

CANON INC
Form 20-F
March 30, 2010

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

FORM 20-F

- o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
- OR
- o ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

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

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

(Name, Telephone, Facsimile number and Address of Company Contact Person)
Securities registered or to be registered pursuant to Section 12(b) of the Act.

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

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

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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, 2009, 1,234,475,463 shares of common stock, including 50,443,092
ADSs, were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

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, 2009 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 19, 2010, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥90.50 = U.S.\$1.

The Company's fiscal year end is December 31. In this Annual Report fiscal 2009 refers to the Company's fiscal year ended December 31, 2009, and other fiscal years of the Company are referred to in a corresponding manner.

FORWARD-LOOKING INFORMATION

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

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:	2009 *4	2008 *4	2007 *4	2006	2005
	(Millions of yen, except average number of shares and per share data)				
Net sales	¥ 3,209,201	¥ 4,094,161	¥ 4,481,346	¥ 4,156,759	¥ 3,754,191
Operating profit	217,055	496,074	756,673	707,033	583,043
Net income attributable to Canon Inc.	131,647	309,148	488,332	455,325	384,096
Advertising expenses	78,009	112,810	132,429	116,809	106,250
Research and development expenses	304,600	374,025	368,261	308,307	286,476
Depreciation of property, plant and equipment	277,399	304,622	309,815	235,804	205,727
Increase in property, plant and equipment	216,128	361,988	428,549	379,657	383,784
Long-term debt, excluding current installments	4,912	8,423	8,680	15,789	27,082
Common stock	174,762	174,762	174,698	174,603	174,438
Canon Inc. stockholders' equity	2,688,109	2,659,792	2,922,336	2,986,606	2,604,682
Total assets	3,847,557	3,969,934	4,512,625	4,521,915	4,043,553
Average number of common shares in thousands *2	1,234,482	1,255,626	1,293,296	1,331,542	1,330,761
Per share data *2:					
Net income attributable to Canon Inc. stockholders per share:					
Basic	¥ 106.64	¥ 246.21	¥ 377.59	¥ 341.95	¥ 288.63
Diluted	106.64	246.20	377.53	341.84	288.36
Cash dividends declared	110.00	110.00	110.00	83.33	66.67
Cash dividends declared (U.S.\$)*3	\$ 1.196	\$ 1.073	\$ 1.034	\$ 0.709	\$ 0.580

Notes:

1. The above financial data is prepared in accordance with U.S. generally accepted accounting principles.
2. The Company made a three-for-two stock split on July 1, 2006. The average number of common shares and the per share data for the periods prior to the stock split have been adjusted to reflect the stock split.
3. 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.
4. Effective April 1, 2007, the Company and its domestic subsidiaries elected to change the declining-balance method of depreciating machinery and equipment from the fixed-percentage-on-declining base application to the 250% declining-balance application.

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 19, 2010, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥90.50 = U.S.\$1.

Yen exchange rates per U.S. dollar:	Average	Term end	High	Low
2005	110.74	117.88	120.93	102.26
2006	115.99	119.02	119.81	110.07
2007	117.45	111.71	124.09	108.17
2008	102.85	90.79	110.48	87.84
2009 -Year	93.67	93.08	100.71	86.12
- 1(st) half		96.42	100.71	87.80
- July		94.54	96.41	92.33
- August		92.82	97.65	92.82
- September		89.49	93.09	89.34
- October		90.50	92.04	88.44
- November		86.12	90.96	86.12
- December		93.08	93.08	86.62
2010 - January		90.38	93.31	89.41
- February		88.84	91.94	88.84

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

B. Capitalization and indebtedness

Not applicable.

C. Reasons for the offer and use of proceeds

Not applicable.

D. Risk Factors

Canon is one of the world's leading manufacturers of plain paper copying machines, digital multifunction devices, laser printers, inkjet printers, cameras, steppers and aligners.

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 exposed to a variety of risks and uncertainties in carrying out its businesses, including, but not limited to, the following:

Risks Related to Canon's Industries

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

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 drive products under development by Canon to become uncompetitive. For the several years, Canon has increased 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, 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 process and in-house production of key devices. If Canon cannot effectively implement these techniques, it may fail to realize cost advantages or product differentiation, and consequently lose business opportunities, which may adversely affect Canon's operating results. While differentiation in technology and product development is an important part of Canon's strategy, Canon must also accurately assess the demand for and commercial acceptance of new technologies and products that it develops. If Canon pursues technologies or develops

products that are not well received by the market, its operating results could be adversely affected.

Canon seeks to enter into new business areas through the development of next-generation technologies as a focal point of Canon's corporate strategies. 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 risks were to occur, Canon's operating results may be adversely affected.

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

Many of the businesses in which Canon competes are characterized by rapid technological advances in hardware performance, software functionality and product features; frequent introduction of new products; short product life cycles, and continued qualitative improvements to current products at stable price levels. If Canon does not make an effective transition from existing products and services to new offerings, its revenue and profits may decline. Among the risks associated with the introduction of new products and services are delays in development or manufacturing, low marketability due to poor product quality, variations in manufacturing costs, delays of customer purchasing decisions in anticipation of further introductions, uncertainty in predicting customer demand for new offerings and difficulty in effectively managing inventory levels in line with anticipated demand. Moreover, if technologically innovative information systems and networks are developed beyond Canon's expectations and its actions result in a delay, Canon's revenue may be substantially impacted as a result of delays associated with the incorporation of such new information technology into existing products and services as well as new offerings.

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

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

With respect to the market of compact digital cameras, the downward price trend mainly triggered by fierce competition is likely to continue, resulting in a more severe market environment. If the market develops beyond Canon's expectations, such as via the entry of a new competitor that launches relatively lower-priced compact digital cameras, it may not be able to maintain its position as an industry leader in this business category.

As for the market for digital single-lens-reflex (SLR) cameras, one of Canon's competitors recently announced a new product standard and released new, more compact models. If the market develops beyond Canon's expectation, such as via the widespread adoption of this new standard or the development of new products by other competitors, Canon may not be able to maintain its position as an industry leader in this business category.

Furthermore, Canon's success in this increasingly competitive environment will depend on its investments in research and development, its ability to cut costs and its continued commitment to providing the market with attractive products offering high added value. If Canon is unable to remain innovative while reducing costs, it may lose market share and its results of operations may be adversely affected.

Increased diversification of recording media and products with movie-recording functionality may adversely affect Canon's video camcorder business.

The video camcorder market is now almost entirely based on digital formats, and the increase in High Definition (HD) television broadcasts has led to a gradual shift from the Standard Definition format to the HD format. At the same time, many products using new media formats such as MiniDV tapes, Digital Versatile Drive (DVD), Hard Disk Drive (HDD) and Secure Digital (SD) cards, have appeared at a rate that outpaces the proliferation of HD technology. Failure by Canon to accurately forecast demand in these increasingly diversified markets could have an adverse effect on Canon's operating results.

Apart from the current video cameras that enable recording movies using the HD format, new products of digital SLR cameras and compact digital cameras with the same functionality have been launched in the market. In addition, other products such as WebCams, which are competitively priced compared to digital video cameras, are recording solid growth in sales volume mainly in North America. If the market share of these new products increases and for instance, induces a contraction of the video camera market, it may have an adverse effect on Canon's business and operating results.

Because the semiconductor industry is highly cyclical, Canon may be adversely affected by any downturn in the industry.

The semiconductor industry is characterized by business cycles, the timing, length and volatility of which are difficult to predict. Recurring periods of oversupply of integrated circuits have at times led to significantly reduced demand for capital equipment, including the steppers and aligners Canon produces. Despite this cyclicity, Canon must maintain significant levels of research and development expenditures in order to maintain its competitiveness. A future cyclical downturn in the semiconductor industry and related fluctuations in the demand for capital equipment, particularly by memory manufacturers, could cause cash flow from sales to fall below the level necessary to offset Canon's expenditures, including those arising from research and development, and could consequently have a material adverse effect on Canon's operating results and financial condition. In addition, liquid crystal display (LCD) panel manufacturers are facing demands for severe price reductions of LCD panels, as a result of intense competition among makers of LCD televisions and LCD monitors used in personal computers. As a result, panel manufacturers may reduce their investment in equipment, which may adversely affect Canon's business operations.

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

Many device manufacturers have changed their business models to focus on the design of semiconductors, while consigning the production of semiconductors to lower-cost foundries. It is difficult for Canon to accurately predict the future effects of these trends on its business. However, as research and development, manufacturing and sales activities become increasingly globalized in response to these trends, shifting particularly to emerging markets, unexpected global developments, such as adverse regulatory or legal changes, and unanticipated events, such as natural disasters, may adversely affect Canon's business operations.

In addition, an oligopoly is developing in the large-sized LCD panel production industry. Therefore, if Canon is insufficiently responsive to market trends, including market reorganization led by LCD panel manufacturers, Canon may not be able to maintain its customer base, which may have a material adverse effect on Canon's business operations.

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

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

Risks Related to Canon's Business

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

The global economy has been experiencing an unprecedented economic crisis but recently there have been signs of a turnaround. Amid this trend, the prospects of the global economy remain uncertain, including the possibility of deflation in Japan. As a result of the economic downturn, declines in consumption and restrained investment in Canon's major markets, including Japan, the United States, Europe and Asia, have affected and may continue to affect both consumer and corporate sales. Canon's operating results for products such as office and industrial equipment are affected by the financial results of its corporate customers, and deterioration of these financial results has caused and may continue to cause the customers to restrain their capital investments. Demand for Canon's consumer products, such as cameras and inkjet printers, is discretionary. The rise in inventory levels and price declines due to intensifying competition, in addition to the recent decline in the level of consumer spending and corporate investments driven by the economic downturn, could adversely affect Canon's results of operations and financial position.

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

Canon depends on Hewlett-Packard for a significant part of its business. During fiscal 2009, approximately 20% of Canon's net sales were to Hewlett-Packard. As a result, Canon's business and results of operations may be affected by the policies, business and results of operations of Hewlett-Packard. Any decision by Hewlett-Packard management to limit or reduce the scope of its relationship with Canon would adversely affect Canon's business and results of operations.

Canon depends on specific outside suppliers for certain key components.

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

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

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

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

In recent years, Canon has experienced a worldwide increase in the counterfeiting of its products. Such counterfeit products may diminish Canon's brand image, particularly if purchasers of such products are unaware of their counterfeit status and attribute the counterfeit products' poor product quality to Canon. Canon has been taking measures to halt the spread of counterfeit products. However, there can be no assurance that such measures will be successful, and the continued production and sale of such products could adversely affect Canon's brand image as well as its operating results.

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

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

engineering improvements;

economies of scale;

improvements in manufacturing processes;

improved serviceability of products; and

reduced inventories of parts and products.

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

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

Canon generally experiences seasonal trends in the sales of its consumer-oriented products. Canon has little control over the various factors that produce these seasonal trends. Accordingly, it is difficult to predict short-term demand, which as a result, places pressure on Canon's inventory management and logistics systems. If product supply from

Canon exceeds the actual demand, excess inventory will put downward pressure on selling prices and raise inefficiency in cash management, consequently reducing Canon's revenue. Alternatively, if the actual demand exceeds the supply of products from Canon, its ability to fulfill orders may be limited, which could adversely affect net sales and increase the risk of unanticipated variations in its results of operations.

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

Particularly in Europe and the United States, a substantial portion of Canon's market share is concentrated in a relatively small number of large distributors. Canon's product sales to these distributors constitute a significant percentage of its overall sales. As a result, any disruptions in its relationships with these large distributors in specific sales territories could adversely affect Canon's ability to meet its sales targets. Any increase in the concentration of sales to these large distributors could result in a reduction of Canon's pricing power and adversely affect its profits. In addition, the rapid proliferation of Internet-based businesses may render conventional distribution channels obsolete. These and other changes in Canon's sales environment could adversely affect Canon's results of operations.

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

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

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

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

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

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

underdeveloped technological infrastructure, which can affect production or other activities or result in lower customer acceptance of Canon's services;

difficulties in recruiting and retaining qualified personnel;

potentially adverse tax consequences, including transfer pricing issues and increases in corporate tax rates;

longer payment cycles;

political turmoil or unfavorable economic factors; and

unexpected legal or regulatory changes.

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

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

In addition, unexpected changes in the imposition of import taxes by foreign governments could adversely affect Canon's business and results of operations.

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

All of the above factors regarding international operations could have an adverse impact on Canon's business results.

Canon's operating and financing activities expose Canon 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, and its margins have been and may continue to be adversely affected due to the strong yen against foreign currencies. Conversely, a strengthening of foreign currencies against the yen will be generally favorable to Canon's foreign currency sales. Canon's consolidated financial statements are presented in yen. As such, the yen value of Canon's assets and liabilities arising from foreign currency business transactions and the yen value of Canon's foreign currency-denominated equity investments have fluctuated and may continue to fluctuate. These fluctuations may have unpredictable effects on Canon's consolidated financial statements. Moreover, Canon's consolidated financial statements have been and may

continue to be affected by currency translations from the financial statements of Canon's foreign affiliates, which are denominated in various foreign currencies. Furthermore, the values of a number of foreign currencies, such as the U.S. dollar and the euro, used by Canon for its business has become significantly weaker than expected against the yen in the foreign exchange market, which has led and may further lead to negatively affecting Canon's operating results and financial position. Although Canon has been striving to mitigate the effects of foreign currency fluctuations arising from its international business activities, Canon's operating results and financial position could continue to be adversely affected if the current strong yen environment persists. Canon is also exposed to the risk of interest rate fluctuations, which may affect the value of Canon's financial assets and liabilities.

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

Canon depends on efficient logistics services to distribute its products worldwide. Problems with Canon's computerized logistics systems, an outbreak of wars and friction within the 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 due 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 adjusted 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 increasingly higher levels of precision required of semiconductor production equipment such as steppers and mask aligners and the resulting increase in the value and the size of this equipment in recent years have resulted in a concurrent increase in the need for sensitive handling and transportation of these products. Due to their precise nature, even a minor shock to these products during the handling and transportation process could irreparably damage the entire product. If unforeseen accidents during the handling and transportation process render a significant portion of Canon's high-end precision products unmarketable, costs will increase, and Canon may lose sales opportunities and the trust of its customers.

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 results of operations.

Canon is endeavoring to reduce carbon dioxide emissions by increasing its use of railroad and sea transportation to ship its products, combined with the reuse of import container vessels. Failure by Canon to meet its targets may adversely affect Canon's brand, image and its business.

Risks Related to Environmental Issues

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

Canon is subject to certain Japanese and foreign environmental laws and regulations in areas such as energy resource conservation, reduction of hazardous substances, product recycling, clean air, clean water and waste disposal. With respect to energy conservation in particular, Canon's operating results may be adversely affected by future environmental legislation or regulations applied to energy conservation systems and international emissions trading regime, depending on the results in 2013 and onwards of the intergovernmental dialogue on global climate change.

In other cases, such as the Directive establishing a framework for the setting of EcoDesign requirements for Energy-related Products across the European Union, detailed implementation standards responsive to environmental requirements have not yet been determined. Canon intends to comply with such standards beforehand if and when the standards are foreseen. If Canon's current measures are deemed insufficient to satisfy such standards when released, Canon may be required to take further action and incur additional costs to comply with these regulations.

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

Environmental clean-up and remediation costs relating to Canon's properties and associated litigation could decrease Canon's net cash flow, adversely affect its results of operations and impair its financial condition.

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

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

Risks Related to Intellectual Property

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

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

Canon faces the 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 not be successful; and

intellectual property laws may not adequately protect Canon's intellectual property, particularly in certain emerging markets.

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

In addition, Canon may need to litigate in order to enforce its patents, copyrights or other intellectual property rights, to protect its trade secrets, to determine the validity and scope of the proprietary rights of others or to defend

against claims of infringement, which can be expensive and time-consuming. In the event any government agency or third party were adjudicated to have a valid claim against Canon, Canon could be required to:

refrain from selling the relevant product in certain markets;

pay monetary damages;

pursue development of non-infringing technologies, which may not be feasible; or

attempt to acquire licenses to the infringed technology and to make royalty payments, which may not be available on commercially reasonable terms, if at all.

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

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

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

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

Other Risks

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 for Canon's operations. The competition for human resources in the high-tech industries in which Canon operates has intensified in recent years. Moreover, due 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 adversely affect Canon's business and results of operations.

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 is currently undertaking a series of planning exercises in order 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 results of operations.

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, its information systems and its 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, material procurement, manufacturing, logistics, sales and services are located throughout the world and subject to the possibility of disaster, outage or similar disruption as a result of a variety of events, including natural disasters, computer viruses and terrorist attacks. Although Canon is working to establish appropriate backup structures for its facilities and information systems, there can be no assurance that Canon will be able to completely prevent or mitigate the effect of events or developments such as the aforementioned disasters, leakage of harmful substances, shutdowns of information systems, and leakage, falsification, and disappearances of internal databases. Although Canon has implemented backup plans to permit the production of 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 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 be adversely affected.

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

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

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

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

Canon's assets include investments in publicly traded securities. As a result, Canon's operating results and general financial position may be affected by price fluctuations in the stock and bond markets. The current volatility in

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

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

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

Inadvertent disclosure of confidential information regarding new technology, would also have a material adverse effect upon Canon's business.

Item 4. Information on the Company

A. History and development of the Company

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

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

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

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

On September 30, 2005, Canon acquired all of the issued and outstanding shares of ANELVA Corporation, which possessed advanced vacuum technology, and made it into a subsidiary. ANELVA Corporation's corporate name was changed to Canon ANELVA Corporation as of October 1, 2005. By making Canon ANELVA Corporation a subsidiary of the Company, Canon aims to promote in-house manufacturing equipment production. This in-house capacity will help differentiate Canon products from the competition in various business areas, including products manufactured as part of Canon's recently acquired display business.

On October 19, 2005, Canon acquired the shares of NEC Machinery Corporation (listed on the Second Section of the Osaka Securities Exchange Co., Ltd.), which possessed advanced automation technologies, through a tender offer and made it into a subsidiary. NEC Machinery Corporation's corporate name was changed to Canon Machinery Inc. as of December 17, 2005. By making Canon Machinery Inc. a subsidiary of the Company, Canon aims to make further advances in its production reform activities, including the automation of production processes for Canon products.

On December 27, 2006, Canon Electronics Inc. acquired the shares of e-System Corporation (listed on the Hercules Section of the Osaka Securities Exchange) through a third party distribution and made it into a subsidiary. By making e-System Corporation into a subsidiary, Canon aims to strengthen its group's information-related business and develop it into a core business.

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

On December 28, 2007, Canon acquired the shares of Tokki Corporation (listed on the JASDAQ Securities Exchange Inc.) through a tender offer, and made it into a subsidiary. With Tokki Corporation as a subsidiary, Canon aims to accelerate the development of its display business.

On February 27, 2008, Canon entered into a stock purchase agreement with Hitachi, Ltd. (Hitachi) to acquire shares of Hitachi Displays, Ltd. (Hitachi Displays), a wholly-owned subsidiary of Hitachi, with the aim of accelerating ongoing development of organic light-emitting diode (OLED) displays, ensuring stable procurement of LCD panels and facilitating product development. Under the terms of this agreement, Canon acquired a 24.9% stake in Hitachi Displays on March 31, 2008.

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

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

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

In fiscal 2009, 2008, and 2007, Canon's increases in property, plant and equipment were ¥216,128 million, ¥361,988 million and ¥428,549 million, respectively. In fiscal 2009, the increases in property, plant and equipment were mainly used to expand production capabilities in both domestic and overseas regions, and to bolster Canon's production-technology related infrastructure. In addition, Canon has been continually investing in tools and dies for business machines, in which the amount invested is generally the same each year.

For fiscal 2010, Canon projects its increase in property, plant and equipment will be approximately ¥220,000 million, mainly in Japan. This amount is expected to be spent for investments in new production plants and new facilities of Canon. Canon anticipates that the funds needed for this increase will be generated internally through operations.

B. Business overview

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

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. Approximately 78% of consolidated net sales in fiscal 2009 were generated outside Japan; approximately 28% in the Americas, 31% in Europe and 19% in other areas including Asia.

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

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

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

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

Products

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

- Office Business Unit -

Canon manufactures, markets and services a wide range of monochrome network digital MFDs, color network digital MFDs, office copying machines and personal-use copying machines.

The office-use market is subject to rapid change, and customer preferences have been shifting from monochrome to color products and from devices to services. In response to these trends, Canon has launched a new lineup of digital color MFDs offered as the imageRUNNER ADVANCE series. This series performs multiple functions, such as copying, printing, scanning, faxing and data-sharing on the Internet and customer intranets. Canon is also marketing diverse expansion modules, software and business solutions to increase customer value. The MFD development process effectively utilizes a wide range of technologies in the fields of optics, mechatronics, electrophotography, chemistry and image processing. Canon has developed a high-performance image processing chip called Advanced iR Controller and an expandable and functional platform known as Multifunctional Embedded Application Platform (MEAP), which enables easy integration of customers' IT environments with speedy, high-quality image processing. This integration boosts office and print-on-demand productivity and has met with the acclaim of business and professional customers.

In fiscal 2009, sales of copying machines declined due to the lingering economic downturn. Customers experienced difficulties in obtaining credit and businesses exercised stricter control over their capital expenditure and IT investment, leading to delayed purchasing decisions. Sales of monochrome office imaging products and color network digital MFDs have been affected by this economic climate.

Canon launched the imageRUNNER ADVANCE series in fiscal 2009, a new document service platform that blends hardware, software and services for use in advanced modern business environments. It seamlessly bridges the distance between user and multifunction printer to transform business and digital communications. With this new series, Canon expanded its color MFD offerings with products such as the imageRUNNER ADVANCE C9075PRO, imageRUNNER ADVANCE C7065 and imageRUNNER ADVANCE C5051, further expediting the shift from monochrome to color.

In concert with the introduction of the imageRUNNER ADVANCE series, Canon announced the launch of Canon Managed Document Services (Canon MDS), a unified global initiative for outsourced printing and document management services, setting a new standard for delivering managed print services to regional and global customers. The Canon MDS offering leverages innovative technologies and tools that uniquely combine Canon's developed device functions, software solutions and professional service capabilities. With Canon MDS, Canon will help customers improve their office efficiency and reduce total cost of ownership.

In fiscal 2009, Canon announced an expanded alliance with Hewlett-Packard. By improving cooperation between the two companies in terms of product lines and services structure, Canon and Hewlett-Packard will continue to offer unmatched office workflow solutions that are highly responsive to client needs.

Canon offers color network digital MFDs for users ranging from professional graphic designers to business offices. The trend in the printing industry is gradually moving away from long-run printing using expensive machinery to short-run printing-on-demand and variable data printing. Canon's high-end network digital MFDs and color network digital MFDs are available in the print-on-demand market. The imagePRESS 6000/7000 series and the imagePRESS C1+ launched in the market earlier continue to meet with commercial success. Canon has leveraged the strength of the color imagePRESS by designing a new product based on the core architecture of the imagePRESS line to make an entrance into the high-end monochrome market with the introduction of imagePRESS 1135/1125/1110 series.

Canon has a leading market share in monochrome MFDs and copying machines, including machines for personal use.

Developed and fostered by Canon, laser printers are standard output peripherals for offices. Canon's laser printers are relatively small in size and have high-quality printing capabilities attributable to Canon's expertise with the relevant technologies. Canon's adoption of a user-replaceable toner cartridge system containing optical components

makes its laser printers easy to maintain. Most of Canon's laser printer sales are made on an original equipment manufacturer (OEM) basis.

On a global basis, the production and sales of monochrome and color laser printers, mainly low-end products, expanded rapidly and achieved unit growth in excess of 10% in each of 2005, 2006 and 2007. However, unit growth of both monochrome and color laser printers was negative in fiscal 2008 and 2009 due to the economic downturn in Japan and abroad.

Canon continued to strengthen its large format printer portfolio in fiscal 2009 with the release of four new models, in order to establish a strong position in this market. However, due to the effects of the worldwide economic downturn, the market for large format printers has contracted and unit sales of Canon's products have also declined compared to the previous year.

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

Canon manufactures and markets digital cameras and digital video cameras as well as lenses and various other camera accessories.

Due to the economic downturn, the size of the global compact digital camera market is believed to have shrunk by approximately 10% year-on-year in fiscal 2009. Against this background, Canon has continued to maintain its overwhelming position at the top of the industry by bringing fifteen new models to market, including the PowerShot G11 and PowerShot S90, which combine high-ISO sensors with the DIGIC 4 image processor in a dual clear system greatly reducing noise while expanding dynamic range, and the PowerShot SD980 IS DIGITAL ELPH (referred to as the IXY DIGITAL 930 IS in Japan and as the DIGITAL IXUS 200 IS elsewhere), with a touch panel display that allows for simple and intuitive operations.

At the same time, in the SLR market, Canon has included full HD video functions across entire EOS series ever since the release of the 5D Mark II in 2008. The full HD video functions of the EOS series have been highly rated and are considered to be a new standard specification for digital SLR cameras, with well-known movie directors adopting EOS models for use in shooting films.

Canon introduced three new products in fiscal 2009, further strengthening its lineup:

In the entry-level class, Canon released the EOS Rebel T1i (Kiss X3 in Japan and 500D elsewhere) in April, a product that is selling well in all markets. The EOS Rebel T1i features an approximately 15-megapixel APS-C size CMOS sensor and DIGIC 4. Canon also enjoyed strong results with respect to the previously released EOS Rebel XSi (Kiss X2 in Japan and 450D elsewhere) and Rebel XS (Kiss F in Japan and 1000D elsewhere) models as both of which continue to meet with commercial success due to their excellent basic specifications and affordability. The synergistic effect of these entry-level models is contributing to an increase in sales.

In the mid-range product class, Canon released the EOS 7D in September with an approximately 18-megapixel APS-C size CMOS sensor and two high-performance DIGIC 4 image processors. Not only does the EOS 7D offer a high degree of functionality, it was designed considering the importance of user-friendliness and the joy of ownership in mind and has consequently achieved a commensurate reputation. In addition, the EOS 50D and EOS 5D Mark II released in fiscal 2008 also continue to sell well, contributing to Canon's increased share of the mid-range market segment.

Canon released the EOS-1D Mark IV for professionals in December. This model includes a newly developed approximately 16-megapixel APS-H size CMOS sensor and dual DIGIC 4 and features an expanded range of ISO settings for normal use between 100 and 12800, achieving beautiful images with low noise levels throughout the entire ISO range.

Although the market for interchangeable lenses used in SLR cameras grew, the overall market declined during the first half of fiscal 2009 due to the economic downturn starting in the fourth quarter of fiscal 2008. While the market began to recover in the second half of the year, Canon's lens division still experienced a decline in revenue compared with the previous year. Canon introduced a total of five new interchangeable lens models in fiscal 2009 and now offers more than sixty different lenses for the EF series. Canon's technological position (including the development of diffractive optical elements, image stabilizers and ultrasonic motors) has helped Canon to maintain a decisive competitive edge over other manufacturers. These high-performance, high-quality lenses give Canon's digital SLR cameras an excellent image quality, and contribute greatly to Canon's business results. Canon is releasing a variety of interchangeable lenses to satisfy user needs in the digital SLR camera market. This market is expected to grow and Canon aims to continue to improve its lens sales and market share.

In fiscal 2008, Canon introduced a series of flash memory models to the digital video camera market ahead of its competitors. In fiscal 2009, Canon strengthened its lineup by launching a series of flash memory models. The top-of-the-line model, which aims to provide the best image quality in the world using an approximately 8-megapixel sensor, and a core model, which offers full HD, high-quality images in a compact size. These models have contributed to Canon's brand reputation and continue to receive a number of accolades and awards. Despite the current slowdown in the overall digital video camera market, the trends toward HD and flash memory are proceeding steadily, and Canon's product concepts have enjoyed a positive reception worldwide.

In the business LCD projectors category, Canon has been supporting the trend toward brighter and higher resolution images with LCOS panels featuring next-generation display elements and proprietary optical systems, starting with products released in January 2009. Although growth in the high-resolution market has not yet accelerated to the extent predicted, Canon intends to play a trailblazing role in every market segment where the trend is toward ever-higher resolutions, creating markets for displays and preparing for the expected expansion of the high-resolution market.

As the inventor of bubble jet printing technology, Canon believes it continues to provide customers with the best performing inkjet printer models. Canon offers high-performance and high value-added multifunction and single function inkjet printers. In response to intense competition in this segment, Canon launched a new lineup of multifunction printers (MFP) and single function printers in fiscal 2009. The new models span the spectrum from entry-level to professional use and expand Canon's lineup of wireless MFPs. All of these models feature print heads based on Canon Full-photolithography Inkjet Nozzle Engineering (FINE) technology, which boosts print speed and image quality up to 9600 x 2400 dpi, and the ChromaLife100+ system, which provides high quality and long-lasting photo images using a combination of genuine ink and paper. Canon PIXMA photo printers offer many advanced features, including two-way paper feeding, two-sided duplex printing, Easy-Scroll Wheel, Quick Start and Auto-Image Fix feature which makes printer operation much easier. Canon's advanced printer lineup has led to increased unit sales.

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

toward MFPs, Canon has maintained a high market share through continued introduction of new scanner models.

Canon is the global market leader in the market for television lenses used for sports, news events, concerts and studio broadcasts. Canon firmly maintained its position as the leader of the broadcast TV lens market in fiscal 2009, in part by introducing super-wide angle HDTV lenses that are first in their class. In addition, Canon's TV lenses are used in large numbers at major events around the world and continue to deliver thrilling true depictions of events to television viewers. A large number of Canon television lenses were used at the Winter Olympics in Vancouver and will also be used at this year's FIFA World Cup soccer matches in South Africa.

- Industry and Others Business Unit -

The size of the global stepper market has shrunk from approximately six hundred units annually in 2007 to fewer than two hundred units in recent years. These conditions are expected to continue due to drastic changes in the structure of the semiconductor device market. Canon has begun to rationalize its scale and structure in response to the shrinking market, and progress has been made in bringing Canon's production more in line with market trends. Canon has created consistent systems responsible for each stepper model and has integrated production and sales so that customer needs may be quickly incorporated into product development.

Similarly, the global market for mask aligners for LCD panels fell to approximately sixty units in 2009, roughly half the size of the market in 2008. Canon is working to reduce lead times for procurement, production and installation, while bolstering systems that allow for more flexible production. Competition in the LCD production equipment industry has grown fierce. Against this difficult background, Canon has secured profits by winning most of the major deals in South Korea as well as many significant deals in China. Canon has been able to capture a commanding share of the South Korean market with the MPAsp-H700 series of large mask aligners, which supports seventh and eighth generation glass plates. The MPAsp-H700 has helped to improve customer productivity through speedy installation at existing factories. Solid sales of the MPA-7800+, a remodeled version of the fifth generation model have helped Canon to seize a large share of the Chinese market.

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

Other Canon products such as electronic components are sold primarily to equipment manufacturers. These components include magnetic heads for audio and video tape recorders and micro-motors for printers and other components.

Canon also offers business information products, which primarily consist of personal computers, servers, document scanners, calculators and micrographic equipment.

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

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

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

Marketing and distribution

Canon sells its products primarily through subsidiaries organized under regional marketing subsidiaries. These regional marketing subsidiaries are as follows: Canon Marketing Japan Co., 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 Co., Inc., mainly to dealers and retail outlets.

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

In Europe, Canon sells its products primarily through Canon Europa N.V., which sells mainly through subsidiaries or independent distributors to dealers and retail outlets in each locality. In addition, copying machines are sold directly to end-users by several subsidiaries such as Canon (U.K.) 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 by Canon Australia Pty. Ltd. in Australia.

Canon also sells laser printers on an OEM basis to Hewlett-Packard Company. Hewlett-Packard resells these printers under the HP LaserJet Printers' name. During fiscal 2009, such sales constituted approximately 20% of Canon's consolidated net sales, which was approximately the same as the previous fiscal year.

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

Service

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

Most of Canon's business machines carry warranties of varying terms, depending upon the model and country of sale. Cameras and camera accessories carry a limited one-year warranty.

Canon services its copying machines and supplies replacement drums, parts, toner and paper. Most customers enter into a maintenance service contract under which Canon provides maintenance services, replacement drums and parts in return for 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.

Seasonality

Canon's sales for the fourth quarter are typically higher than those in 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 of the respective regions.

Sources of supply

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

Prices of some raw materials fluctuate according to market trends. In fiscal 2009, the market for raw materials was stable due to a decline in crude oil prices beginning in the second half of 2008 and stagnant demand. Although there is a possibility that prices of crude oil and raw materials will gradually increase, Canon believes it will be able to continue procuring sufficient quantities of raw materials to meet its needs.

NET SALES BY SEGMENT

	Years ended December 31				
	2009	change	2008	change	2007
	(Millions of yen, except percentage data)				
Office	¥ 1,645,076	-26.8%	¥ 2,246,609	-9.3%	¥ 2,477,518
Consumer	1,301,160	-10.6	1,456,075	-8.3	1,587,952
Industry and Others	357,998	-31.5	522,405	-5.0	549,983
Eliminations	(95,033)		(130,928)		(134,107)
Total	¥ 3,209,201	-21.6%	¥ 4,094,161	-8.6%	¥ 4,481,346

NET SALES BY GEOGRAPHIC AREA

	Years ended December 31				
	2009	change	2008	change	2007
	(Millions of yen, except percentage data)				
Japan	¥ 702,344	-19.1%	¥ 868,280	-8.4%	¥ 947,587
Americas	894,154	-22.6	1,154,571	-13.6	1,336,168
Europe	995,150	-25.8	1,341,400	-10.5	1,499,286
Other areas	617,553	-15.4	729,910	4.5	698,305
Total	¥ 3,209,201	-21.6%	¥ 4,094,161	-8.6%	¥ 4,481,346

Competition

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

Consumer Business Unit

In addition to the traditional camera manufacturers, electrical appliance manufacturers also started aggressively launching digital SLR products in fiscal 2008. Nevertheless, Canon has continued to invest aggressively in competitive new products and intends to maintain its leadership position in this market. Canon's primary competitors in the SLR camera market are Nikon Corporation, Sony Corporation and Panasonic Corporation.

Canon's primary competitor in the digital SLR interchangeable lens market is Nikon Corporation. Another major competitor is Sigma Corporation, which produces lenses for use with Canon's digital SLR products. The compact digital camera market is extremely competitive due to the large number of companies releasing inexpensive compact digital cameras.

The trend toward a decline in market prices in the compact digital camera market is expected to continue in 2010. Market contraction and exchange rate fluctuations caused by the financial crisis are having a major impact, resulting in a severe profit profile in the digital camera market. Despite these difficulties, Canon will continue to take advantage of its status as the number one brand in the industry, along with its economies of scale, in order to maintain profitability. Canon's primary competitors in the compact digital camera market are Sony Corporation; Nikon Corporation; Panasonic Corporation; Fujifilm Co., Ltd.; Samsung Electronics Co., Ltd.; Olympus Corporation; Hoya Corporation; Eastman Kodak Company; and Casio Computer Co., Ltd.

Canon's primary competitors in the digital video camera market are Sony Corporation, Matsushita Electric Industrial Co.; Ltd., Victor Company of Japan, Ltd.; Sanyo Electric Co., Ltd.; and Samsung Electronics Co., Ltd.

Canon's primary competitors in the inkjet printer market are Hewlett-Packard Company and Seiko Epson Corporation.

Industry and Others Business Unit

Severe competition continues in the markets for steppers and scanners used in the production of semiconductor devices and LCD panels. In order to produce steppers that are capable of ultra-fine processing, integration of advanced optical, control and system technologies is necessary along with continued investment in technological development.

The main competitors in this market are Nikon and ASML Holdings N.V. (only in the market for steppers). Canon has helped its customers hold down equipment investment expense by continuously improving the cost performance of steppers using i-line and KrF laser light sources. In particular, the i-line has captured a large share of the global market. Canon has also been meeting the needs of image sensor manufacturers by quickly adapting to various unique specifications.

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

Patents and licenses

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

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

Companies that Canon has granted licenses to include:

Oki Electric Industry Co., Ltd.	(LED printers, multifunction printers and facsimile machines)
Panasonic Corporation	(electrophotography)
Ricoh Company, Ltd.	(electrophotography)
Sanyo Electric Co., Ltd.	(electronic camera)
Samsung Electronics Co., Ltd.	(laser printers, multifunction printers and facsimile machines)
Kyocera Mita Corporation	(electrophotography)
Konica Minolta Holdings, Inc.	(business machines)
Sharp Corporation	(electrophotography)
Brother Industries, Ltd.	(electrophotography and facsimile machines)

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

Companies that have granted licenses to Canon:

Jerome H. Lemelson Patent Incentives, Inc.	(computer systems, image recording apparatus and communication apparatus)
Energy Conversion Devices, Inc.	(solar battery)
Honeywell International Inc.	(camera and video products)
Gilbert P. Hyatt U.S. Philips Corporation	(microcomputer)
Applied Nanotech Holdings, Inc.	(FED technology)
St. Clair Intellectual Property Consultants, Inc.	(selection of digital camera's image format)

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

Companies that Canon has entered into cross-licensing agreements with:

International Business Machines Corporation	(information handling systems)
Hewlett-Packard Company	(bubble jet printers)
Xerox Corporation	(business machines)
Panasonic Corporation	(video tape recorders and video cameras)
Eastman Kodak Company	(electrophotography and image processing technology)
Ricoh Company, Ltd.	(electrophotography products, facsimile machines and word processors)
Seiko Epson Corporation	(information-related instruments)

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

Environmental regulations

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

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

Calendar year 2009 was the second year of the first commitment period (2008-2012) under the Kyoto Protocol. In order to ensure that Japan achieves the numerical target set by the Kyoto Protocol for the first commitment period (i.e., reduction of total carbon dioxide emissions by an average of 6% from the level in calendar year 1990), the Japanese Government is calling on the manufacturing, transport, services and household sectors to take further action for energy conservation.

The revised Energy Saving Law in Japan (Law Concerning the Rational Use of Energy) and the revised Act on Promotion of Global Warming Countermeasures will take effect wholly in April 2010. These laws require business operators to report their energy consumption and medium-term energy conservation plans in an effort to encourage energy efficiency. The Japanese government is also implementing multi-faceted measures to reduce emissions, including the granting of a domestic credit to any large company that helps small and medium enterprises to conserve energy. This credit is expected to provide substantial incentives, as it will be deemed an emission reduction for participating companies. Trial implementation of an emissions trading scheme was launched in October 2008. Under this scheme, it was confirmed in December 2009 that all of the year 2008 target-setting companies achieved their targets.

Despite the economic downturn, Canon has been working to achieve its voluntary action plan target (which is consistent with the plan of the Electrics and Electronics Industrial Associations) and has been strengthening its group structure to comply with revised environmental laws. Canon has been participating in the trial emissions trading scheme and has been conducting improvements in energy efficiency, to respond rapidly to any future energy conservation requirements. However, these activities could increase Canon's management costs and have adverse effects on its results of operations and financial condition.

2. *Post-Kyoto Initiatives*

In September 2009, the Japanese government announced its conditional commitment to a 25% reduction of CO2 emissions from the calendar year 1990 level by 2020. The announcement was made in the interest of concluding an agreement to establish binding CO2 emission reduction targets at the Fifteenth Conference of the Parties to the United Nations Framework Convention on Climate Change (COP15), which was held in December 2009. The United States, the European Union and China have also indicated their respective targets; however, results of the COP15 negotiations have not been clarified and the agenda has been postponed to a future conference. It remains unclear how a legally binding scheme will be implemented in those countries, including Japan.

Canon continues to pursue CO2 emission reductions through energy efficient product design, logistics and factory operations on the basis of its understanding of the COP15 discussions. However, its efforts could increase Canon's management costs and have adverse effects on its results of operations and financial condition.

3. *Soil Pollution Prevention Law of Japan*

The Soil Pollution Prevention Law of Japan, administered by the Japanese Ministry of the Environment, went into effect in February 2003. The law requires certain landowners to engage certain designated organizations to perform a soil investigation to measure the level of soil pollution when land is transferred or converted to a new use. The results of such investigation are reported to the governor of the prefecture where the land is located. If soil pollution does not fall within legally specified standards, the governor may declare the land to be a designated area, publicly announce such designation and make the investigation report available upon request. The substances designated as pollutants consist of twenty-five chemical groups, including lead, arsenic and trichloro ethylene. If the results of an investigation show that there is a likelihood that the soil of the investigated area may affect human health, the governor may issue an order to the landowner to take remedial actions. Canon has commenced a detailed survey and measurement of soil and groundwater to check for pollution at all of Canon's operational sites in Japan. Additional costs may arise if these investigations determine that remedial measures are necessary. These factors could adversely affect Canon's results of operations and financial condition.

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

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

The Law for Promotion of Effective Utilization of Resources, administered by the Japanese Ministry of Economy, Trade and Industry, was enacted in April 2001 and is currently being reevaluated and may be revised. This law requires manufacturers of specified reuse-promoted products, including copying machines, to promote the use of recyclable resources and recovered products (designing and manufacturing products that may be easily reused or recycled). The coverage and requirements of the law may be expanded to other products such as printers and could adversely affect Canon's results of operations.

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

These two directives were published in *the Official Journal of the European Union* on February 13, 2003. Member states were required to enact laws necessary to comply with these directives by August 13, 2004. From July 1, 2006, companies have been required to ensure that electrical and electronic equipment sold in the European Union does not contain lead, cadmium, hexavalent chromium, mercury, polybrominated biphenyls or polybrominated diphenyl ethers if placed on the market after that date. Pursuant to the RoHS Directive, Canon adapted its products so that they do not contain the prohibited hazardous substances.

The WEEE Directive requires that companies selling electrical and electronic equipment bearing their trade names in the European Union after August 13, 2005 must arrange and pay for the collection, treatment, recycling, recovery and disposal of their equipment. Canon has become a member company of collective compliance schemes in each member state of the European Union and has achieved the required recycling levels for electrical and electronic equipment waste.

The European Union is reviewing both the WEEE and the RoHS directives. After 2010, when tighter restrictions may be enforced, Canon's costs could increase due to a need to develop and adopt substitute materials or processes. Such increased costs may have an adverse effect on its results of operations.

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

On December 30, 2006, the REACH Regulation was published in *the Official Journal of the European Union*, and implemented on June 1, 2007. This regulation covers almost all chemicals (products in gaseous, liquid, paste or powder form) and articles (products in solid state) manufactured in or imported into the European Union.

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

If certain substances are contained in an article, the substances must be communicated to the recipient or consumer of the article. This requirement has been in place since October 2008. Furthermore, starting in 2011, certain cases will require the notification of European Chemical Agency as to more specific information. Canon has been implementing these requirements under the REACH Regulation, which could increase Canon's management costs and have adverse effects on its results of operations and financial condition.

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

The European Union published the EuP Directive on July 22, 2005 (and revised as ErP Directive on November 20, 2009). Member states were required to enact laws necessary to comply with the directive by August 11, 2007 (and November 20, 2010 for ErP). This framework directive applies to all energy-using products, and implementing measures for specific product categories must be adopted by each European Union member state. Until these implementing measures are issued, it is difficult to predict the effects of the ErP Directive. However, Canon expects that the implementing measures for off-mode and standby mode, External supply, Imaging Equipment, Network stand-by and Sound Imaging equipment (including, Beamers) start becoming effective from calendar year 2010 and later (expected until 2012). Canon is continuing its preparations to comply with the ErP Directive, but achieving

compliance is likely to increase Canon's costs.

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

Electrical and electronic equipment recycling laws have been enacted or proposed in more than twenty American states. Most such laws cover only displays or television sets. However, some states, such as Illinois, Michigan and Hawaii, and others, require manufacturers to bear the costs of collection and recycling of printers and other products made by Canon. Canon expects that compliance with such state requirements might increase its costs, such as recycling fees and product guarantees.

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

The Chinese Ministry of Information Industry published Administrative Measures on the Control of Pollution Caused by Electronic Information Products on February 28, 2006. These measures are modeled on the European Union RoHS Directive described above and regulate six substances: lead, mercury, hexavalent chromium, cadmium, polybrominated biphenyls and polybrominated diphenyl ethers in electronic information products. The measures establish two stages of implementation. Stage 1 was implemented for products manufactured on or after March 1, 2007. Almost all Canon products were covered by this regulation.

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

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

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

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

The Regulation for the Management of the Recycling and Disposal of Waste Electrical and Electronic Products was issued by the Chinese government on February 25, 2009. This regulation concerns the management of recycling and disposal activities with regard to waste electrical and electronic products in the interest of promoting comprehensive utilization of resources and the development of a circular economy. Producers and importers will be required to pay a fee to a government fund. This regulation will be implemented on January 1, 2011; however, the list of products falling under the waste electrical and electronic products catalogue has not yet been issued, and the funding scheme remains under review. Four types of household appliances, personal computers and possibly printers have been considered products that may fall under the scope of the regulation.

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

11. Other Environmental Regulations

In addition to those described above, various environmental regulations may have been promulgated or enacted by European Union member states, states of the United States, developing countries or others. Compliance with any such additional regulations may increase Canon's costs and may adversely affect Canon's results of operations and financial condition.

C. Organizational structure

Canon Inc. and its subsidiaries and affiliates form a group of which Canon Inc. is the parent company. As of December 31, 2009, Canon had 241 consolidated subsidiaries and 15 affiliated companies accounted for by the equity method.

The following table lists the significant subsidiaries owned by Canon Inc., all of which are consolidated as of December 31, 2009.

Name of company	Head office location	Proportion of ownership interest owned	Proportion of voting power held
Canon Marketing Japan Inc.	Tokyo, Japan	50.1%	55.2%
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%

D. Property, plants and equipment

Canon's manufacturing is conducted primarily at 25 plants in Japan and 16 plants in other countries. Canon owns all of the buildings and the land on which its plants are located, with the exception of certain 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 at December 31, 2009 are as follows:

Name and location	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Domestic		
Headquarters, Tokyo	2,557	R&D, corporate administration and other functions
Canon Global Management Institute, Tokyo	164	Training & administration
Kawasaki Office, Kanagawa	1,223	R&D and manufacturing of production equipment and molds, R&D in semiconductor devices
Kosugi Office, Kanagawa	395	Development of software for office imaging products
Fuji-Susono Research Park, Shizuoka	1,037	R&D in electrophotographic technologies
Ayase Office, Kanagawa	393	R&D and manufacturing of semiconductor devices
Tamagawa Office, Kanagawa	155	Quality Engineering
Oita Office, Oita	199	Manufacturing of semiconductor devices
Yako Development Center, Kanagawa	903	Development of inkjet printers, inkjet chemical products
Utsunomiya Plant, Tochigi	2,748	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	3,370	R&D in electrophotographic technologies, mass-production trials and support; manufacturing of office imaging products, chemical products; training of manufacturing
Ami Plant, Ibaraki	1,145	Manufacturing of LCD production equipment
Oita Manufacturing Training Center, Oita	75	Training for enhancing practical technologies and skills of production division

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Canon Electronics Inc., Saitama and Gunma	1,269	Components, magnetic heads, document scanners and laser printers
Canon Finetech Inc., Saitama, Ibaraki, and Fukui	967	Large format inkjet printers, business-use printers, business machines peripherals and chemical products
Canon Precision Inc., Aomori	1,634	Toner cartridges, sensors and micromotors
Canon Optron Inc., Ibaraki	142	Optical crystals (for steppers, cameras, telescopes) and vapor deposition materials

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Name and location	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Domestic		
Canon Chemicals Inc., Ibaraki	2,090	Toner cartridges and rubber functional components
Canon Components Inc., Saitama	565	Contact image sensors, inkjet cartridges and medical equipment
Oita Canon Inc., Oita	1,204	Digital cameras, lenses and digital video camcorders
Nagahama Canon Inc., Shiga	1,092	Laser printers, toner cartridges and A-Si drums
Oita Canon Materials Inc., Oita	3,110	Chemical products for copying machines and printers, and inkjet cartridges
Ueno Canon Materials Inc., Mie	638	Chemical products for copying machines and printers
Fukushima Canon Inc., Fukushima	971	Inkjet printers and inkjet cartridges
Canon Semiconductor Equipment Inc., Ibaraki	512	Development and production of semiconductor production-related equipment
Canon Ecology Industry Inc., Ibaraki	448	Recycling of toner cartridges, repair and recycling of business machines
Nisca Corporation, Yamanashi	441	Copying machine peripherals, scanner units and optical equipment
Miyazaki Daishin Canon Inc., Miyazaki	153	Digital cameras
Canon Mold Co., Ltd., Ibaraki	106	Molds
Canon ANELVA Corporation, Kanagawa and Yamanashi	714	Production equipment for electron devices, Flat Panel Display and semiconductors
Canon Machinery Inc., Shiga	615	Automated production equipment and semiconductor production-related equipment
Tokki Corporation, Niigata	192	Vacuum technology-related equipment
SED Inc., Kanagawa	1,074	

Flat-screen SED (Surface-conduction Electron-emitter
Display)
panels
19

Name and location	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
Overseas		
[Europe]		
Canon Giessen GmbH, Giessen, Germany	336	Remanufacturing of copying machines and semiconductor production equipment
Canon Bretagne S.A.S., Liffre, France	506	Manufacturing and recycling of toner cartridges
[Americas]		
Canon Virginia, Inc., Virginia, U.S.	1,676	Toner cartridges, molds and remanufacturing of copying machines
Industrial Resource Technologies, Inc., Virginia, U.S.	185	Recycling of toner cartridges
[Asia]		
Canon Inc., Taiwan, Taiwan	653	Lenses, digital cameras
Canon Opto (Malaysia) Sdn. Bhd., Selangor, Malaysia	584	Digital cameras, lenses and optical lens parts
Canon Dalian Business Machines, Inc., Dalian, China	1,741	Production and recycling of toner cartridges, production of laser printers
Canon Zhuhai, Inc., Zhuhai, China	752	Laser printers, MFPs, digital cameras and contact image sensors
Tianjin Canon Inc., Tianjin, China	148	Copying machines
Canon Hi-Tech Thailand Ltd., Ayutthaya, Thailand	1,700	Inkjet printers, MFPs and scanners
Canon Engineering Thailand Ltd., Ayutthaya, Thailand	129	Molds and plastic injection mold parts
Canon Zhongshan Business Machines Co., Ltd., Zhongshan, China	496	Laser printers

Canon Vietnam Co., Ltd., Hanoi, Vietnam	3,207	Inkjet printers, laser printers, MFPs, scanners and contact image sensors
Canon (Suzhou) Inc., Suzhou, China	1,097	Copying machines
Canon Finetech (Suzhou) Business Machines Inc., Suzhou, China	392	Copying machines
Canon Finetech Nisca (Shenzhen) Inc., Shenzhen, China	600	Copying machines and laser printer peripherals

Canon considers its manufacturing and other facilities to be well maintained and believes that its plant capacity is adequate for its current requirements.

Main facilities under construction for establishment/expansion

Name and location	Principal activities and products manufactured
Domestic	
Canon Inc., Kawasaki Office, Kanagawa	New R&D building
Oita Canon Materials Inc., Oita	New production base* (Office business unit) *To be leased to Oita Canon Materials Inc. by the Company
Canon Inc., Toride Plant, Ibaraki	New production base (Office business unit)
Nagasaki Canon Inc., Nagasaki	New administration and welfare Building* / New production base* (Consumer business unit) *To be leased to Nagasaki Canon Inc. by the Company
Canon Chemicals Inc., Ibaraki	New production base* (Office business unit) *To be leased to Canon Chemicals Inc. by the Company

Item 4A. Unresolved Staff Comments

Not applicable.

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 copying machines, laser printers, inkjet printers, cameras, steppers and aligners. Canon earns revenues primarily from the manufacture and sale of these products domestically and internationally. Canon's basic management policy is to contribute to the prosperity and well-being of the world while endeavoring to become a truly excellent global corporate group targeting continued growth and development.

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

Economic environment

Looking back at the global economy in fiscal 2009, although the year began amid an unprecedentedly harsh business climate, economic stimulus measures implemented by different countries have started to yield results, leading to moderate recoveries as the second half of the year approached. Although countries such as China and India, whose economies have rapidly grown in prominence, maintained their stable growth largely owing to increased consumer spending, developed countries such as Japan, the United States and European nations all recorded negative growth for the first time since the end of World War II, leading to negative growth overall around the globe.

Market environment

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

Summary of operations

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

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

	2009	2008	2007	2006	2005
Net sales (Millions of yen)	¥3,209,201	¥4,094,161	¥4,481,346	¥4,156,759	¥3,754,191
Gross profit to net sales ratio	44.5%	47.3%	50.1%	49.6%	48.5%
R&D expense to net sales ratio	9.5%	9.1%	8.2%	7.4%	7.6%
Operating profit to net sales ratio	6.8%	12.1%	16.9%	17.0%	15.5%
Inventory turnover measured in days	39 days	47 days	44 days	45 days	47 days

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Debt to total assets ratio	0.3%	0.4%	0.6%	0.7%	0.8%
Canon Inc. stockholders' equity to total assets ratio	69.9%	67.0%	64.8%	66.0%	64.4%

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

-Revenues-

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

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

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

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

-Cash flow management-

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

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

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

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

Critical accounting policies and estimates

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

Revenue recognition

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

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

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

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

variable amounts are earned.

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

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

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

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

Allowance for doubtful receivables

Allowance for doubtful receivables is determined using a combination of factors to ensure that Canon's trade and financing receivables are not overstated due to uncollectibility. Canon maintains an allowance for doubtful receivables for all customers based on a variety of factors, including the length of time receivables are past due, trends in the overall weighted average risk rating of the total portfolio, macroeconomic conditions, significant one-time events and historical experience. Also, Canon records specific reserves for individual accounts when Canon becomes aware of a customer's inability to meet its financial obligations to Canon, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted.

Valuation of inventories

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

Impairment of long-lived assets

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

Property, plant and equipment

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

Income taxes

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

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

In preparing its financial statements for fiscal 2009, Canon estimated a weighted-average discount rate of 2.4% for Japanese plans and 5.3% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.7% for Japanese plans and 6.2% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income governmental and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate

of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. A decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately 9%. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For fiscal 2010, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥2,661 million in net periodic benefit cost. Canon multiplies management's expected long-term rate of return on plan assets by the value of its plan assets, to arrive at the expected return on plan assets that is included in pension expense. Canon defers recognition of the difference between this expected return on plan assets and the actual return on plan assets. The net deferral affects future pension expense.

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

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

Consolidated results of operations
Fiscal 2009 compared with fiscal 2008

Summarized results of operations for fiscal 2009 and fiscal 2008 are as follows:

	2009	Change	2008
	(Millions of yen, except per share amounts and percentage data)		
Net sales	¥ 3,209,201	-21.6%	¥ 4,094,161
Operating profit	217,055	-56.2	496,074
Income before income taxes	219,355	-54.4	481,147
Net income attributable to Canon Inc.	131,647	-57.4	309,148
Net income attributable to Canon Inc. stockholders per share:			
Basic	106.64	-56.7	246.21
Diluted	106.64	-56.7	246.20

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

Sales

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

Overseas operations are significant to Canon's operating results and generated approximately 78% of total net sales in fiscal 2009. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen in fiscal 2009 was ¥93.21 to the U.S. dollar, and ¥130.46 to the euro, representing an appreciation of about ¥10 or 10% to the U.S. dollar, and a significant appreciation of approximately ¥21 or 14% against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively impacted net sales by approximately ¥249,500 million in 2009. This unfavorable impact was comprised of approximately ¥116,800 million for U.S. dollar denominated sales, ¥114,800 million for euro denominated sales and ¥17,900 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses along with rent expenses. The ratio of cost of sales to net sales for fiscal 2009 and 2008 was 55.5% and 52.7%, respectively.

Gross profit

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

Operating expenses

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

Operating profit

Operating profit in fiscal 2009 dropped 56.2% to a total of ¥217,055 million from fiscal 2008, recording 6.8% to net sales.

Other income (deductions)

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

Income before income taxes

Income before income taxes in fiscal 2009 was ¥219,355 million, a decline of 54.4% from fiscal 2008, and constituted 6.8% of net sales.

Income taxes

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

Net income attributable to Canon Inc.

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

Segment information

The Company adopted guidance for segment reporting in accordance with U.S. GAAP in the year ending December 31, 2009. See Note 21 of the Notes to Consolidated Financial Statements for further details.

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

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

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

The Industry and Others Business Unit mainly includes semiconductor production equipment, mirror projection mask aligners for LCD panels, medical equipment, components, computer information systems, document scanners and personal information products.

Sales by segment

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

Canon's sales by segment are summarized as follows:

	2009	Change	2008
	(Millions of yen, except percentage data)		
Office	¥ 1,645,076	-26.8%	¥ 2,246,609
Consumer	1,301,160	-10.6	1,456,075
Industry and Others	357,998	-31.5	522,405
Eliminations	(95,033)		(130,928)
Total	¥ 3,209,201	-21.6%	¥ 4,094,161

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

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

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

Intersegment sales of ¥95,033 million, representing 3.0% of total sales, are eliminated from the total sales of the three segments, and are described as Eliminations.

Sales by geographic area

Please refer to the table of sales by geographic area in Note 21 of the Notes to Consolidated Financial Statements. A summary of net sales by geographic area in fiscal 2009 and fiscal 2008 is provided below:

	2009	Change	2008
	(Millions of yen, except percentage data)		
Japan	¥ 702,344	-19.1%	¥ 868,280
Americas	894,154	-22.6	1,154,571
Europe	995,150	-25.8	1,341,400
Other areas	617,553	-15.4	729,910
Total	¥ 3,209,201	-21.6%	¥ 4,094,161

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

A geographical analysis indicates that net sales in fiscal 2009 decreased in each of the major geographic areas.

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

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

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

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

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 fiscal 2009 decreased by ¥227,950 million to ¥229,396 million. This decline resulted primarily from the decrease in gross profit led by the significant reduction in sales.

Operating profit for the Consumer Business Unit in fiscal 2009 declined by ¥39,632 million to ¥183,492 million as a result of the decrease in gross profit arising from the reduction in sales.

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

Fiscal 2008 compared with fiscal 2007

Summarized results of operations for fiscal 2008 and fiscal 2007 are as follows:

	2008	Change	2007
	(Millions of yen, except per share amounts and percentage data)		
Net sales	¥ 4,094,161	-8.6%	¥ 4,481,346
Operating profit	496,074	-34.4	756,673
Income before income taxes	481,147	-37.4	768,388
Net income attributable to Canon Inc.	309,148	-36.7	488,332
Net income attributable to Canon Inc. stockholders per share:			
Basic	246.21	-34.8	377.59
Diluted	246.20	-34.8	377.53

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

Sales

Canon's consolidated net sales in fiscal 2008 totaled ¥4,094,161 million. This represents an 8.6% decrease from the previous fiscal year, reflecting the effects of the significant appreciation of the yen coupled with declining prices of products such as digital cameras and inkjet printers, and reduced sales volumes stemming from decreased demand for network MFDs, laser printers, and other office equipment.

Overseas operations are significant to Canon's operating results and generated approximately 79% of total net sales in fiscal 2008. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen in fiscal 2008 was ¥103.23 to the U.S. dollar, and ¥151.46 to the euro, representing a significant appreciation of about 14% to the U.S. dollar, and approximately 7% appreciation against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively impacted net sales by approximately ¥299,500 million in 2008. This unfavorable impact was comprised of approximately ¥218,700 million for U.S. dollar denominated sales, ¥66,400 million for euro denominated sales and ¥14,400 million for other foreign currency denominated sales.

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses along with rent expenses. The ratio of cost of sales to net sales for fiscal 2008 and 2007 was 52.7% and 49.9%, respectively.

Gross profit

Canon's gross profit in fiscal 2008 decreased by 13.8% to ¥1,938,008 million from fiscal 2007. The gross profit ratio deteriorated by 2.8 points year on year to 47.3%. Despite the continued launch of new products and ongoing cost-reduction efforts, the deteriorated gross profit ratio was mainly the result of such factors as the sharp appreciation of the yen, falling product prices accompanied by the rise in prices of materials.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. While R&D expenditures increased slightly compared with the previous year, Group-wide cost reduction efforts contributed to a decline in total operating expenses of 3.2%.

Operating profit

Operating profit in fiscal 2008 dropped 34.4% to a total of ¥496,074 million from fiscal 2007, recording 12.1% to net sales.

Other income (deductions)

Other income (deductions) for fiscal 2008 decreased by ¥26,642 million due to such factors as a reduction in interest income stemming from a decrease in cash surplus and a lower yield on investments, a decline in earnings on investments in affiliates accounted for by the equity method, and write-downs of non-current marketable securities.

Income before income taxes

Income before income taxes in fiscal 2008 was ¥481,147 million, a decline of 37.4% from fiscal 2007, and constituted 11.8% of net sales.

Income taxes

Provision for income taxes in fiscal 2008 decreased by ¥103,470 million from fiscal 2007, primarily as a result of the decline in income before income taxes. The effective tax rate during fiscal 2008 declined by 1.0% compared with fiscal 2007.

Net income attributable to Canon Inc.

As a result, net income attributable to Canon Inc. in fiscal 2008 decreased by 36.7% to ¥309,148 million, which represents a 7.6% return on net sales.

Segment information

The Company adopted guidance for segment reporting in accordance with U.S. GAAP in the year ending December 31, 2009. See Note 21 of the Notes to Consolidated Financial Statements for further details.

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

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

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

The Industry and Others Business Unit mainly includes semiconductor production equipment, mirror projection mask aligners for LCD panels, medical equipment, components, computer information systems, document scanners and personal information products.

Sales by segment

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

Canon's sales by segment are summarized as follows:

	2008	Change	2007
	(Millions of yen, except percentage data)		
Office	¥ 2,246,609	-9.3%	¥ 2,477,518
Consumer	1,456,075	-8.3	1,587,952
Industry and Others	522,405	-5.0	549,983
Eliminations	(130,928)		(134,107)
Total	¥ 4,094,161	-8.6%	¥ 4,481,346

Sales of the Office Business Unit, constituting 54.9% of consolidated net sales, decreased 9.3%, to ¥2,246,609 million in fiscal 2008. Although demand for network MFDs in global markets continued to shift to color models, the appreciation of the yen along with restrained investment due to concern over business performance led to flagging sales in major regions. In addition, laser printer sales suffered the significant impact of the strong yen along with reduced demand, resulting in a decrease in sales volume for monochrome models and slight increase for color models.

Sales of the Consumer Business Unit declined by 8.3% in fiscal 2008, to ¥1,456,075 million due primarily to the appreciation of the yen. The high-resolution, competitively priced EOS Rebel XSi (EOS 450D) and advanced-amateur model EOS 40D enjoyed healthy sales, however, contributing to growth in sales volume for digital SLR cameras. Sales volume also increased for compact digital cameras despite stagnant market conditions as the Company bolstered its product lineup with the introduction of sixteen new models, including six new ELPH (IXUS)-series models and ten PowerShot-series models. As for inkjet printers, as sales volume for single-function models continued to drop, efforts focusing on expanded sales of multifunction business-use models resulted in an increase in sales volume overall. Sales

of the Consumer Business Unit constituted 35.5% of consolidated net sales in fiscal 2008.

Sales of the Industry and Others Business Unit decreased by 5.0% in fiscal 2008, to ¥522,405 million. Within this segment, while sales of aligners, used to produce LCD panels, gained momentum owing to a recovery in demand, sales of steppers, used in the production of semiconductors, remained stagnant due to deteriorating market conditions. Sales of the Industry and Others Business Unit constituted 12.8% of consolidated net sales in fiscal 2008.

Intersegment sales of ¥130,928 million, consisting 3.2% of total sales, are eliminated from the total sales of the three segments, and is 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 fiscal 2008 and fiscal 2007 is provided below:

	2008	Change	2007
	(Millions of yen, except percentage data)		
Japan	¥ 868,280	-8.4%	¥ 947,587
Americas	1,154,571	-13.6	1,336,168
Europe	1,341,400	-10.5	1,499,286
Other areas	729,910	+ 4.5	698,305
Total	¥4,094,161	-8.6%	¥4,481,346

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

A geographical analysis indicates that net sales in fiscal 2008 decreased in each of the geographic areas.

In Japan, net sales decreased by 8.4% in fiscal 2008 largely due to weakened sales of monochrome models of network digital MFDs, compact digital cameras and steppers.

In the Americas, net sales decreased by 1.6% on a local currency basis in fiscal 2008, mainly due to reduced sales of such products as monochrome network MFDs and compact digital cameras. On a yen basis, net sales in the Americas declined by 13.6% in fiscal 2008 as the yen strengthened to the U.S. dollar rapidly and significantly.

In Europe, net sales fell by 3.4% on a local currency basis in fiscal 2008, mainly due to reduced sales of such products as compact digital cameras and laser printers. On a yen basis, net sales in Europe dropped by 10.5% in fiscal 2008 resulting from the impact of the rapid appreciation of the yen to the euro.

Net sales in other areas increased by 4.5% on a yen basis in fiscal 2008, reflecting the robust rise in sales of digital cameras and aligners.

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 fiscal 2008 decreased by ¥107,829 million to ¥457,346 million. This decline resulted primarily from the reduction in sales.

Operating profit for the Consumer Business Unit in fiscal 2008 declined by ¥104,715 million to ¥223,124 million as a result of the drop in sales value, coupled with the significant decline in the gross profit ratio largely stemming from the effects of the strong yen.

Operating profit for the Industry and Others Business Unit in fiscal 2008 decreased by ¥70,820 million to an operating loss of ¥47,876 million as a result of a significant increase in cost of sales and outlays due to such factors as the disposal of inventories, which was carried out in response to rising concerns that weak market sentiment may continue, the appreciation of the yen, along with an impairment charge for fixed assets equipped with current technologies.

Foreign operations and foreign currency transactions

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

The operating profit on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. Please refer to the table of geographic information in Note 21 of the Notes to Consolidated Financial Statements.

Recent Developments

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

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

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

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

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

Canon acquired shares of Océ N.V. (Océ , listed on the NYSE Euronext Amsterdam) through a public cash tender offer in addition to in