoption. While Canon currently does not expect the adoption of this standard to have a material impact on revenue recognition pattern of each performance obligation, the adoption of this standard is expected to result in changes in allocation of transaction prices between goods and services primarily in Office Business Unit. Canon is in the process of finalizing the assessment of the effect from the adoption and related adjustments. Also, in the course of the adoption of the guidance, Canon has reconsidered the scope of performance obligations related to services, and as a result, Canon will separately disclose revenues and costs of services from those of products and equipment from the quarter beginning January 1, 2018. In this context, certain costs related to service will be also reclassified from operating expenses to cost of sales.

In January 2016, the FASB issued an amendment which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This guidance includes the requirement that equity investments that do not result in consolidation and are not accounted for under the equity method

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Basis of Presentation and Significant Accounting Policies (continued)

(w) Recently Issued Accounting Guidance (continued)

be measured at fair value with changes in the fair value recognized in net income. This guidance is effective for Canon from the first quarter beginning January 1, 2018, and Canon will recognize a cumulative-effect adjustment to retained earnings of ¥5,343 million as of January 1, 2018 for the after-tax unrealized gains of available-for-sale equity securities previously recognized in accumulated other comprehensive income.

In February 2016, the FASB issued an amendment which requires lessees to recognize most leases on their balance sheets but recognize expenses on their income statements in a manner similar to current guidance. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. The new guidance is required to be applied with a modified retrospective approach. The guidance is effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. Canon currently plans to adopt the guidance from the quarter beginning after January 1, 2019. The adoption of the guidance is expected to have an impact on its consolidated balance sheet by recognizing right-of-use assets and lease liabilities for non-cancelable operating leases. Canon is currently evaluating the effect that the adoption of the guidance will have on its consolidated results of operations and financial condition.

In October 2016, the FASB issued an amendment which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this guidance eliminate the exception for an intra-entity transfer of an asset other than inventory. Two common examples of assets included in the scope of this guidance are intellectual property and property, plant, and equipment. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption. This guidance is effective for Canon from the quarter beginning January 1, 2018. Canon does not expect the adoption of this guidance to have a material impact on its consolidated results of operation and financial condition.

In March 2017, the FASB issued an amendment which requires an entity to disaggregate the service cost component from the other components of net benefit cost and report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component, such as in other income (deductions). The amendments also allow only the service cost component to be eligible for capitalization (for example, as a cost of internally manufactured inventory). The amendments in this guidance should be applied retrospectively for the presentation of the service cost component and the other components of net benefit cost, and prospectively for the capitalization of the service cost component of net benefit cost. This guidance is effective for Canon from the quarter beginning January 1, 2018 and the adoption of this standard will result in the decrease in operating profit and the increase in other income of ¥9,874 million, ¥12,441 million and ¥11,352 million for the years ended December 31, 2017, 2016 and 2015, respectively.

In August 2017, the FASB issued an amendment which amends existing guidance to simplify the application of the hedge accounting in certain situations and enable an entity to better portray the economic results of an entity's risk management activities in its financial statements. This guidance eliminates the requirement to separately measure and report hedge ineffectiveness, and requires an entity to present the earnings effect of the hedging instrument in the same income statement line item which the earnings effect of the hedged item is reported. This guidance is effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. Canon is currently evaluating the adoption date and the effect that the adoption of this guidance will have on its consolidated results of operations and financial condition.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in short-term investments and investments by major security type at December 31, 2017 and 2016 are as follows:

| | Cost | December 31, 2017 Gross unrealized holding gains (Millions of yen) | Gross unrealized holding losses | Fair value |
|--------------------|--------|---|--|---------------|
| Current: | | | | |
| Corporate bonds | 1,222 | | | 1,222 |
| | 1,222 | | | 1,222 |
| Noncurrent: | | | | |
| Government bonds | 305 | | 16 | 289 |
| Corporate bonds | 640 | 182 | | 822 |
| Fund trusts | 122 | 2 | | 124 |
| Equity securities | 10,965 | 11,612 | 1,676 | 20,901 |
| | 12,032 | 11,796 | 1,692 | 22,136 |

| | Cost | December 31, 2016 Gross unrealized holding gains (Millions of yen) | Gross unrealized holding losses | Fair value |
|--------------------|--------|---|--|---------------|
| Noncurrent: | | | | |
| Government bonds | 277 | | 8 | 269 |
| Corporate bonds | 43 | 188 | 2 | 229 |
| Fund trusts | 85 | 1 | | 86 |
| Equity securities | 19,026 | 23,439 | 21 | 42,444 |
| | 19,431 | 23,628 | 31 | 43,028 |

Maturities of available-for-sale debt securities included in short-term investments and investments in the accompanying consolidated balance sheets are as follows at December 31, 2017:

| | Cost | Fair value |
|---------------------------------------|-------------------|------------|
| | (Millions of yen) | |
| Due within one year | 1,222 | 1,222 |
| Due after one year through five years | 605 | 605 |
| Due after five years | 340 | 506 |

2,167

2,333

During the year ended December 31, 2017, Canon contributed certain marketable equity securities, not including those of its subsidiaries and affiliated companies, to an established employee retirement benefit trust, with no cash proceeds there on. The fair value of those securities at the time of contribution was ¥30,473 million. Upon

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Investments (continued)

contribution of those available-for-sale securities, the unrealized gains amounting to ¥17,836 million were realized and were included in Other, net in the consolidated statements of income.

Gross realized gains were ¥18,514 million, ¥750 million and ¥329 million for the years ended December 31, 2017, 2016 and 2015, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥42 million, ¥1,032 million and ¥31 million for the years ended December 31, 2017, 2016 and 2015, respectively.

At December 31, 2017, 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 were ¥743 million and ¥3,206 million at December 31, 2017 and 2016, respectively, and were 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 ¥3,760 million and ¥7,800 million at December 31, 2017 and 2016, respectively. These investments were not evaluated for impairment at December 31, 2017 and 2016, 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 ¥20,496 million and ¥21,514 million at December 31, 2017 and 2016, respectively. Canon's share of the net earnings in affiliated companies accounted for by the equity method, included in other income (deductions), were earnings of ¥1,196 million, ¥890 million and ¥447 million for the years ended December 31, 2017, 2016 and 2015 respectively.

3. Trade Receivables

Trade receivables are summarized as follows:

| | December 31 | |
|---|-------------------|----------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Notes | 37,077 | 28,811 |
| Accounts | 627,173 | 623,722 |
| | 664,250 | 652,533 |
| Less allowance for doubtful receivables | (13,378) | (11,075) |
| | 650,872 | 641,458 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Inventories

Inventories are summarized as follows:

| | December 31 | |
|-----------------|-------------------|---------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Finished goods | 377,632 | 373,337 |
| Work in process | 144,251 | 143,298 |
| Raw materials | 48,150 | 44,101 |
| | 570,033 | 560,736 |

5. Property, Plant and Equipment

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

| | December 31 | |
|-------------------------------|--------------------|-------------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Land | 274,551 | 283,893 |
| Buildings | 1,638,202 | 1,656,087 |
| Machinery and equipment | 1,804,982 | 1,778,552 |
| Construction in progress | 46,940 | 54,786 |
| | 3,764,675 | 3,773,318 |
| Less accumulated depreciation | (2,638,055) | (2,578,342) |
| | 1,126,620 | 1,194,976 |

Depreciation expenses for the years ended December 31, 2017, 2016 and 2015 were ¥189,712 million, ¥199,133 million and ¥223,759 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥23,432 million and ¥31,318 million at December 31, 2017 and 2016, 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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Finance Receivables and Operating Leases

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the sales of Canon's and complementary third-party products. These receivables typically have terms ranging from 1 year to 6 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

| | December 31 | |
|---|-------------------|----------------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Total minimum lease payments receivable | 361,686 | 306,766 |
| Unguaranteed residual values | 15,055 | 14,776 |
| Executory costs | (2,216) | (34) |
| Unearned income | (32,286) | (30,288) |
| | 342,239 | 291,220 |
| Less allowance for credit losses | (2,681) | (2,325) |
| | 339,558 | 288,895 |
| Less current portion | (120,186) | (105,308) |
| | 219,372 | 183,587 |

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

| | Years ended December 31 | |
|-----------------------------------|-------------------------|--------------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Balance at beginning of year | 2,325 | 2,878 |
| Charge-offs | (1,523) | (978) |
| Provision | 1,436 | 398 |
| Translation adjustments and other | 443 | 27 |
| Balance at end of year | 2,681 | 2,325 |

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, 2017 and 2016 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2017 and 2016 was ¥103,078 million and ¥97,890 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2017 and 2016 was ¥78,307 million and ¥75,997 million, respectively.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Finance Receivables and Operating Leases (continued)

The following is a schedule by year of the future minimum lease payments to be received under financing leases and noncancelable operating leases at December 31, 2017.

| Year ending December 31: | Financing leases | Operating leases |
|---------------------------------|--------------------------|-------------------------|
| | (Millions of yen) | |
| 2018 | 134,020 | 8,580 |
| 2019 | 102,203 | 4,446 |
| 2020 | 69,180 | 2,636 |
| 2021 | 38,264 | 1,347 |
| 2022 | 14,819 | 401 |
| Thereafter | 3,200 | 34 |
| | 361,686 | 17,444 |

7. Acquisitions

On March 17, 2016, Canon entered into a Shares and Other Securities Transfer Agreement with Toshiba Corporation and acquired the share options for consideration of cash to acquire all the ordinary shares of Toshiba Medical Systems Corporation (TMSC), which is exercisable upon the clearances of necessary competition regulatory authorities. As such clearances were obtained, Canon exercised the share options and acquired all the ordinary shares of TMSC on December 19, 2016. The acquisition date was December 19, 2016 and the purchase price was ¥665,498 million, which approximates the fair value at that date.

The acquisition was accounted for using the acquisition method of accounting. Acquisition-related costs were expensed as incurred and were not material.

Under Phase V of the Excellent Global Corporation Plan, a five-year initiative that Canon has been implementing since 2016, embracing the challenge of new growth through a grand strategic transformation has been set as a basic policy. With regard to strengthening and growing new businesses, and creating future businesses, a particularly important strategy, Canon intends to develop a health care business within the realm of safety and security, as a next-generation pillar of growth.

TMSC is one of the leading global companies in the medical equipment industry. Within the field of medical X-ray computed tomography systems in particular, TMSC is the overwhelming market share leader in Japan and has been steadily increasing its global market share. By maximizing the combination of both companies' management resources, Canon aims to solidify its business foundation for health care that can contribute to the world.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Acquisitions (continued)

The purchase price allocation was based on estimated fair values of the assets acquired and liabilities assumed at acquisition date. Since the acquisition date of TMSC was near the balance sheet date in 2016, and TMSC is composed of various entities located around the world, the purchase price allocation was preliminary at December 31, 2016. The purchase price allocation was finalized in the fourth quarter of 2017. The certain underlying inputs for inventories and intangible assets have been updated during the measurement period. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at acquisition date.

| | Preliminary | Measurement Period Adjustment (Millions of yen) | Final |
|----------------------------------|----------------|--|----------------|
| Cash and cash equivalents | 25,301 | | 25,301 |
| Other current assets | 169,545 | (1,962) | 167,583 |
| Intangible assets | 227,500 | 627 | 228,127 |
| Other noncurrent assets | 42,975 | | 42,975 |
| Total assets acquired | 465,321 | (1,335) | 463,986 |
| Current liabilities | 199,223 | (877) | 198,346 |
| Noncurrent liabilities | 92,231 | (1,049) | 91,182 |
| Total liabilities assumed | 291,454 | (1,926) | 289,528 |
| Noncontrolling interest | 1,047 | | 1,047 |
| Net identifiable assets acquired | 172,820 | 591 | 173,411 |
| Goodwill | 492,678 | (591) | 492,087 |
| Net assets acquired | 665,498 | | 665,498 |

Intangible assets acquired, which are subject to amortization, mainly consist of customer relationships of ¥143,600 million, and patents and developed technology of ¥73,000 million. Canon has estimated the amortization period for the customer relationships, and patents and developed technology to be 15 years and 10 years, respectively. The weighted average amortization period for all intangible assets is approximately 13 years.

Goodwill recorded is attributable primarily to expected synergies from combining operations of TMSC and Canon, such as accelerating entry into new fields, further improvement in quality through shared production technology and expanding business domains through the enhancement of R&D capabilities. None of the goodwill is expected to be deductible for tax purposes.

The amounts of net sales of TMSC since the acquisition date included in the Canon's consolidated statement of income for the year ended December 31, 2016 were ¥13,582 million. The amounts of net income of TMSC included in the Canon's consolidated statement of income were not material.

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The unaudited pro forma net sales for the years ended December 31, 2016 and 2015 as if TMSC had been included in Canon's consolidated statement of income from the beginning of the year ended December 31, 2015 were ¥3,806,667 million and ¥4,224,181 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 that described above during the years ended December 31, 2017 and 2016 that were not material to its consolidated financial statements.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Goodwill and Other Intangible Assets

Intangible assets subject to amortization acquired during the year ended December 31, 2017, including those recorded from businesses acquired, totaled ¥35,112 million, which primarily consist of software of ¥33,437 million and customer relationships of ¥1,203 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2017 are approximately 5 years. The weighted average amortization periods for software and customer relationships acquired during the year ended December 31, 2017 are approximately 5 years and 8 years, respectively.

Intangible assets subject to amortization acquired during the year ended December 31, 2016, including those recorded from businesses acquired, totaled ¥266,325 million, which primarily consist of customer relationships of ¥155,997 million, patents and developed technology of ¥73,451 million and software of ¥36,054 million. The weighted average amortization periods for intangible assets in total acquired during the year ended December 31, 2016 are approximately 14 years. The weighted average amortization periods for customer relationships, patents and developed technology and software acquired during the year ended December 31, 2016 are approximately 15–20 years, 10 years and 5 years, respectively.

The components of intangible assets subject to amortization at December 31, 2017 and 2016 were as follows:

| | December 31, 2017 | | December 31, 2016 | |
|----------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
| | Gross carrying amount | Accumulated amortization | Gross carrying amount | Accumulated amortization |
| | (Millions of yen) | | | |
| Software | 342,322 | 217,654 | 313,599 | 193,785 |
| Customer relationships | 162,832 | 22,463 | 172,234 | 11,146 |
| Patents and developed technology | 121,886 | 27,085 | 106,250 | 16,272 |
| Trademarks | 48,823 | 9,890 | 44,704 | 5,610 |
| License fees | 13,565 | 6,375 | 15,561 | 6,756 |
| Other | 18,592 | 8,136 | 17,713 | 8,250 |
| | 708,020 | 291,603 | 670,061 | 241,819 |

Aggregate amortization expense for the years ended December 31, 2017, 2016 and 2015 was ¥72,169 million, ¥50,963 million and ¥49,568 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥67,791 million in 2018, ¥57,214 million in 2019, ¥45,435 million in 2020, ¥37,265 million in 2021, and ¥30,805 million in 2022.

Intangible assets not subject to amortization other than goodwill at December 31, 2017 were not significant. Intangible assets not subject to amortization other than goodwill at December 31, 2016 were ¥18,026 million, which primarily consist of in-process research and development recorded from businesses acquired.

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

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Goodwill and Other Intangible Assets (continued)

The changes in the carrying amount of goodwill by segment for the years ended December 31, 2017 and 2016 were as follows:

| | Year ended December 31, 2017 | | | | | Total |
|-----------------------------------|------------------------------|----------------|----------------|---------------------|----------------|----------|
| | Office | Imaging System | Medical System | Industry and Others | Unallocated *1 | |
| Balance at beginning of year | 136,256 | 49,034 | | 258,456 | 492,678 | 936,424 |
| Goodwill acquired during the year | 857 | 236 | | 2,394 | | 3,487 |
| Transfer *1 | | | 499,855 | (7,177) | (492,678) | |
| Impairment loss *2 | (33,912) | | | | | (33,912) |
| Translation adjustments and other | 9,855 | 3,291 | 60 | 17,517 | | 30,723 |
| Balance at end of year | 113,056 | 52,561 | 499,915 | 271,190 | | 936,722 |

| | Year ended December 31, 2016 | | | | | Total |
|-----------------------------------|------------------------------|----------------|----------------|---------------------|----------------|----------|
| | Office | Imaging System | Medical System | Industry and Others | Unallocated *1 | |
| Balance at beginning of year | 142,551 | 53,474 | | 282,918 | | 478,943 |
| Goodwill acquired during the year | 863 | | | 4,589 | 492,678 | 498,130 |
| Translation adjustments and other | (7,158) | (4,440) | | (29,051) | | (40,649) |
| Balance at end of year | 136,256 | 49,034 | | 258,456 | 492,678 | 936,424 |

*1 Canon did not complete the allocation of goodwill to the segments for impairment testing which was attributable to the acquisition of TMSC as of December 31, 2016. Based on the realignment of Canon's internal reporting and management structure, Canon newly established Medical System Business Unit effective at the beginning of the second quarter of 2017. Goodwill related to TMSC as well as goodwill related to certain medical business which was previously included in Industry and Others Business Unit have been transferred to Medical System Business Unit.

*2 After entering the commercial printing business through the acquisition of Océ N.V. in 2010, the market environment surrounding this business has become significantly competitive and rapid technological changes have required increasing investments into R&D. These factors resulted in lower operating margin than expected, which led to the decline in the estimated fair value of this business which was determined based on the income approach. As the result of the annual goodwill impairment test as of October 1, 2017, it was determined that the estimated fair value of commercial printing business was less than its carrying value of the reporting unit. Based on the accounting policy described in Note 1, Canon recognized an impairment charge of ¥33,912 million representing the excess of the carrying amount over the reporting unit's fair value.

9. Short-Term Loans and Long-Term Debt

Short-term loans consisting of bank borrowings at December 31, 2017 and 2016 were ¥33,398 million and ¥601 million, respectively. The weighted average interest rate on short-term borrowings outstanding at December 31, 2017 was 0.52%.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Short-Term Loans and Long-Term Debt (continued)

Long-term debt consisted of the following:

| | December 31 | |
|---|-------------------|---------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Loan from the banks; bearing interest of 0.06% at December 31, 2017 and 0.13% at December 31, 2016 *1 | 490,000 | 610,000 |
| Other debt *2 | 9,168 | 2,538 |
| | 499,168 | 612,538 |
| Less current portion | (5,930) | (1,249) |
| | 493,238 | 611,289 |

*1 On January 31, 2017, Canon entered into the unsecured revolving credit facility contracts expiring in December 2021 in order to refinance the bank term loan which was due in 2017. Canon prepaid ¥120,000 million of the loan with cash flows generated during the year. The outstanding loans under the credit facilities are ¥490,000 million at a floating interest of 0.06% and Canon has no unused credit facilities as of December 31, 2017.

*2 The other debt consisted of term-loans and capital lease obligations as of December 31, 2017 and 2016. The aggregate annual maturities of long-term debt outstanding at December 31, 2017 were as follows:

| | (Millions of yen) |
|---------------------------------|-------------------|
| Year ending December 31: | |
| 2018 | 5,930 |
| 2019 | 2,372 |
| 2020 | 404 |
| 2021 | 490,342 |
| 2022 | 48 |
| Thereafter | 72 |
| | 499,168 |

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

10. Trade Payables

Trade payables are summarized as follows:

| | December 31 | |
|----------|-------------------|---------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Notes | 81,002 | 38,073 |
| Accounts | 299,652 | 334,196 |
| | 380,654 | 372,269 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits

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

TMSC temporarily participates in Toshiba Corporate Pension Fund. However, it is not allowed to permanently continue to participate in the fund as a result of the acquisition by Canon. In addition, Canon is required to maintain an equivalent level of pension benefit and therefore plans to establish a new pension plan in 2018. Canon calculated the projected benefit obligations based on the benefit level of Toshiba Corporate Pension Fund at December 31, 2017 and 2016, and included proportional share of the plan assets of TMSC to which they have legal right in the following tables. These obligations and plan assets are expected to be reasonable estimates of the impact of creating the new plan.

Obligations and funded status

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

| | Japanese plans December 31 | | Foreign plans December 31 | |
|--|-------------------------------|-----------|------------------------------|-----------|
| | 2017 (Millions of yen) | 2016 | 2017 (Millions of yen) | 2016 |
| Change in benefit obligations: | | | | |
| Projected benefit obligations at beginning of year | 906,007 | 781,350 | 392,086 | 349,680 |
| Service cost | 30,889 | 29,367 | 6,962 | 6,816 |
| Interest cost | 5,689 | 8,238 | 8,691 | 8,792 |
| Plan participants' contributions | | | 1,644 | 1,594 |
| Actuarial (gain) loss | 11,112 | 45,778 | (1,760) | 55,629 |
| Benefits paid | (29,020) | (25,032) | (7,884) | (6,268) |
| Acquisition | 4,239 | 71,040 | | 21,285 |
| Plan amendments | 1,149 | (4,734) | (1,069) | |
| Curtailments and settlements | (435) | | | |
| Foreign currency exchange rate changes | | | 24,909 | (45,442) |
| Projected benefit obligations at end of year | 929,630 | 906,007 | 423,579 | 392,086 |
| Change in plan assets: | | | | |
| Fair value of plan assets at beginning of year | 667,436 | 626,575 | 224,939 | 217,870 |
| Actual return on plan assets | 47,376 | 12,145 | 14,262 | 18,276 |
| Employer contributions | 43,468 | 7,304 | 7,160 | 7,271 |
| Plan participants' contributions | | | 1,644 | 1,594 |
| Benefits paid | (23,967) | (21,782) | (7,884) | (6,268) |
| Acquisition | 1,223 | 43,194 | | 14,972 |
| Settlements | (23) | | | |
| Foreign currency exchange rate changes | | | 13,899 | (28,776) |
| Fair value of plan assets at end of year | 735,513 | 667,436 | 254,020 | 224,939 |
| Funded status at end of year | (194,117) | (238,571) | (169,559) | (167,147) |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)
Obligations and funded status (continued)

Employer contributions for the year ended December 31, 2017 include contribution of equity securities to a retirement benefit trust. The fair value of those securities at the time of contribution was ¥30,473 million.

Amounts recognized in the consolidated balance sheets at December 31, 2017 and 2016 are as follows:

| | Japanese plans December 31 | | Foreign plans December 31 | |
|------------------------------------|-------------------------------|-----------|------------------------------|-----------|
| | 2017 (Millions of yen) | 2016 | 2017 (Millions of yen) | 2016 |
| Other assets | 1,695 | 976 | 1,215 | 1,346 |
| Accrued expenses | | | (1,004) | (840) |
| Accrued pension and severance cost | (195,812) | (239,547) | (169,770) | (167,653) |
| | (194,117) | (238,571) | (169,559) | (167,147) |

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2017 and 2016 before the effect of income taxes are as follows:

| | Japanese plans December 31 | | Foreign plans December 31 | |
|----------------------|-------------------------------|----------|------------------------------|---------|
| | 2017 (Millions of yen) | 2016 | 2017 (Millions of yen) | 2016 |
| Actuarial loss | 221,106 | 251,078 | 105,883 | 116,930 |
| Prior service credit | (57,430) | (71,439) | (3,638) | (2,652) |
| | 163,676 | 179,639 | 102,245 | 114,278 |

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

| | Japanese plans December 31 | | Foreign plans December 31 | |
|--------------------------------|-------------------------------|---------|------------------------------|---------|
| | 2017 (Millions of yen) | 2016 | 2017 (Millions of yen) | 2016 |
| Accumulated benefit obligation | 894,329 | 869,355 | 402,390 | 377,004 |

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:

| | Japanese plans December 31 | | Foreign plans December 31 | |
|--|-------------------------------|---------|------------------------------|---------|
| | 2017 | 2016 | 2017 | 2016 |
| | (Millions of yen) | | (Millions of yen) | |
| Plans with projected benefit obligations in excess of plan assets: | | | | |
| Projected benefit obligations | 924,536 | 905,975 | 420,383 | 390,942 |
| Fair value of plan assets | 728,724 | 666,428 | 249,609 | 222,449 |
| Plans with accumulated benefit obligations in excess of plan assets: | | | | |
| Accumulated benefit obligations | 889,652 | 867,706 | 394,840 | 375,860 |
| Fair value of plan assets | 728,724 | 664,586 | 245,247 | 222,449 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)*Components of net periodic benefit cost and other amounts recognized in other comprehensive income (loss)*

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2017, 2016 and 2015 consisted of the following components:

| | Japanese plans | | | Foreign plans | | |
|---|-------------------------|----------|----------|-------------------------|----------|----------|
| | Years ended December 31 | | | Years ended December 31 | | |
| | 2017 | 2016 | 2015 | 2017 | 2016 | 2015 |
| | (Millions of yen) | | | (Millions of yen) | | |
| Service cost | 30,889 | 29,367 | 30,009 | 6,962 | 6,816 | 7,760 |
| Interest cost | 5,689 | 8,238 | 8,008 | 8,691 | 8,792 | 10,572 |
| Expected return on plan assets | (20,493) | (19,443) | (19,579) | (10,722) | (10,012) | (11,857) |
| Amortization of prior service credit | (12,860) | (13,230) | (12,592) | (83) | 85 | (145) |
| Amortization of actuarial loss | 14,220 | 10,944 | 10,402 | 5,747 | 2,185 | 3,839 |
| (Gain) loss on curtailments and settlements | (63) | | | | | |
| | 17,382 | 15,876 | 16,248 | 10,595 | 7,866 | 10,169 |

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2017, 2016 and 2015 are summarized as follows:

| | Japanese plans | | | Foreign plans | | |
|--------------------------------------|-------------------------|----------|----------|-------------------------|---------|---------|
| | Years ended December 31 | | | Years ended December 31 | | |
| | 2017 | 2016 | 2015 | 2017 | 2016 | 2015 |
| | (Millions of yen) | | | (Millions of yen) | | |
| Current year actuarial (gain) loss | (15,771) | 53,076 | 9,519 | (5,300) | 47,365 | 6,302 |
| Current year prior service credit | 1,149 | (4,734) | | (1,069) | | (2,655) |
| Amortization of actuarial loss | (14,220) | (10,944) | (10,402) | (5,747) | (2,185) | (3,839) |
| Amortization of prior service credit | 12,860 | 13,230 | 12,592 | 83 | (85) | 145 |
| Curtailments and settlements | 19 | | | | | |
| | (15,963) | 50,628 | 11,709 | (12,033) | 45,095 | (47) |

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

| | |
|-------------------------------------|------------------------------------|
| Japanese plans (Millions of yen) | Foreign plans (Millions of yen) |
|-------------------------------------|------------------------------------|

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| | | |
|----------------------|----------|-------|
| Prior service credit | (12,727) | (52) |
| Actuarial loss | 11,821 | 4,466 |
| <i>Assumptions</i> | | |

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

| | Japanese plans December 31 | | Foreign plans December 31 | |
|--|-------------------------------|------|------------------------------|------|
| | 2017 | 2016 | 2017 | 2016 |
| Discount rate | 0.6% | 0.7% | 2.2% | 2.2% |
| Assumed rate of increase in future compensation levels | 2.6% | 2.6% | 1.8% | 2.1% |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)*Assumptions (continued)*

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

| | Japanese plans | | | Foreign plans | | |
|--|-------------------------|------|------|-------------------------|------|------|
| | Years ended December 31 | | | Years ended December 31 | | |
| | 2017 | 2016 | 2015 | 2017 | 2016 | 2015 |
| Discount rate | 0.7% | 1.1% | 1.1% | 2.2% | 3.0% | 2.9% |
| Assumed rate of increase in future compensation levels | 2.6% | 3.0% | 3.0% | 2.1% | 2.0% | 2.0% |
| Expected long-term rate of return on plan assets | 3.1% | 3.1% | 3.1% | 4.2% | 4.4% | 5.6% |

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 25% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 25% 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 25% is invested in debt securities, and approximately 35% 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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)***Plan assets (continued)***

The three levels of input used to measure fair value are more fully described in Note 20. The fair values of Canon's pension plan assets at December 31, 2017 and 2016, by asset category, are as follows:

| | Level 1 | Japanese plans | | December 31, 2017 | | Foreign plans | | Total |
|--|---------|----------------|---------|----------------------------|---------|---------------|---------|---------|
| | | Level 2 | Level 3 | Total (Millions of yen) | Level 1 | Level 2 | Level 3 | |
| Equity securities: | | | | | | | | |
| Japanese companies (a) | 83,765 | | | 83,765 | | | | |
| Foreign companies | 8,261 | | | 8,261 | 32,240 | | | 32,240 |
| Pooled funds (b) | | 164,946 | | 164,946 | | 73,968 | | 73,968 |
| Debt securities: | | | | | | | | |
| Government bonds (c) | 138,092 | | | 138,092 | 9,343 | | | 9,343 |
| Municipal bonds | | 1,166 | | 1,166 | | 2,901 | | 2,901 |
| Corporate bonds | | 15,246 | | 15,246 | | 22,045 | | 22,045 |
| Pooled funds (d) | | 130,507 | | 130,507 | | 25,821 | | 25,821 |
| Mortgage backed securities (and other asset backed securities) | | 8,076 | | 8,076 | | 3 | | 3 |
| Life insurance company general accounts | | 126,985 | | 126,985 | | 8,683 | | 8,683 |
| Other assets | | 43,070 | | 43,070 | | 73,320 | | 73,320 |
| Investment measured at net asset value | | | | 15,399 | | | | 5,696 |
| | 230,118 | 489,996 | | 735,513 | 41,583 | 206,741 | | 254,020 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)**Plan assets (continued)**

| | December 31, 2016 | | | | | | | Total |
|--|-------------------|----------------|---------|-------------------|---------|---------------|---------|---------|
| | Level 1 | Japanese plans | | Total | Level 1 | Foreign plans | | |
| | | Level 2 | Level 3 | (Millions of yen) | | Level 2 | Level 3 | |
| Equity securities: | | | | | | | | |
| Japanese companies (e) | 46,630 | | | 46,630 | | | | |
| Foreign companies | 7,902 | | | 7,902 | 22,680 | | | 22,680 |
| Pooled funds (f) | | 133,023 | | 133,023 | | 62,641 | | 62,641 |
| Debt securities: | | | | | | | | |
| Government bonds (g) | 99,157 | | | 99,157 | 11,558 | | | 11,558 |
| Municipal bonds | | 1,317 | | 1,317 | | 2,577 | | 2,577 |
| Corporate bonds | | 14,298 | | 14,298 | | 19,989 | | 19,989 |
| Pooled funds (h) | | 121,066 | | 121,066 | | 22,296 | | 22,296 |
| Mortgage backed securities (and other asset backed securities) | | 13,612 | | 13,612 | | | | |
| Life insurance company general accounts | | 128,220 | | 128,220 | | 6,898 | | 6,898 |
| Other assets | | 90,637 | | 90,637 | | 71,358 | 24 | 71,382 |
| Investment measured at net asset value | | | | 11,574 | | | | 4,918 |
| | 153,689 | 502,173 | | 667,436 | 34,238 | 185,759 | 24 | 224,939 |

- (a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥381 million.
- (b) These funds invest in listed equity securities consisting of approximately 30% Japanese companies and 70% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (c) This class includes approximately 90% Japanese government bonds and 10% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
- (d) These funds invest in approximately 30% Japanese government bonds, 45% foreign government bonds, 5% Japanese municipal bonds, and 20% corporate bonds for Japanese plans. These funds invest in approximately 70% foreign government bonds and 30% 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 ¥187 million.
- (f) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (g) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
- (h) These funds invest in approximately 25% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 20% corporate bonds for Japanese plans. These funds invest in approximately 70% foreign government bonds and 30% 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,

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Employee Retirement and Severance Benefits (continued)***Plan assets (continued)***

investments in life insurance company general accounts and other assets. 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. Other assets are comprised principally of interest bearing cash and hedge funds.

Amounts of actual returns on, and purchases and sales of, Level 3 assets during the years ended December 31, 2017 and 2016 were not significant.

The fair values of plan assets by each asset category of TMSC are calculated based on a pro-rata basis of total plan assets of Toshiba Corporate Pension Fund.

Contributions

Canon expects to contribute ¥14,447 million to its Japanese defined benefit pension plans and ¥22,303 million to its foreign defined benefit pension plans for the year ending December 31, 2018.

Estimated future benefit payments

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

| | Japanese plans (Millions of yen) | Foreign plans (Millions of yen) |
|---------------------------------|--|---------------------------------------|
| Year ending December 31: | | |
| 2018 | 33,137 | 10,599 |
| 2019 | 34,534 | 10,743 |
| 2020 | 36,631 | 11,250 |
| 2021 | 38,470 | 11,986 |
| 2022 | 41,900 | 12,666 |
| 2023 – 2027 | 218,317 | 71,944 |

Multiemployer pension plans

The amounts of cost recognized for the multiemployer pension plans primarily in the Netherlands for the years ended December 31, 2017, 2016 and 2015 were ¥4,165 million, ¥3,482 million and ¥3,864 million, respectively. The multiemployer pension plan in which the subsidiaries in the Netherlands participated was 96% funded as of December 31, 2016. The collective bargaining agreements have no expiration date. Canon is not liable for other participating employers' obligations under the terms and conditions of the agreements.

Defined contribution plans

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, 2017, 2016 and 2015 were ¥18,979 million, ¥17,603 million and ¥17,277 million, respectively.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes

Domestic and foreign components of income before income taxes and the current and deferred income tax expense attributable to such income are summarized as follows:

| | Year ended December 31, 2017 | | |
|----------------------------|------------------------------|----------|----------|
| | Japanese | Foreign | Total |
| | (Millions of yen) | | |
| Income before income taxes | 276,149 | 77,735 | 353,884 |
| Income taxes: | | | |
| Current | 80,225 | 35,402 | 115,627 |
| Deferred | (7,453) | (10,150) | (17,603) |
| | 72,772 | 25,252 | 98,024 |

| | Year ended December 31, 2016 | | |
|----------------------------|------------------------------|---------|---------|
| | Japanese | Foreign | Total |
| | (Millions of yen) | | |
| Income before income taxes | 135,131 | 109,520 | 244,651 |
| Income taxes: | | | |
| Current | 47,687 | 27,806 | 75,493 |
| Deferred | 4,126 | 3,062 | 7,188 |
| | 51,813 | 30,868 | 82,681 |

| | Year ended December 31, 2015 | | |
|----------------------------|------------------------------|---------|---------|
| | Japanese | Foreign | Total |
| | (Millions of yen) | | |
| Income before income taxes | 228,871 | 118,567 | 347,438 |
| Income taxes: | | | |
| Current | 80,020 | 31,413 | 111,433 |
| Deferred | 3,414 | 1,258 | 4,672 |
| | 83,434 | 32,671 | 116,105 |

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 31%, 33% and 35% for the years ended December 31, 2017, 2016 and 2015, respectively.

The statutory income tax rate utilized for deferred tax assets and liabilities which are expected to be settled or realized in the periods from January 1, 2017 is approximately 31%. The adjustments of deferred tax assets and liabilities for amendments to the Japanese tax regulations which have been reflected in income taxes in the consolidated statements of income for the years ended December 31, 2016 and 2015 were

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¥3,498 million and ¥6,456 million, respectively.

The Tax Cuts and Jobs Act of 2017 (the Act) was enacted in the U.S. on December 22, 2017. Due to the Act, the federal corporate income tax rate in the U.S. is reduced from 35% to 21% from the fiscal year commencing on January 1, 2018. The adjustment to deferred tax assets and liabilities for the tax rate change was tax benefit of ¥14,563 million for the year ended December 31, 2017. The impacts related to other changes from the Act are not material.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

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 | | |
|--|-------------------------|-------|-------|
| | 2017 | 2016 | 2015 |
| Japanese statutory income tax rate | 31.0% | 33.0% | 35.0% |
| Increase (reduction) in income taxes resulting from: | | | |
| Expenses not deductible for tax purposes * | 3.7 | 0.8 | 0.8 |
| Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate | (2.1) | (3.0) | (2.9) |
| Tax credit for research and development expenses | (4.8) | (3.0) | (4.8) |
| Change in valuation allowance | 1.7 | (0.8) | (0.4) |
| Effect of enacted changes in tax laws and rates on Japanese tax | | 1.4 | 1.9 |
| Effect of enacted changes in U.S. tax laws | (3.6) | | |
| Other | 1.8 | 5.4 | 3.8 |
| Effective income tax rate | 27.7% | 33.8% | 33.4% |

* Expenses not deductible for tax purposes for the year ended December 31, 2017 primarily consist of impairment losses on goodwill. Net deferred income tax assets and liabilities are included in the accompanying consolidated balance sheets under the following captions:

| | December 31 | |
|------------------------------|-------------------|-----------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Other assets | 150,854 | 149,866 |
| Other noncurrent liabilities | (90,010) | (108,429) |
| | 60,844 | 41,437 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2017 and 2016 are presented below:

| | December 31 | |
|---|-------------------|-----------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Deferred tax assets: | | |
| Inventories | 11,921 | 15,387 |
| Accrued business tax | 4,705 | 1,835 |
| Accrued pension and severance cost | 98,114 | 108,781 |
| Research and development costs capitalized for tax purposes | 5,383 | 5,998 |
| Property, plant and equipment | 33,488 | 26,519 |
| Accrued expenses | 30,126 | 31,316 |
| Net operating losses carried forward | 29,006 | 29,167 |
| Other | 38,526 | 33,782 |
| | 251,269 | 252,785 |
| Less valuation allowance | (30,783) | (26,687) |
| Total deferred tax assets | 220,486 | 226,098 |
| Deferred tax liabilities: | | |
| Undistributed earnings of foreign subsidiaries | (9,859) | (9,450) |
| Net unrealized gains on securities | (1,815) | (7,321) |
| Tax deductible reserve | (4,396) | (4,449) |
| Financing lease revenue | (38,287) | (47,802) |
| Intangible assets | (74,377) | (85,888) |
| Other | (30,908) | (29,751) |
| Total deferred tax liabilities | (159,642) | (184,661) |
| Net deferred tax assets | 60,844 | 41,437 |

The net changes in the total valuation allowance were an increase of ¥4,096 million for the year ended December, 2017 and a decrease of ¥6,244 million and ¥4,567 million for the years ended December 31, 2016 and 2015, respectively.

Based on 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 valuation allowance, at December 31, 2017.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

At December 31, 2017, Canon had net operating losses which can be carried forward for income tax purposes of ¥185,637 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to an indefinite period as follows:

| | (Millions of yen) |
|--------------------------------------|-------------------|
| Within one year | 654 |
| After one year through five years | 38,641 |
| After five years through ten years | 39,278 |
| After ten years through twenty years | 52,250 |
| Indefinite period | 54,814 |
| Total | 185,637 |

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 ¥27,361 million for a portion of undistributed earnings of foreign subsidiaries of ¥961,735 million as of December 31, 2017 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.

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

| | Years ended December 31 | | |
|---|-------------------------|--------------|--------------|
| | 2017 | 2016 | 2015 |
| | (Millions of yen) | | |
| Balance at beginning of year | 7,318 | 6,056 | 6,431 |
| Additions for tax positions of the current year | 2,956 | 2,741 | 2,174 |
| Additions for tax positions of prior years | 250 | | 165 |
| Reductions for tax positions of prior years | (915) | (665) | (1,180) |
| Settlements with tax authorities | | (370) | (505) |
| Other | 673 | (444) | (1,029) |
| Balance at end of year | 10,282 | 7,318 | 6,056 |

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, were ¥10,282 million and ¥7,318 million at December 31, 2017 and 2016, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax examination settlements and any related litigation could affect the effective tax rate in a future period. Based on each of the items of which Canon is aware at December 31, 2017, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

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Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2017 and 2016, and interest and penalties included in income taxes for the years ended December 31, 2017, 2016 and 2015 were not significant.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Income Taxes (continued)

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 2017 with few exceptions. Canon is also no longer subject to a transfer pricing examination by the tax authority for years before 2017 with few exceptions. In other major foreign tax jurisdictions, including the United States and the Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2007 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2006 in major foreign tax jurisdictions.

13. Legal Reserve and Retained Earnings

The Corporation Law of Japan provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law of Japan also provides that additional paid-in capital and legal reserve are available for appropriations by resolution of the shareholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of their respective countries.

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2017, 2016 and 2015 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2017 did not reflect current year-end dividends in the amount of ¥91,779 million which were approved by the shareholders in March 2018.

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 ¥953,952 million at December 31, 2017.

Retained earnings at December 31, 2017 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥17,139 million.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for the years ended December 31, 2017, 2016 and 2015 are as follows:

| | Foreign currency translation adjustments | Unrealized gains and losses on securities | Gains and losses on derivative instruments (Millions of yen) | Pension liability adjustments | Total |
|---|---|--|--|-------------------------------------|-----------|
| Balance at December 31, 2014 | 144,557 | 12,546 | (2,603) | (126,214) | 28,286 |
| Equity transactions with noncontrolling interests and other | 73 | | | | 73 |
| Other comprehensive income (loss) before reclassifications | (57,592) | 1,691 | (256) | (6,155) | (62,312) |
| Amounts reclassified from accumulated other comprehensive income (loss) | | (182) | 3,041 | 1,352 | 4,211 |
| Net change during the year | (57,519) | 1,509 | 2,785 | (4,803) | (58,028) |
| Balance at December 31, 2015 | 87,038 | 14,055 | 182 | (131,017) | (29,742) |
| Equity transactions with noncontrolling interests and other | 259 | | | (1) | 258 |
| Other comprehensive income (loss) before reclassifications | (101,350) | 814 | 938 | (67,511) | (167,109) |
| Amounts reclassified from accumulated other comprehensive income (loss) | 93 | 382 | (3,862) | 99 | (3,288) |
| Net change during the year | (100,998) | 1,196 | (2,924) | (67,413) | (170,139) |
| Balance at December 31, 2016 | (13,960) | 15,251 | (2,742) | (198,430) | (199,881) |
| Equity transactions with noncontrolling interests and other | | | | | |
| Other comprehensive income (loss) before reclassifications | 44,184 | 2,813 | (1,452) | 14,785 | 60,330 |
| Amounts reclassified from accumulated other comprehensive income (loss) | (16) | (12,580) | 4,014 | 4,905 | (3,677) |
| Net change during the year | 44,168 | (9,767) | 2,562 | 19,690 | 56,653 |
| Balance at December 31, 2017 | 30,208 | 5,484 | (180) | (178,740) | (143,228) |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss) (continued)

Reclassifications out of accumulated other comprehensive income (loss) for the years ended December 31, 2017, 2016 and 2015 are as follows:

| | Year ended December 31, 2017 | Year ended December 31, 2016 (Millions of yen) | Year ended December 31, 2015 | Amount reclassified from |
|--|------------------------------------|---|------------------------------------|---|
| | | | | accumulated other comprehensive income (loss) *1 |
| | | | | Affected line items in consolidated statements of income |
| Foreign currency translation adjustments | (39) | 139 | | Other, net |
| | 12 | (46) | | Income taxes |
| | (27) | 93 | | Consolidated net income |
| | 11 | | | Net income attributable to noncontrolling interests |
| | (16) | 93 | | Net income attributable to Canon Inc. |
| Unrealized gains and losses on securities | (18,472) | 282 | (298) | Other, net |
| | 5,727 | (94) | 104 | Income taxes |
| | (12,745) | 188 | (194) | Consolidated net income |
| | 165 | 194 | 12 | Net income attributable to noncontrolling interests |
| | (12,580) | 382 | (182) | Net income attributable to Canon Inc. |
| Gains and losses on derivative instruments | 5,772 | (5,890) | 4,217 | Other, net |
| | (1,732) | 2,049 | (1,180) | Income taxes |
| | 4,040 | (3,841) | 3,037 | Consolidated net income |
| | (26) | (21) | 4 | Net income attributable to noncontrolling interests |
| | 4,014 | (3,862) | 3,041 | Net income attributable to Canon Inc. |
| Pension liability adjustments | 7,005 | (16) | 1,504 | See Note 11 |
| | (1,832) | 164 | (175) | Income taxes |
| | 5,173 | 148 | 1,329 | Consolidated net income |
| | (268) | (49) | 23 | Net income attributable to noncontrolling interests |
| | 4,905 | 99 | 1,352 | Net income attributable to Canon Inc. |

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| | | | |
|--|---------|---------|-------|
| Total amount reclassified, net of tax and noncontrolling interests | (3,677) | (3,288) | 4,211 |
|--|---------|---------|-------|

*1 Amounts in parentheses indicate gains in consolidated statements of income.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss) (continued)

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments, including amounts attributable to noncontrolling interests, are as follows:

| | Years ended December 31 | | |
|--|-------------------------|---|-------------------|
| | Before-tax amount | Tax (expense) or benefit (Millions of yen) | Net-of-tax amount |
| 2017: | | | |
| Foreign currency translation adjustments | | | |
| Amount arising during the year | 47,825 | (708) | 47,117 |
| Reclassification adjustments for gains and losses realized in net income | (39) | 12 | (27) |
| Net change during the year | 47,786 | (696) | 47,090 |
| Net unrealized gains and losses on securities: | | | |
| Amount arising during the year | 5,100 | (1,717) | 3,383 |
| Reclassification adjustments for gains and losses realized in net income | (18,472) | 5,727 | (12,745) |
| Net change during the year | (13,372) | 4,010 | (9,362) |
| Net gains and losses on derivative instruments: | | | |
| Amount arising during the year | (2,080) | 628 | (1,452) |
| Reclassification adjustments for gains and losses realized in net income | 5,772 | (1,732) | 4,040 |
| Net change during the year | 3,692 | (1,104) | 2,588 |
| Pension liability adjustments: | | | |
| Amount arising during the year | 20,991 | (4,957) | 16,034 |
| Reclassification adjustments for gains and losses realized in net income | 7,005 | (1,832) | 5,173 |
| Net change during the year | 27,996 | (6,789) | 21,207 |
| Other comprehensive income (loss) | 66,102 | (4,579) | 61,523 |
| 2016: | | | |
| Foreign currency translation adjustments | | | |
| Amount arising during the year | (108,280) | 521 | (107,759) |
| Reclassification adjustments for gains and losses realized in net income | 139 | (46) | 93 |
| Net change during the year | (108,141) | 475 | (107,666) |
| Net unrealized gains and losses on securities: | | | |
| Amount arising during the year | 1,184 | (375) | 809 |
| Reclassification adjustments for gains and losses realized in net income | 282 | (94) | 188 |
| Net change during the year | 1,466 | (469) | 997 |
| Net gains and losses on derivative instruments: | | | |

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| | | | |
|--|-----------|--------|-----------|
| Amount arising during the year | 1,619 | (726) | 893 |
| Reclassification adjustments for gains and losses realized in net income | (5,890) | 2,049 | (3,841) |
| Net change during the year | (4,271) | 1,323 | (2,948) |
| Pension liability adjustments: | | | |
| Amount arising during the year | (95,707) | 25,204 | (70,503) |
| Reclassification adjustments for gains and losses realized in net income | (16) | 164 | 148 |
| Net change during the year | (95,723) | 25,368 | (70,355) |
| Other comprehensive income (loss) | (206,669) | 26,697 | (179,972) |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

14. Other Comprehensive Income (Loss) (continued)

| | Years ended December 31 | | |
|--|-------------------------|---|-------------------|
| | Before-tax amount | Tax (expense) or benefit (Millions of yen) | Net-of-tax amount |
| 2015: | | | |
| Foreign currency translation adjustments | (56,054) | 550 | (55,504) |
| Net unrealized gains and losses on securities: | | | |
| Amount arising during the year | 3,249 | (1,045) | 2,204 |
| Reclassification adjustments for gains and losses realized in net income | (298) | 104 | (194) |
| Net change during the year | 2,951 | (941) | 2,010 |
| Net gains and losses on derivative instruments: | | | |
| Amount arising during the year | 52 | (304) | (252) |
| Reclassification adjustments for gains and losses realized in net income | 4,217 | (1,180) | 3,037 |
| Net change during the year | 4,269 | (1,484) | 2,785 |
| Pension liability adjustments: | | | |
| Amount arising during the year | (13,166) | 5,294 | (7,872) |
| Reclassification adjustments for gains and losses realized in net income | 1,504 | (175) | 1,329 |
| Net change during the year | (11,662) | 5,119 | (6,543) |
| Other comprehensive income (loss) | (60,496) | 3,244 | (57,252) |

15. Stock-Based Compensation

On May 1, 2011, based on the approval of the shareholders, 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 exercisable period. The grant-date fair value per share of the stock options granted during the year ended December 31, 2011 was ¥772.

On May 1, 2010, based on the approval of the shareholders, 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 exercisable period. The grant-date fair value per share of the stock options granted during the year ended December 31, 2010 was ¥988.

The compensation cost recognized for these stock options for the years ended December 31, 2017, 2016 and 2015 was nil.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Stock-Based Compensation (continued)

A summary of option activity under the stock option plans as of and for the years ended December 31, 2017, 2016 and 2015 is presented below:

| | Shares | Weighted-average exercise price (Yen) | Weighted-average remaining contractual term (Year) | Aggregate intrinsic value (Millions of yen) |
|----------------------------------|------------------|---|--|---|
| Outstanding at January 1, 2015 | 1,861,800 | 4,036 | 0.7 | 248 |
| Exercised | (249,600) | 3,311 | | |
| Forfeited/Expired | (316,200) | 3,678 | | |
| Outstanding at December 31, 2015 | 1,296,000 | 4,263 | 0.4 | |
| Exercised | | | | |
| Forfeited/Expired | (693,000) | 4,500 | | |
| Outstanding at December 31, 2016 | 603,000 | 3,990 | 0.2 | |
| Exercised | | | | |
| Forfeited/Expired | (603,000) | 3,990 | | |

Outstanding at December 31, 2017

Exercisable at December 31, 2017

Cash received from the exercise of stock options for the years ended December 31, 2017 and 2016 were nil, and 2015 was ¥826 million, respectively.

16. Net Income Attributable to Canon Inc. Shareholders per Share

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

| | 2017 | Years ended December 31 2016 (Millions of yen) | 2015 |
|---------------------------------------|----------------------|--|---------------|
| Net income attributable to Canon Inc. | 241,923 | 150,650 | 220,209 |
| | | (Number of shares) | |
| Average common shares outstanding | 1,085,439,370 | 1,092,070,680 | 1,092,017,955 |
| Effect of dilutive securities: | | | |
| Stock options | | | 34,931 |

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| | | | |
|-----------------------------------|----------------------|---------------|---------------|
| Diluted common shares outstanding | 1,085,439,370 | 1,092,070,680 | 1,092,052,886 |
|-----------------------------------|----------------------|---------------|---------------|

(Yen)

| | | | |
|---|---------------|--------|--------|
| Net income attributable to Canon Inc. shareholders per share: | | | |
| Basic | 222.88 | 137.95 | 201.65 |
| Diluted | 222.88 | 137.95 | 201.65 |

The computation of diluted net income attributable to Canon Inc. shareholders per share for the years ended December 31, 2017 and 2016 excludes outstanding stock options because the effect would be anti-dilutive. The computation of diluted net income attributable to Canon Inc. shareholders per share for the year ended December 31, 2015 excludes certain outstanding stock options because the effect would be anti-dilutive.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. 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, 2017 and 2016 are set forth below:

| | December 31 | |
|----------------------------|-------------------|---------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| To sell foreign currencies | 272,563 | 371,644 |
| To buy foreign currencies | 46,168 | 46,741 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Derivatives and Hedging Activities (continued)*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, 2017 and 2016.

Derivatives designated as hedging instruments

| | Balance sheet location | Fair value December 31 | |
|----------------------------|---|---------------------------|-------|
| | | 2017 | 2016 |
| Assets: | | | |
| Foreign exchange contracts | Prepaid expenses and other current assets | 255 | 19 |
| Liabilities: | | | |
| Foreign exchange contracts | Other current liabilities | 367 | 1,913 |

Derivatives not designated as hedging instruments

| | Balance sheet location | Fair value December 31 | |
|----------------------------|---|---------------------------|-------|
| | | 2017 | 2016 |
| Assets: | | | |
| Foreign exchange contracts | Prepaid expenses and other current assets | 289 | 567 |
| Liabilities: | | | |
| Foreign exchange contracts | Other current liabilities | 2,892 | 7,479 |

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, 2017, 2016 and 2015.

Derivatives in cash flow hedging relationships

| Gain (loss) recognized in OCI (effective portion) Amount | Years ended December 31 | | | |
|---|---|-----------------------------|---|--------|
| | Gain (loss) reclassified from accumulated OCI into income (effective portion) | | Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing) | |
| | Location | Amount (Millions of yen) | Location | Amount |

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| | | | | | |
|----------------------------|---------|------------|---------|------------|-------|
| 2017: | | | | | |
| Foreign exchange contracts | (2,080) | Other, net | (5,772) | Other, net | (332) |
| 2016: | | | | | |
| Foreign exchange contracts | 1,619 | Other, net | 5,890 | Other, net | (311) |
| 2015: | | | | | |
| Foreign exchange contracts | 52 | Other, net | (4,217) | Other, net | (131) |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Derivatives and Hedging Activities (continued)*Effect of derivative instruments in the consolidated statements of income (continued)*Derivatives not designated as hedging instruments

| | Location | Gain (loss) recognized in income on derivative Years ended December 31 | | |
|----------------------------|------------|---|-------------------|-------|
| | | 2017 | 2016 | 2015 |
| | | | (Millions of yen) | |
| Foreign exchange contracts | Other, net | (7,932) | 7,018 | 1,099 |

18. Commitments and Contingent Liabilities*Commitments*

At December 31, 2017, commitments outstanding for the purchase of property, plant and equipment approximated ¥36,199 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥135,649 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥13,740 million and ¥13,128 million at December 31, 2017 and 2016, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses of cancelable and noncancelable operating leases amounted to ¥47,619 million, ¥42,714 million and ¥46,483 million for the years ended December 31, 2017, 2016 and 2015, 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, 2017 are as follows:

| | (Millions of yen) |
|-------------------------------------|-------------------|
| Year ending December 31: | |
| 2018 | 28,414 |
| 2019 | 21,437 |
| 2020 | 16,185 |
| 2021 | 12,721 |
| 2022 | 9,774 |
| Thereafter | 22,971 |
| Total future minimum lease payments | 111,502 |

Guarantees

Canon provides guarantees for its employees, affiliates and other companies. The guarantees for the employees are principally made for their housing loans. The guarantees for affiliates and other companies are made for their lease obligations and bank loans to ensure that those

companies operate with less financial risk.

Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract terms. The contract terms are 1 year to 30 years in case of employees with housing loans, and 1 year to 7 years in case of affiliates and other companies with lease obligations and bank loans. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥6,059 million at December 31, 2017. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2017 were not significant.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

18. Commitments and Contingent Liabilities (continued)*Guarantees (continued)*

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 costs for the years ended December 31, 2017 and 2016 are summarized as follows:

| | Years ended December 31 | |
|------------------------------|----------------------------|----------|
| | 2017 | 2016 |
| | (Millions of yen) | |
| Balance at beginning of year | 13,168 | 14,014 |
| Additions | 18,893 | 15,403 |
| Utilization | (12,957) | (12,759) |
| Other | (1,652) | (3,490) |
| Balance at end of year | 17,452 | 13,168 |

Legal proceedings

Canon is involved in various claims and legal actions 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 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.

19. 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, 2017 and 2016 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 and derivative instruments which are disclosed in Note 2 and Note 17, respectively.

| | December 31 | | | |
|--|--------------------|-------------------------|--------------------|-------------------------|
| | 2017 | | 2016 | |
| | Carrying amount | Estimated fair value | Carrying amount | Estimated fair value |
| | (Millions of yen) | | | |

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| | | | | |
|--|-----------|-----------|-----------|-----------|
| Long-term debt, including current installments | (499,168) | (499,126) | (612,538) | (612,668) |
|--|-----------|-----------|-----------|-----------|

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

Long-term debt

Canon's long-term debt instruments are classified as Level 2 instruments and valued 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. The levels are more fully described in Note 20.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

19. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk (continued)

Fair value of financial instruments (continued)

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, 2017 and 2016, one customer accounted for approximately 8% and 12% 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.

20. 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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

20. Fair Value Measurements (continued)*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, 2017 and 2016.

| | Level 1 | December 31, 2017 Level 2 Level 3 (Millions of yen) | | Total |
|----------------------------------|---------------|--|--|---------------|
| Assets: | | | | |
| Cash and cash equivalents | | 70,500 | | 70,500 |
| Available-for-sale (current): | | | | |
| Corporate bonds | 1,222 | | | 1,222 |
| Available-for-sale (noncurrent): | | | | |
| Government bonds | 289 | | | 289 |
| Corporate bonds | 605 | 217 | | 822 |
| Fund trusts | 13 | 111 | | 124 |
| Equity securities | 20,901 | | | 20,901 |
| Derivatives | | 544 | | 544 |
| Total assets | 23,030 | 71,372 | | 94,402 |
| Liabilities: | | | | |
| Derivatives | | 3,259 | | 3,259 |
| Total liabilities | | 3,259 | | 3,259 |

| | Level 1 | December 31, 2016 Level 2 Level 3 (Millions of yen) | | Total |
|----------------------------------|---------------|--|--|---------------|
| Assets: | | | | |
| Cash and cash equivalents | | 30,500 | | 30,500 |
| Available-for-sale (noncurrent): | | | | |
| Government bonds | 269 | | | 269 |
| Corporate bonds | | 229 | | 229 |
| Fund trusts | 12 | 74 | | 86 |
| Equity securities | 42,444 | | | 42,444 |
| Derivatives | | 586 | | 586 |
| Total assets | 42,725 | 31,389 | | 74,114 |
| Liabilities: | | | | |
| Derivatives | | 9,392 | | 9,392 |

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| | | |
|-------------------|-------|-------|
| Total liabilities | 9,392 | 9,392 |
|-------------------|-------|-------|

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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

20. Fair Value Measurements (continued)*Assets and liabilities measured at fair value on a recurring basis (continued)*

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.

Assets and liabilities measured at fair value on a nonrecurring basis

The following table presents the Canon's asset that was measured at fair value on a nonrecurring basis consistent with the fair value hierarchy and related impairment charge recognized during the year ended December 31, 2017. There were no assets or liabilities to be measured at fair value on a nonrecurring basis during the year ended December 31, 2016.

| | Year ended December 31, 2017 | | | | Total |
|----------|------------------------------|---------|---------|---------|--------|
| | Total loss | Level 1 | Level 2 | Level 3 | |
| | Fair value | | | | |
| | (Millions of yen) | | | | |
| Asset: | | | | | |
| Goodwill | (33,912) | | | 29,370 | 29,370 |

Goodwill was classified as Level 3 items and valued based on an income approach using unobservable inputs. Canon performed the annual goodwill impairment test as of October 1, 2017, which indicated that the fair value of the reporting unit was less than its carrying value. Canon recognized the impairment charge for the amount representing the excess of the carrying amount over the reporting unit's fair value. The fair value for the reporting unit was measured based on the discounted cash flow method with 6.0% of weighted average cost of capital and estimated future cash flows. Future cash flows are based on management's estimates of projected revenues, gross profits, operating expenses, a long-term growth rate, taking into consideration industry trends and market conditions.

21. Segment Information

Canon operates its business in four segments: the Office Business Unit, the Imaging System Business Unit, the Medical System 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.

Based on the realignment of Canon's internal reporting and management structure, Canon newly established Medical System Business Unit effective at the beginning of the second quarter of 2017, and certain businesses included in Industry and Others Business Unit have been reclassified. Operating results for the year ended December 31, 2017 have been reclassified and for the years ended December 31, 2016 and 2015 were not restated since they were not material. Total assets for the year ended December 31, 2016 have been restated and for the year ended December 31, 2015 were not restated since they were not material.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

21. Segment Information (continued)

The primary products included in each segment are as follows:

| | |
|------------------------------------|--|
| Office Business Unit: | Office multifunction devices (MFDs) / Laser multifunction printers (MFPs) / Laser printers / Digital production printing systems / High speed continuous feed printers / Wide-format printers / Document solutions |
| Imaging System Business Unit: | Interchangeable-lens digital cameras / Digital compact cameras / Digital camcorders / Digital cinema cameras / Interchangeable lenses / Compact photo printers / Inkjet printers / Large format inkjet printers / Commercial photo printers / Image scanners / Multimedia projectors / Broadcast equipment / Calculators |
| Medical System Business Unit: | Digital radiography systems / Diagnostic X-ray systems / Computed tomography / Magnetic resonance imaging / Diagnostic ultrasound systems / Clinical chemistry analyzers / Ophthalmic equipment |
| Industry and Others Business Unit: | Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders / Micromotors / Network cameras / 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.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

21. Segment Information (continued)

Information about operating results and assets for each segment as of and for the years ended December 31, 2017, 2016 and 2015 is as follows:

| | Office | Imaging System | Medical System | Industry and Others | Corporate and eliminations | Consolidated |
|-------------------------------|-------------------|----------------|----------------|---------------------|----------------------------|--------------|
| | (Millions of yen) | | | | | |
| 2017: | | | | | | |
| Net sales: | | | | | | |
| External customers | 1,863,688 | 1,135,584 | 434,985 | 645,758 | | 4,080,015 |
| Intersegment | 2,240 | 604 | 1,202 | 85,946 | (89,992) | |
| Total | 1,865,928 | 1,136,188 | 436,187 | 731,704 | (89,992) | 4,080,015 |
| Operating cost and expenses | 1,685,280 | 960,275 | 413,682 | 674,916 | 14,383 | 3,748,536 |
| Operating profit | 180,648 | 175,913 | 22,505 | 56,788 | (104,375) | 331,479 |
| Total assets | 962,006 | 387,088 | 238,824 | 360,271 | 3,250,102 | 5,198,291 |
| Depreciation and amortization | 74,377 | 41,695 | 5,212 | 37,705 | 102,892 | 261,881 |
| Impairment losses on goodwill | 33,912 | | | | | 33,912 |
| Capital expenditures | 47,653 | 28,508 | 8,963 | 15,736 | 80,529 | 181,389 |
| 2016: | | | | | | |
| Net sales: | | | | | | |
| External customers | 1,804,862 | 1,094,291 | | 502,334 | | 3,401,487 |
| Intersegment | 2,957 | 998 | | 82,326 | (86,281) | |
| Total | 1,807,819 | 1,095,289 | | 584,660 | (86,281) | 3,401,487 |
| Operating cost and expenses | 1,638,333 | 950,876 | | 577,212 | 6,200 | 3,172,621 |
| Operating profit | 169,486 | 144,413 | | 7,448 | (92,481) | 228,866 |
| Total assets | 961,749 | 391,661 | 204,755 | 340,455 | 3,239,909 | 5,138,529 |
| Depreciation and amortization | 78,319 | 47,386 | | 41,053 | 83,338 | 250,096 |
| Capital expenditures | 72,189 | 25,564 | | 29,346 | 81,280 | 208,379 |
| 2015: | | | | | | |
| Net sales: | | | | | | |
| External customers | 2,108,246 | 1,262,667 | | 429,358 | | 3,800,271 |
| Intersegment | 2,570 | 1,168 | | 95,293 | (99,031) | |
| Total | 2,110,816 | 1,263,835 | | 524,651 | (99,031) | 3,800,271 |
| Operating cost and expenses | 1,820,230 | 1,080,396 | | 537,730 | 6,705 | 3,445,061 |
| Operating profit | 290,586 | 183,439 | | (13,079) | (105,736) | 355,210 |

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| | | | | | |
|-------------------------------|-----------|---------|---------|-----------|-----------|
| Total assets | 1,020,758 | 452,283 | 332,252 | 2,622,480 | 4,427,773 |
| Depreciation and amortization | 86,206 | 52,070 | 45,064 | 89,987 | 273,327 |
| Capital expenditures | 73,819 | 38,337 | 24,241 | 106,733 | 243,130 |

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. Amortization costs of identified intangible assets resulting from the purchase price allocation of TMSC are also included in corporate expenses. Segment assets are based on those directly associated with each segment. Corporate assets primarily consist of

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

21. Segment Information (continued)

cash and cash equivalents, investments, deferred tax assets, goodwill, identified intangible assets from acquisitions and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis.

Information about product sales to external customers by business unit for the years ended December 31, 2017, 2016 and 2015 is as follows:

| | Years ended December 31 | | |
|-----------------------|-------------------------|-----------|-----------|
| | 2017 | 2016 | 2015 |
| | (Millions of yen) | | |
| Office | | | |
| Monochrome copiers | 287,823 | 289,532 | 328,061 |
| Color copiers | 405,576 | 386,193 | 421,209 |
| Printers | 702,491 | 664,846 | 857,369 |
| Others | 467,798 | 464,291 | 501,607 |
| Total | 1,863,688 | 1,804,862 | 2,108,246 |
| Imaging System | | | |
| Cameras | 702,598 | 666,868 | 782,623 |
| Inkjet printers | 333,721 | 329,066 | 362,663 |
| Others | 99,265 | 98,357 | 117,381 |
| Total | 1,135,584 | 1,094,291 | 1,262,667 |
| Medical System | | | |
| Diagnostic equipment | 434,985 | | |
| Industry and Others | | | |
| Lithography equipment | 193,113 | 121,090 | 123,887 |
| Others | 452,645 | 381,244 | 305,471 |
| Total | 645,758 | 502,334 | 429,358 |
| Consolidated | 4,080,015 | 3,401,487 | 3,800,271 |

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

21. Segment Information (continued)

Information by major geographic area as of and for the years ended December 31, 2017, 2016 and 2015 is as follows:

| | 2017 | 2016 | 2015 |
|--------------------|-------------------|-----------|-----------|
| | (Millions of yen) | | |
| Net sales: | | | |
| Japan | 884,828 | 706,979 | 714,280 |
| Americas | 1,107,515 | 963,544 | 1,144,422 |
| Europe | 1,028,415 | 913,523 | 1,074,366 |
| Asia and Oceania | 1,059,257 | 817,441 | 867,203 |
| Total | 4,080,015 | 3,401,487 | 3,800,271 |
| Long-lived assets: | | | |
| Japan | 1,081,522 | 1,163,374 | 937,716 |
| Americas | 141,937 | 147,129 | 150,105 |
| Europe | 174,889 | 166,734 | 183,451 |
| Asia and Oceania | 149,244 | 164,007 | 189,588 |
| Total | 1,547,592 | 1,641,244 | 1,460,860 |

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 were ¥1,022,305 million, ¥884,083 million and ¥1,047,838 million for the years ended December 31, 2017, 2016 and 2015, respectively.

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

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Canon Inc. and Subsidiaries

Schedule II Valuation and Qualifying Accounts

| | Balance at beginning of period | Addition- charged to income | Deduction bad debts written off (Millions of yen) | Translation adjustments and other | Balance at end of period |
|------------------------------------|---|-----------------------------------|--|---|--------------------------------|
| Year ended December 31, 2017: | | | | | |
| Allowance for doubtful receivables | | | | | |
| Trade receivables | 11,075 | 3,574 | (1,787) | 516 | 13,378 |
| Finance receivables | 2,325 | 1,436 | (1,523) | 443 | 2,681 |
| Year ended December 31, 2016: | | | | | |
| Allowance for doubtful receivables | | | | | |
| Trade receivables | 12,077 | 1,460 | (1,824) | (638) | 11,075 |
| Finance receivables | 2,878 | 398 | (978) | 27 | 2,325 |
| Year ended December 31, 2015: | | | | | |
| Allowance for doubtful receivables | | | | | |
| Trade receivables | 12,122 | 2,180 | (1,745) | (480) | 12,077 |
| Finance receivables | 6,276 | 55 | (1,343) | (2,110) | 2,878 |

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Item 19. Exhibits

List of exhibits

- 1.1 Articles of Incorporation of Canon Inc. (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 001-15122) filed on March 30, 2016
- 1.2 Regulations of the Board of Directors of Canon Inc. (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 001-15122) filed on March 30, 2016
- 2 Regulations for Handling of Shares of Canon Inc. (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 001-15122) filed on March 27, 2009
- 8 List of Significant Subsidiaries (See Organizational Structure in Item 4.C. of this Form 20-F)
- 11.1 Canon Group Code of Conduct (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 001-15122) filed on March 28, 2013
- 11.2 Code of Ethics (Supplement to The Canon Group Code of Conduct) (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 001-15122) filed on June 10, 2004
- 12 Certifications of Chairman and CEO and Executive Vice President and CFO pursuant to Section 302 of the Sarbanes-Oxley Act
- 13 Certification of Chairman and CEO and Executive Vice President and CFO pursuant to Section 906 of the Sarbanes-Oxley Act
- 101 INSTANCE DOCUMENT
- 101 SCHEMA DOCUMENT
- 101 CALCULATION LINKBASE DOCUMENT
- 101 LABELS LINKBASE DOCUMENT
- 101 PRESENTATION LINKBASE DOCUMENT
- 101 DEFINITION LINKBASE DOCUMENT

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SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, as amended, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANON INC.
(Registrant)

/s/ Toshizo Tanaka
Toshizo Tanaka
Executive Vice President & CFO

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

Date March 29, 2018