

CANON INC  
Form 20-F  
March 28, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 20-F**

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

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2013**

**OR**

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

**OR**

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

**Commission file number 001-15122**

**CANON KABUSHIKI KAISHA**

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

**CANON INC.**

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

**JAPAN**

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

**Shinichi Aoyama, +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.

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

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

**None**

(Title of Class)

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

**None**

(Title of Class)

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

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

As of December 31, 2013, 1,136,999,404 shares of common stock, including 23,634,424 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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

by the International Accounting Standards Board

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

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

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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, 2013 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 14, 2014, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥101.46= U.S.\$1.

The Company's fiscal year end is December 31. In this Annual Report 2013 refers to the Company's fiscal year ended December 31, 2013, and other fiscal years of the Company are referred to in a corresponding manner.

FORWARD-LOOKING INFORMATION

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

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

Not applicable.

**Item 2. Offer Statistics and Expected Timetable**

Not applicable.

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

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

Selected financial data *1:	2013	2012	2011	2010	2009
	(Millions of yen, except average number of shares and per share data)				
Net sales	¥ 3,731,380	¥ 3,479,788	¥ 3,557,433	¥ 3,706,901	¥ 3,209,201
Operating profit	337,277	323,856	378,071	387,552	217,055
Net income attributable to Canon Inc.	230,483	224,564	248,630	246,603	131,647
Advertising expenses	86,398	83,134	81,232	94,794	78,009
Research and development expenses	306,324	296,464	307,800	315,817	304,600
Depreciation of property, plant and equipment	223,158	211,973	210,179	232,327	277,399
Increase in property, plant and equipment	188,826	270,457	226,869	158,976	216,128
Long-term debt, excluding current installments	1,448	2,117	3,368	4,131	4,912
Common stock	174,762	174,762	174,762	174,762	174,762
Canon Inc. stockholders' equity	2,910,262	2,598,026	2,551,132	2,645,782	2,688,109
Total assets	4,242,710	3,955,503	3,930,727	3,983,820	3,847,557
Average number of common shares in thousands	1,147,934	1,173,648	1,215,832	1,234,817	1,234,482
Per share data:					
Net income attributable to Canon Inc. stockholders per share:					
Basic	¥ 200.78	¥ 191.34	¥ 204.49	¥ 199.71	¥ 106.64
Diluted	200.78	191.34	204.48	199.70	106.64
Cash dividends declared	130.00	130.00	120.00	120.00	110.00
Cash dividends declared (U.S.\$) *2	\$ 1.309	\$ 1.498	\$ 1.503	\$ 1.447	\$ 1.196
Notes:					

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



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The following table provides the noon buying rates for Japanese yen in New York City as reported by the Federal Reserve Bank of New York expressed in Japanese yen per U.S.\$1 during the periods indicated and the high and low noon buying rates for Japanese yen per U.S.\$1 during the months indicated. On March 14, 2014, the noon buying rate for yen in New York City as reported by the Federal Reserve Bank of New York was ¥101.46 = U.S.\$1.

Yen exchange rates per U.S. dollar:	Average	Term end	High	Low
2009	93.67	93.08	100.71	86.12
2010	87.16	81.67	94.68	80.48
2011	79.43	76.98	85.26	75.72
2012	80.10	86.64	86.64	76.11
2013 - Year	98.00	105.25	105.25	86.92
- 1(st) half		99.21	103.52	86.92
- July		98.35	101.08	97.80
- August		98.22	99.30	96.03
- September		98.29	100.22	98.29
- October		98.1	98.90	96.94
- November		102.45	102.45	98.56
- December		105.25	105.25	101.82
2014 - January		102.28	104.87	102.20
- February		102.08	102.71	101.11

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

**B. Capitalization and indebtedness**

Not applicable.

**C. Reasons for the offer and use of proceeds**

Not applicable.

**D. Risk factors**

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

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

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

As a result of the economic downturn in Canon's major markets, including Japan, the United States, Europe and Asia, declines in consumption and restrained investment may affect Canon's operating results. The operating results for products such as office and industrial equipment are affected by the financial results of its corporate customers, and deterioration of their financial results has caused and may continue to cause customers to limit capital investments. Demand for Canon's consumer products, such as cameras and inkjet printers, is discretionary. Fluctuating inventory levels, rapid price declines owing to intensifying competition and declines in levels of consumer spending and corporate investment could adversely affect Canon's operating results and financial position.

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

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

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

Canon's assets include investments in publicly traded securities. As a result, Canon's operating results and general financial position may be affected by price fluctuations in the stock and bond markets. Volatility in financial markets and overall economic uncertainty create the risk that the actual amounts realized in the future on Canon's investments could differ significantly from the fair values currently assigned to them. In addition, if valuations of investment assets decrease because of conditions in stock or bond markets, for example, additional funding and accruals with respect to Canon's pension and other obligations may be required, and such funding and accruals may adversely affect Canon's operating results and consolidated financial condition.

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

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

### **Risks Related to Canon's Industries and Business Operations**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mirrorless cameras are interchangeable lens cameras which, because they do not incorporate a mirror mechanism, are more compact and lightweight than digital single-lens-reflex ( SLR ) cameras. The growth of the mirrorless camera market has the potential to adversely affect the market for digital SLR cameras, in which Canon boasts the top market share. If the mirrorless camera market continues to grow and Canon fails to gain a leading share of that market or the digital SLR camera market shrinks relative to that market, our revenues and our overall presence in the camera market may be adversely affected.

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

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

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

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

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

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

### ***Canon depends on specific outside suppliers for certain key components.***

Canon relies on specific outside suppliers that meet Canon's strict criteria for quality, efficiency and environmental friendliness for critical components and special materials used in its products. In some cases, Canon may be forced to discontinue production of some or all of its products if the specific outside suppliers that

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supply key components and special materials across Canon's product lines experience unforeseen difficulties, or if such parts and special materials suffer from quality problems or are in short supply. Further, the prices of components and special materials purchased from specific outside suppliers may rise, triggered by the imbalance of supply and demand along with other factors. If such events occur as an outcome of the dependency on outside vendors, Canon's operating results may be adversely affected.

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

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

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

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

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

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

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

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

Canon depends on efficient logistics services to distribute its products worldwide. Problems with Canon's computerized logistics systems, an outbreak of war or strife within Canon's operating regions or regional labor

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disputes, such as a dockworkers' strike, could lead to a disruption of Canon's operations and result not only in increased logistical costs, but also in the loss of sales opportunities owing to delays in delivery. Moreover, because demand for Canon's consumer products may fluctuate throughout the year, transportation means, such as cargo vessels or air freight, and warehouse space must be appropriately managed to take such fluctuations into account. Failure to do so could result in either a loss of sales opportunities or the incurrence of unnecessary costs.

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

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

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

### Other Risks

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

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

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

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

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

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

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

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

### ***Canon is subject to risks relating to legal proceedings.***

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

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

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

In relation to protection of its technologies, Canon faces risks that:

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

In relation to third party intellectual property rights, if any governmental agency or third party is adjudicated to have a valid infringement claim against Canon, Canon could be required to:

- refrain from selling the relevant product in certain markets;
- pay monetary damages;
- pursue development of non-infringing technologies, 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 may need to litigate in order to enforce its intellectual property rights or in order to defend against claims of infringement, which can be expensive and time-consuming.

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

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

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

### ***Canon must attract and retain highly qualified professionals.***

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

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

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

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

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

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

## **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.



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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.

In 2013, 2012, and 2011, Canon's increases in property, plant and equipment were ¥188,826 million, ¥270,457 million and ¥226,869 million, respectively. In 2013, 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 2014, Canon projects an increase in property, plant and equipment of approximately ¥210,000 million. This amount is expected to be spent for investments in new production plants and new facilities of Canon. Canon anticipates that the funds needed for this increase will be generated internally through operations.

### **B. Business overview**

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

Canon sells its products principally under the Canon brand name and through sales subsidiaries. Each of these subsidiaries is responsible for marketing and distribution to retail dealers in an assigned territory. In 2013, 80.8% of consolidated net sales were generated outside Japan, with approximately 28.4%, 30.1% and 22.3% generated in the Americas, Europe and Asia and Oceania, respectively.

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

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

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

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 Imaging System Business Unit and the Industry and Others Business Unit.

#### *- Office Business Unit -*

Canon manufactures, markets and services a full range of MFDs, printers, copying machines for personal and office use and production print products for print professionals. Canon also delivers added value to

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customers through software, services and solutions. Our offerings cover a wide variety of markets from Small Office Home Office ( SOHO ), and Small and Midsize Business ( SMB ) to large enterprises and professional graphic arts.

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

\* Source: IDC, Dec 2013 IDC MarketScape: U.S. Smart Multifunction Peripheral 2013 Vendor Assessment (245058)

In 2013, Canon enhanced its portfolio starting with the launch of the imageRUNNER ADVANCE 4200 series and the A4-size imageRUNNER ADVANCE 400iF and 500iF. To deliver higher value added and expand our presence in the existing market while acquiring new markets in the production print industry, Canon introduced the varioPRINT DP line with new Canon branding and the imagePRESS C1+II. Aiming to accelerate the transition from offset to high volume digital color, Canon previewed our future solution Niagara, an ultra high-volume color inkjet cutsheet printing platform. In the high speed continuous feed printer area, Océ announced new Océ ColorStream 3000 Z series.

As for software, services and solutions, Canon's application development platform, the Multifunctional Embedded Application Platform ( MEAP ), allows the creation of customized applications for Canon MFDs enabling tight integration into the customer's IT infrastructure. The integration boosts productivity and allows users to fully take advantage of the power of MFDs. Canon has introduced Enterprise Imaging Platform ( EIP ), a middleware application that enables customers to integrate enterprise applications and automate the business processes.

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

In the monochrome laser printer market, the transition to a low price segment is expected to expand sales in the micro office/home office market and in emerging markets. Canon expects an expansion in the color laser printer market to be driven by increasing demand for color printing. Moreover, Canon plans to aggressively launch new products in the MFDs market and to drive Canon's business growth.

However, Canon is experiencing fierce competition with aggressive competitors in the laser printer market and an eventual decline in sales prices is becoming a major threat. Growth of the tablet PC and smartphone market, which affects users' printing behavior and may also lead to a decrease in demand for printing, is becoming a new threat. Canon implements numerous efforts to enhance mobile printing solutions to tackle with the new threat and create further business opportunities.

In response, Canon aims to promote technological developments in order to introduce competitive products in a timely manner across the office business unit, and to pursue business efficiency through continuous cost reduction and optimization of its supply chain.

*- Imaging System Business Unit -*

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

In 2013, Canon launched three new products and particularly strengthened its product line up.

EOS Rebel T5i, succeeding T4i performance, is equipped with the smooth and silent Auto Focus the movie function with Stepping Motor (lead-screw type) lenses. The Vari-angle Touch Screen LCD monitor enables

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flexible shooting positions with clear views. EOS Rebel SL1 is the new offering in the Entry category and the world's smallest and lightest digital SLR camera which uses APS-C size equivalent sensors. With excellent basic performance of the Digital SLR, it offers the smallest body through a redesigned inside structure. Despite its compact design, it offers outstanding grip and operability. EOS 70D is equipped with the new innovative AF system, Dual Pixel CMOS AF offers smooth and silent AF, and Built-in Wireless LAN, enabling to expand image capturing area and increase the communication performance. EOS 5D Mark III, EOS 7D and EOS 6D show steady sales and Canon keeps No.1 share in the advanced amateur category. In addition to the need for higher resolution and more compact and lightweight sizes, such function as video recording with a full high definition ( HD ) format, is becoming a new standard feature for interchangeable lens digital cameras. Canon believes there remains considerable room for future growth in this category through development of new products based on state-of-the-art technology.

Canon launched four new lens products, and cumulative production of the EF lens series surpassed 90 million in May 2013. The interchangeable lens line up currently exceeds 70 products. By enhancing our core capability, Canon has been introducing high-quality and high-performance lenses built on superior optical technology and new elemental technology, which Canon believes allowed it to maintain its advantage over the competition.

Canon introduced eighteen new models to the compact digital camera market in 2013 in order to add value to its products. While there has been a strong tendency toward reliance on electronic manufacturing services ( EMS ) in the compact digital camera industry, there is a possibility that the EMS manufactures cannot maintain their business and some of them might exit from the market. Canon is pressing forward with entire internal manufacturing leveraging the economies of scale and building an optimum cost structure to strive to maintain profitability.

The market for conventional camcorders has been shrinking, as many other popular devices start equipping a movie function. On the other hand, new categories like web cameras and action cameras are emerging and expanding. Canon aims to expand sales in this market with a product lineup including higher value added based on Canon's distinctive high-definition, high-resolution technologies. Concurrently, Canon has introduced a new product with unique styled camcorder especially for self-shooting, aiming to exploit a new market category. In the field of professional camcorders, Canon introduced new XA series; small sized camcorders equipped with a wide-angle and high magnification lens in addition to current XF series for use in broadcast news, documentary and independent filmmaking. CINEMA EOS SYSTEM has strengthened its line up by launching new digital cinema cameras capable of recording 4K-resolution video and improved user convenience through a wider selection of related software. Canon aims to solidify its top position in the motion picture production market by introducing new products that suit to a wide variety of market.

In 2013, Canon experienced robust growth in the field of projectors for business applications, and in particular brighter, installation type projectors. In this installation market, Canon enjoyed sales volume expansion in 2013, owing to the increased line-up of introducing three new install-type models in 2012. Canon launched two new install-type models in 2013, which differentiated from the competitor by advanced optical technology, imaging technology and compact design. Those will be strategic and leading models for expanding the projector business and advancing Canon's position in the market. Moving forward, Canon expects to extend its competitive product lineup based around the optical technology on which the company prides itself.

In the broadcast TV lens market, worldwide market demand is stable although demand arising from the switchover to high definition broadcast formats in developed countries slowed down. Canon retains a large share of the TV lens market with high value-added products.

Canon launched the MREAL mixed reality ( MR ) system based on graphic information processing technology that can combine the real world with computer graphics for the purpose of, for example, realizing more efficient product design in July 2012.

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Inkjet printer technology has been evolving, driving expansion of application to not only for home use, but for office and commercial use such as poster printing and photo printing that require high-quality.

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

For the home and business use printers, Canon offers such printer solutions as New PIXMA Cloud Link and PIXMA Printing to tighten the connection with Cloud environment, smartphone and tablet PC which have been proliferating. Canon also offers My Image Garden, the easy-to-use Intelligent Touch System, XL ink tank & ink cartridge. In 2012, Canon started to ship the DreamLabo 5000, the first inkjet production photo printer featuring new FINE high-density print head technology. In the professional printing market, Canon offers three professional photo inkjet printers: the PIXMA PRO-1 with a 12 LUCIA ink system of pigment-based inks, PIXMA PRO-10 with a 10 LUCIA ink system, and the PIXMA PRO-100 with eight dye inks to produce colorful and vivid prints. Canon aims to further expand its business leveraging its strength in the photo printing market.

Canon large-format inkjet printers are based on FINE head technology and employ its unique image processor, L-COA, developed for high-speed, high-resolution printing, and LUCIA pigment inks. Consequently, Canon receives a high evaluation and steadily boosts the market share.

### *- Industry and Others Business Unit -*

The market for semiconductor lithography equipment has shown a recovery trend in the second half of 2013 due to the correction of supply-demand imbalances in the memory device market, although the investments by memory makers had remained low in recent years because supply continued to outweigh demand. However, image sensor, logic device and automotive device makers steadily increased their equipment investments, drawn by the growing market for smartphones, tablet PCs and hybrid cars. At the same time, some manufacturers started to invest in i-line steppers for small diameter wafers used in power devices and LEDs, as well as for new markets such as 3D integration for Through-Silicon Via ( TSV ).

Canon has been rationalizing production systems to more flexibly respond to these market changes, creating new systems with overall responsibility for each stepper model, and integrating manufacturing and sales functions so that customer needs can be more quickly reflected in development. Through these activities, a design-in business style has been taking hold and steady progress is being made in developing and marketing products with high added value. For example, Canon released a new i-line stepper FPA-3030i5+, optimized for the production of green devices such as LEDs and power devices, and FPA-5510iV which enables high productivity in the advanced packaging process such as TSV and Bump. As a result of these activities, Canon has occupied a high share of the i-line stepper market. Canon also released a new DUV scanner FPA-6300ES6a with greatly improved productivity, overlay accuracy and uptime rate compared to conventional equipments.

The market for FPD lithography equipment has been on a downward trend in investment due to deterioration in the earnings of panel makers. The lithography market for small-to-mid sized panel production maintained steady trend drawn by growing demand for smartphones and tablet PCs. The lithography market for large-sized panel production, which has remained low in recent years, showed moderate recovery due to the demand from emerging countries and commercialization of 4K TVs.

Under the circumstances, the MPAsp-H760 supporting 8th generation large-sized panels continues to offer high productivity and has contributed to customer production plans by allowing for quick equipment installation at existing production sites. This has helped Canon capture and maintain a commanding share of the FPD lithography equipment market for large-sized panel production. Furthermore, Canon's sales and service support systems have earned high accolades in China where the market for FPD lithography equipment is growing. On the other hand, Canon has released new FPD lithography equipment, MPAsp-H800 for large-sized panel and the

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MPAsp-E810 for small-to-mid sized panels, with improved on resolution. Canon aims to gain an increasing share of the market for small-to-mid sized panel production in addition to large-sized panel production.

In the medical equipment business, the digital radiography ( DR ) market kept expanding, mainly in emerging markets such as Asia. Moreover, the digital systems market in industrialized nations continued to transition from the digitalization format of computed radiography ( CR ) to the newest format of DR. While the competition offered a rising number of new players, the target market of Canon DR products showed steady growth.

Canon launched new products with the X-ray auto detection function : CXDI-701C/G Wireless, CXDI-801C/G Wireless, CXDI-401C/G Wireless. Canon believes this function, which eliminates the need for communication with X-ray generators, is accelerating replacement of CR by DR.

For the ophthalmic equipment market, the optical coherence tomography ( OCT ) segment showed continuous growth, and further increase in volume and competition is expected. In this OCT segment, Canon sold the first Canon-brand OCT, OCT HS-100 in collaboration with consolidated subsidiary Optopol Technology, Sp. z o.o. (Poland). By adding the OCT to our product portfolio, we strive to increase sales in the ophthalmic equipment market.

The market of network cameras for business surveillance and management applications is expected to show double-digit growth, reflecting the progress of IT and digital technologies. Canon established a dedicated product group in 2013 to expand its network camera business, with its proprietary technologies of optics, sensor, imaging and network devices. With the introduction of four new compact Full HD network cameras at the end of 2013, Canon has extended its market coverage to meet demand for surveillance products for such areas as retail stores and offices.

**NET SALES BY SEGMENT**

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

	Years ended December 31				
	2013	change	2012	change	2011
	(Millions of yen, except percentage data)				
Office	¥ 2,000,073	13.8%	¥ 1,757,575	-8.4%	¥ 1,917,943
Imaging System	1,448,938	3.1	1,405,971	7.2	1,312,044
Industry and Others	374,870	-8.1	407,840	-3.1	420,863
Eliminations	(92,501)		(91,598)		(93,417)
<b>Total</b>	<b>¥ 3,731,380</b>	<b>7.2%</b>	<b>¥ 3,479,788</b>	<b>-2.2%</b>	<b>¥ 3,557,433</b>

**NET SALES BY GEOGRAPHIC AREA**

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

	Years ended December 31				
	2013	change	2012	change	2011
	(Millions of yen, except percentage data)				
Japan	¥ 715,863	-0.6%	¥ 720,286	3.7%	¥ 694,450
Americas	1,059,501	12.7	939,873	-2.3	961,955
Europe	1,124,929	10.9	1,014,038	-8.9	1,113,065
Asia and Oceania	831,087	3.2	805,591	2.2	787,963
<b>Total</b>	<b>¥ 3,731,380</b>	<b>7.2%</b>	<b>¥ 3,479,788</b>	<b>-2.2%</b>	<b>¥ 3,557,433</b>



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### **Seasonality**

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

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

### **Sources of supply**

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

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

### **Marketing and distribution**

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

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

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

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

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

Canon also sells laser printers on an OEM basis to Hewlett-Packard Company. Hewlett-Packard resells these printers under the HP LaserJet Printers name. During 2013 and 2012, OEM sales to Hewlett-Packard constituted 17.6% and 17.0%, respectively, of Canon's consolidated net sales.

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

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**Service**

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

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

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

**Patents and licenses**

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

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

Companies to which Canon has granted licenses include:

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

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

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

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

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



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### **Competition**

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

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

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

#### *- Office Business Unit -*

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

\* Based on the data by IDC's Worldwide Quarterly Hardcopy Peripherals Tracker 2013Q4

#### *- Imaging System Business Unit -*

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

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

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

Average prices in the industry declined in 2013 from the previous year. Prices have been rapidly declining as measured by the standard of specification price value, and the commoditization of products has been progressing. Market contraction and exchange rate fluctuation risks caused by the financial crisis which started in 2008 are having a major impact, resulting in severe conditions in the digital camera market. Despite these difficulties, Canon will seek to take advantage of its status as the major brand in the industry, along with its economies of scale, in order to maintain profitability.

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

### *- Industry and Others Business Unit -*

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

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

Canon believes its FPD lithography equipment with a common platform offers excellent productivity and reliability that has helped it capture market share of the industry-leading South Korea and the growing China. Panel makers are accelerating development of higher definition panels in recent years. Canon believes it has also been meeting the needs of panel makers by continuously offering new products with high-resolution.

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

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

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

If tighter restrictions are enforced in 2014 and beyond, Canon's compliance costs could increase, including with costs related to the actions for newly-covered products and the development and adoption of substitute materials or processes. Such increased costs may have an adverse effect on Canon's operating results.

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

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

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

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

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

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

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

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

The Chinese Ministry of Information Industry published Administrative Measures on the Control of Pollution Caused by Electronic Information Products in February 2006, and regulates the same six substances covered by the EU RoHS in electronic information products. The measures establish two stages of implementation. Stage 1 is in effect and covers nearly all Canon products. To comply with Stage 1 requirements, a China-specific label must be placed on any covered product if any of the six regulated substances are contained therein, and use of the six regulated substances must be disclosed in each product manual. In addition, each product s environmental protection use period ( EPUP ) must be stated within its recycling mark and include the production date. 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 ) be restricted by limitations similar to the EU 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 effect on its operating results and financial condition.

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

The Regulation for the Management of the Recycling and Disposal of Waste Electrical and Electronic Products was issued by the Chinese government in 2009 and implemented on January 1, 2011. Producers and importers are required to pay a fee to a government fund. The first list of products falling under the waste electrical and electronic products catalogue has been issued and includes four types of household appliances as well as personal computers. The Regulation of those payment fees described above was enforced on July 1, 2012.

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

**7. *Soil Pollution Prevention Law of Japan***

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

**8. *Other Environmental Regulations***

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

**Other regulations**

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

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

During the year ended December 31, 2013, the following Canon affiliates had the transactions with Iran-related organizations. These transactions were conducted in compliance with applicable law in the respective countries.

Canon Marketing Japan (CMJ), our 58.5% owned Japanese subsidiary as of December 31, 2013, has a maintenance contract for one copier machine with the Iranian embassy in Tokyo, Japan. The current contract renews annually. Total gross sales for the contract and activities above during the year 2013 was approximately ¥233 thousand. The net profit was substantially less than that.

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Canon Marketing Malaysia Sdn bhd, a wholly-owned Malaysian subsidiary of Canon Singapore Pte. Ltd. ( CSPL ), performed maintenance services on two copier machines of Iran Air in Kuala Lumpur, Malaysia. The current contract will expire in January 2017. Total gross sales for this activity during the year 2013 was in foreign currency of approximately ¥40 thousand. The net profit was substantially less than that.

Canon Marketing (Thailand) Co. Ltd, a wholly-owned Thai subsidiary of CSPL, has a service contract for three copier machines with the Iranian embassy in Bangkok, Thailand. The current contract will expire in October 2014. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥198 thousand. The net profit was substantially less than that.

Canon India Pvt Ltd, a wholly-owned Indian subsidiary of CSPL, has service contracts for six copier machines with the consulate general of Iran in New Delhi and Mumbai, India. The current contract will expire in September 2017. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥109 thousand. The net profit was substantially less than that.

Canon Australia Pty. Ltd., a wholly-owned Australian subsidiary, has service and lease contract for two copier machines with Iranian embassy in Canberra, Australia. The current contract will expire in November 2016. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥954 thousand. The net profit was substantially less than that.

Canon Europe N.V. ( CENV ), a wholly-owned Dutch subsidiary of Canon Finance Netherlands B.V., which is wholly-owned by Canon Inc., had indirect sales transactions through an independent distributor in Dubai, United Arab Emirates ( U.A.E. ) for broadcast products such as TV camera lenses and related products of Islamic Republic of Iran Broadcasting. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥6,639 thousand. The net profit was substantially less than that.

Canon Deutschland GmbH, a wholly-owned German subsidiary of CENV, has a service contract for three copier machines with the consulate general of Iran in Munich, Germany. This contract started from August 2008 and will expire in July 2014. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥144 thousand. The net profit was substantially less than that.

Canon (Austria) GmbH, a wholly-owned Austrian subsidiary of CENV, has a rental contract for one copier machine with Iranian embassy in Vienna, Austria. This machine was relocated to Hamburg, Germany based on the embassy's request. This contract started from June 2012 and will expire in June 2017. Total gross sales for this contract during the year 2013 was in foreign currency of approximately ¥629 thousand. The net profit was substantially less than that.

Canon (Schweiz) AG, a wholly-owned Swiss subsidiary of CENV, has rental and maintenance contract for one copier machine of Naftiran Intertrade Company ( NICO ) in Pully, Switzerland. Total gross sales under this contract during the year 2013 was in foreign currency of approximately ¥912 thousand. The net profit was substantially less than that.

Canon Oy AB, a wholly-owned Finnish subsidiary of CENV, has a service maintenance contract for one copier machine of the Iranian embassy in Helsinki, Finland. Total gross sales under this contract during the year 2013 was approximately ¥11 thousand. The net profit was substantially less than that.

Canon Svenska AB, a wholly-owned Swedish subsidiary of CENV, performed a spot repair on a copier machine of Iran Air in Stockholm, Sweden. The gross sales for this activity was in foreign currency of approximately ¥30 thousand. The net profit was substantially less than that.

Canon Danmark A/S, a wholly-owned Danish subsidiary of CENV, has service maintenance contracts for five copier machines of the Iranian embassy in Copenhagen, Denmark. The oldest contracts of these started from July 2007 and some have non-cancellable clauses until February 2017. The gross sales under these contracts during the year 2013 was in foreign currency of approximately ¥247 thousand. The net profit was substantially less than that.

Canon Middle East FZ-LLC, a wholly-owned subsidiary of CENV in Dubai, U.A.E., has a service contract for a copier and two fax machines with Iranian Hospital in Dubai, U.A.E. in 2013, which we believe to be operated by Iranian Red Crescent. The current contract will expire in July 2014. Total gross sales was in foreign currency of approximately ¥306 thousand. The net profit was substantially less than that.

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Canon France, a wholly-owned subsidiary of CENV, has a service contract for a copier machine with the Iranian embassy in Paris, France. The current contract will expire in April 2014. Total gross sales was in foreign currency of approximately ¥93 thousand. The net profit was substantially less than that.

As of the date of this report, Canon is not aware of any other activity, transaction or dealing by us or any of our affiliates during the year ended December 31, 2013 that requires disclosure in this report under Section 13(r) of the Exchange Act. Canon does not intend to conduct any further business activities with Iranian counterparties required to be disclosed under the ITRA, except for sales of consumables, repair, and maintenance services for products Canon previously sold to such entities.

**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, 2013, Canon Inc. had 257 consolidated subsidiaries and 11 affiliated companies accounted for by the equity method.

The following table lists the significant subsidiaries owned by Canon Inc., all of which are consolidated as of December 31, 2013.

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

**D. Property, plants and equipment**

Canon's manufacturing is conducted primarily at 28 plants in Japan and 18 plants in other countries. Canon owns all of the buildings and the land on which its plants are located, with the exception of certain immaterial leases of land and floor space of certain of its subsidiaries. The names and locations of Canon's plants and other facilities, their approximate floor space and the principal activities and products manufactured therein as of December 31, 2013 are as follows:

Name and location	Floor space (including leased space) (Thousands of square feet)	Principal activities and products manufactured
<b>Domestic</b>		
Headquarters, Tokyo	2,556	R&D, corporate administration and other functions
Canon Global Management Institute, Tokyo	164	Training and administration
Kawasaki Office, Kanagawa	1,238	R&D and manufacturing of production equipment and semiconductor devices; R&D of laser printers and toner cartridges
Kosugi Office, Kanagawa	395	Development of software for office imaging products
Fuji-Susono Research Park, Shizuoka	1,037	R&D in electrophotographic technologies
Ayase Plant, Kanagawa	393	R&D and manufacturing of semiconductor devices

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<b>Name and location Domestic</b>	<b>Floor space (including leased space) (Thousands of square feet)</b>	<b>Principal activities and products manufactured</b>
Hiratsuka Plant, Kanagawa	1,118	R&D of display products
Tamagawa Office, Kanagawa	149	Quality engineering
Oita Plant, Oita	279	Manufacturing of semiconductor devices
Yako Office, Kanagawa	903	Development of inkjet printers, inkjet chemical products
Utsunomiya Plant, Tochigi	2,761	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	3,203	R&D in electrophotographic technologies, mass-production trials and supports; manufacturing of office imaging products, chemical products; training of manufacturing
Ami Plant, Ibaraki	1,131	Manufacturing of FPD production equipment
Canon Electronics Inc., Tokyo, Saitama and Gunma	1,309	Components, magnetic heads, document scanners and laser printers
Canon Finetech Inc., Saitama, Ibaraki and Fukui	915	Business-use printers, business machines peripherals and chemical products
Canon Precision Inc., Aomori	1,506	Toner cartridges, sensors and micromotors
Canon Optron Inc., Ibaraki	143	Optical crystals (for lithography equipments, cameras, telescopes) and vapor deposition materials
Canon Chemicals Inc., Ibaraki	2,098	Toner cartridges and rubber functional components
Canon Components, Inc., Saitama	610	Contact image sensors, inkjet cartridges and medical equipment
Oita Canon Inc., Oita	1,225	Digital cameras, lenses and digital video camcorders
Nagahama Canon Inc., Shiga	1,093	Toner cartridges and A-Si drums
Oita Canon Materials Inc., Oita	2,995	Chemical products for copying machines and printers, and inkjet cartridges
Ueno Canon Materials Inc., Mie	654	Chemical products for copying machines and printers
Fukushima Canon Inc., Fukushima	971	Inkjet printers and inkjet cartridges

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<b>Name and location Domestic</b>	<b>Floor space (including leased space) (Thousands of square feet)</b>	<b>Principal activities and products manufactured</b>
Canon Semiconductor Equipment Inc., Ibaraki	423	Development and production of semiconductor production-related equipment
Canon Ecology Industry Inc., Ibaraki	646	Recycling of toner cartridges, repair and recycling of business machines
Nisca Corporation, Yamanashi	391	Copying machine peripherals, scanner units and optical equipment
Miyazaki Daishin Canon Inc., Miyazaki	168	Digital cameras
Canon Mold Co., Ltd., Ibaraki	219	Molds
Canon ANELVA Corporation, Kanagawa and Yamanashi	746	Production equipment for electron devices, flat panel display and semiconductors
Canon Machinery Inc., Shiga	623	Automated production equipment and semiconductor production-related equipment
Canon Tokki Corporation, Niigata, Kanagawa and Tokyo	232	Vacuum technology-related equipment
Nagasaki Canon Inc., Nagasaki	477	Digital cameras
Hita Canon Materials Inc., Oita	370	Rubber functional components
<b>Name and location Overseas</b>	<b>Floor space (including leased space) (Thousands of square feet)</b>	<b>Principal activities and products manufactured</b>
<b>Europe</b>		
Canon Giessen GmbH, Giessen, Germany	336	Remanufacturing of copying machines and semiconductor production equipment
Canon Bretagne S.A.S., Liffre, France	487	Manufacturing and recycling of toner cartridges
Océ-Technologies B.V., Venlo, the Netherlands	2,493	Document management, high speed digital production printing systems and wide format printers
Océ-Printing Systems GmbH, Poing, Germany	1,233	High speed digital production printing systems
<b>Americas</b>		
Canon Virginia, Inc., Virginia, U.S.	1,679	Toner cartridges, molds and remanufacturing of copying machines
Industrial Resource Technologies, Inc., Virginia, U.S.	185	Recycling of toner cartridges



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<b>Name and location Overseas</b>	<b>Floor space (including leased space) (Thousands of square feet)</b>	<b>Principal activities and products manufactured</b>
<i>Asia</i>		
Canon Inc., Taiwan, Taiwan	1,774	Lenses and digital cameras
Canon Opto (Malaysia) Sdn. Bhd., Selangor, Malaysia	584	Lenses and optical lens parts
Canon Dalian Business Machines, Inc., Dalian, China	1,740	Production and recycling of toner cartridges, production of laser printers
Canon Zhuhai, Inc., Zhuhai, China	1,909	Digital cameras, digital video camcorders and contact image sensors
Canon Prachinburi (Thailand) Ltd., Prachinburi, Thailand	808	Copying machines
Canon Hi-Tech Thailand Ltd., Ayutthaya and Nakohon Ratchasima, Thailand	3,269	Inkjet printers, MFDs, scanners, molds and plastic injection molded parts
Canon Zhongshan Business Machines Co., Ltd., Zhongshan, China	1,331	Laser printers
Canon Vietnam Co., Ltd., Hanoi, Vietnam	3,233	Inkjet printers, laser printers, MFDs, scanners and contact image sensors
Canon (Suzhou) Inc., Suzhou, China	1,517	Copying machines
Canon Finetech Nisca (Shenzhen) Inc., Shenzhen, China	706	Copying machines and laser printer peripherals
Canon Electronics Vietnam Co., Ltd., Hung Yen Province, Vietnam	308	Components
Canon Business Machines (Philippines), Inc., Batangas, Philippines	910	Laser printers

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

**Main facilities under construction for establishment/expansion**

<b>Name and location Domestic</b>	<b>Principal activities and products manufactured</b>
Kawasaki Office, Kanagawa	New Administration and R&D base
Tamagawa Office, Kanagawa	New Administration and R&D base
Canon Ecology Industry Inc., Ibaraki	New production base* (Office business unit)

\* To be leased to Canon Ecology Industry Inc., a wholly-owned subsidiary, by the Company

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### **Item 4A. Unresolved Staff Comments**

None.

### **Item 5. Operating and Financial Review and Prospects**

#### **A. Operating Results**

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

##### **Overview**

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

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

##### *Economic environment*

Looking back at the global economy in 2013, although the U.S. and Japanese economies began heading toward moderate recoveries during the latter half of the year, the economic downturn in Europe continued to drag on while the economies of emerging countries such as China faced slowdowns. As such, contrary to expectations at the beginning of the year, the global economy remained stagnant. As for exchange rates, the correction of the historic high value of the yen continued, with a trend toward a weaker yen growing increasingly clear.

##### *Market environment*

As for the markets in which Canon operates amid these conditions, owing to the economic slowdown, flat demand led to a continuation of the harsh business environment especially for consumer products. Among MFDs, color models continued to drive growth while demand for laser printers realized a turnaround toward recovery. Although demand for interchangeable-lens digital cameras continued to show strong growth in Japan, demand overseas fell short of the previous year's level as the economic rebound in such markets as Europe and China takes longer than expected. As for digital compact cameras, demand continued to shrink in both developed countries as well as emerging markets. Overall market demand for inkjet printers, hit by the prolonged economic downturn, also declined in all major markets. In the industry and others sector, a rebound in capital investment for memory devices led to a pickup in demand for semiconductor lithography equipment in the latter half of the year, while demand for lithography equipment used in the production of FPDs showed healthy market growth for mid- and small-size panels used mainly in smartphones and tablet PCs, and a modest recovery for large-size panels.

The average value of the yen during the year was ¥97.84 against the U.S. dollar, a year-on-year depreciation of approximately ¥18, and ¥130.01 against the euro, a year-on-year depreciation of approximately ¥27.

##### *Summary of operations*

Despite the decline in demand for digital compact cameras and industrial equipment, net sales for the year increased 7.2% to ¥3,731.4 billion from the previous year. This was realized through the steady demands for

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MFDs and laser printers, along with an increase in sales of inkjet printers, made possible through sales-promotion efforts despite the harsh conditions posed by the shrinking inkjet printer market, as well as the positive effects of favorable currency exchange rates. The gross profit ratio rose 0.8 points year on year to 48.2% thanks to the effects of ongoing cost-cutting efforts along with the depreciation of the yen. Despite an increase in foreign-currency-denominated operating expenses after conversion into yen due to the depreciation of the yen, Group-wide efforts to thoroughly reduce spending contributed to limiting the increase in operating expenses to just ¥1,461.1 billion, an increase of 10.2% year on year. Consequently, operating profit increased by 4.1% to ¥337.3 billion. Other income decreased by ¥8.4 billion due to foreign currency exchange losses while income before income taxes increased by 1.5% year on year to ¥347.6 billion. Net income attributable to Canon Inc. increased by 2.6% to ¥230.5 billion. Accordingly, Canon achieved increases in both sales and profit.

*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**

	2013	2012	2011	2010	2009
Net sales (Millions of yen)	¥ 3,731,380	¥ 3,479,788	¥ 3,557,433	¥ 3,706,901	¥ 3,209,201
Gross profit to net sales ratio	48.2%	47.4%	48.8%	48.1%	44.5%
R&D expense to net sales ratio	8.2%	8.5%	8.7%	8.5%	9.5%
Operating profit to net sales ratio	9.0%	9.3%	10.6%	10.5%	6.8%
Inventory turnover measured in days	52 days	57 days	46 days	35 days	39 days
Debt to total assets ratio	0.1%	0.1%	0.3%	0.3%	0.3%
Canon Inc. stockholders' equity to total assets ratio	68.6%	65.7%	64.9%	66.4%	69.9%

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

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

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

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

Operating profit ratio (ratio of operating profit to net sales) and R&D expense to net sales ratio are considered to be KPIs by Canon. Canon is focusing on two areas for improvement. Canon is striving to control

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and reduce its selling, general and administrative expenses as its first key point. Secondly, Canon's R&D policy is designed to maintain adequate spending in core technology to sustain Canon's leading position in its current business areas and to exploit opportunities in other markets. Canon believes such investments will create the basis for future success in its business and operations.

### Cash flow management

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

Inventory turnover measured in days is a KPI because it measures the efficiency of supply chain management. Inventories have inherent risks of becoming obsolete, physically damaged or otherwise decreasing significantly in value, which may adversely affect Canon's operating results. To mitigate these risks, management believes that it is crucial to continue reducing work-in-process inventories by decreasing production lead times in order to promptly recover related product expenses, while balancing risks of supply chain disruptions by optimizing finished goods inventories in order to avoid losing potential sales opportunities.

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 due to lead times required for R&D, manufacturing and sales has to be followed for success. Therefore, management believes that it is important to have sufficient financial strength so that the Company does not have to rely on external funds. Canon has continued to reduce its dependency on external funds for capital investments in favor of generating the necessary funds from its own operations.

Canon Inc. stockholders' equity to total assets ratio is another KPI for Canon. Canon believes that its stockholders' equity to total assets ratio measures its long-term sustainability. Canon also believes that achieving a high or rising stockholders' equity ratio indicates that Canon has maintained a strong financial position or further improved its ability to fund debt obligations and other unexpected expenses. In the long-term, Canon's management believes a high stockholders' equity ratio will enable the company to maintain a high level of stable investments for its future operations and development. As Canon puts strong emphasis on its R&D activities, management believes that it is important to maintain a stable financial base and, accordingly, a high level of its 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. These estimates and assumptions include future market conditions, net sales growth rate, gross margin and discount rate. Though Canon believes that the estimates and assumptions are reasonable, actual future results may differ from these estimates and assumptions. Canon believes that the following are the more critical judgment areas in the application of its accounting policies that currently affect its financial condition and results of operations.

#### Revenue recognition

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

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

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

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

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

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

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions to sales are based upon historical trends and other known factors at the time of sale. In addition, Canon provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced. In 2011, the sales incentive program accruals were quite difficult to estimate compared to prior years because of the significant fluctuation in consumer product supplies from our manufacturing facilities, due to the earthquake in Japan and the flooding in Thailand. Although Canon utilized available data to produce its best estimate of promotion payments to be claimed in 2012, actual claims in 2012 were not as high as Canon had estimated. Moreover, in recent years, as a result of the market conditions and customer preferences, usage of incentive programs has shifted from mail-in rebates to instant rebates. Accordingly, the historical data relating to mail-in-rebates could not be used to determine instant rebates. Given the limited experience with instant rebates, this led Canon to maintain its estimated accruals for a longer period of time. As 2012 progressed and new information became available, Canon reviewed the 2011 accrual balance in order to determine whether the accrual needed to be revised during 2012. By using new additional statistical information and gathering sales and inventory data from customers, Canon was able to revise its estimates.

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.

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### Allowance for doubtful receivables

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

### Valuation of inventories

Inventories are stated at the lower of cost or 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.

### Property, plant and equipment

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

### Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on Canon's forecast of future growth rates. Estimates of discount rates are determined based on the weighted average cost of capital, which considers primarily market and industry data as well as specific risk factors. Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful life of 3 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years.

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### Income tax uncertainties

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

### Valuation of deferred tax assets

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

### Employee retirement and severance benefit plans

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

In preparing its financial statements for 2013, Canon estimated a weighted-average discount rate used to determine benefit obligations of 1.6% for Japanese plans and 3.8% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.1% for Japanese plans and 5.2% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income government and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. For 2013, a decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately ¥97,589 million. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For 2013, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥4,713 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.

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

**Consolidated results of operations****2013 compared with 2012**

Summarized results of operations for 2013 and 2012 are as follows:

	2013	Change	2012
	(Millions of yen, except per share amounts and percentage data)		
Net sales	¥ 3,731,380	+7.2%	¥ 3,479,788
Operating profit	337,277	+4.1	323,856
Income before income taxes	347,604	+1.5	342,557
Net income attributable to Canon Inc.	230,483	+2.6	224,564
Net income attributable to Canon Inc. stockholders per share:			
Basic	200.78	+4.9	191.34
Diluted	200.78	+4.9	191.34

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

*Sales*

Canon's consolidated net sales in 2013 totaled ¥3,731,380 million, representing a 7.2% increase from the previous year. This was realized through steady demands for MFDs and laser printers, along with an increase in sales of inkjet printers as well as the positive effects of favorable currency exchange rates, despite the decline in demand for digital compact cameras and industrial equipment.

Overseas operations are significant to Canon's operating results and generated 80.8% of total net sales in 2013. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen during the year was ¥97.84 against the U.S. dollar, a year-on-year depreciation of approximately ¥18, and ¥130.01 against the euro, a year-on-year depreciation of approximately ¥27. The effects of foreign exchange rate fluctuations positively affected net sales by approximately ¥514,000 million in 2013. This favorable impact consisted of approximately ¥257,000 million for the U.S. dollar denominated sales, ¥193,600 million for the euro denominated sales and ¥63,400 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 foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratio of cost of sales to net sales for 2013 and 2012 was 51.8% and 52.6%, respectively.



**Table of Contents***Gross profit*

Canon's gross profit in 2013 increased by 9.0% to ¥1,798,421 million from 2012. The gross profit ratio also increased by 0.8 points year on year to 48.2%. The growth of gross profit ratio was achieved due to the cost reductions and production innovation along with the positive effects of the depreciation of the yen.

*Operating expenses*

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Despite group-wide efforts to thoroughly reduce spending, total operating expenses increased by 10.2% to ¥1,461,144 million in 2013 mainly due to the negative effect of depreciation of the yen.

*Operating profit*

Operating profit in 2013 increased 4.1% to a total of ¥337,277 million from 2012. The ratio of operating profit to net sales decreased 0.3% to 9.0% from 2012.

*Other income (deductions)*

Other income (deductions) for 2013 decreased ¥8,374 million to ¥10,327 million, owing primarily to foreign currency exchange losses.

*Income before income taxes*

Income before income taxes in 2013 was ¥347,604 million, an increase of 1.5% from 2012, and constituted 9.3% of net sales.

*Income taxes*

Provision for income taxes in 2013 decreased by ¥2,024 million from 2012. The effective tax rate during 2013 remained consistent with 2012. The effective tax rate for 2013 was 31.1%, which was lower than the statutory tax rate in Japan. This was mainly due to the tax credit for R&D expenses.

*Net income attributable to Canon Inc.*

As a result, net income attributable to Canon Inc. in 2013 increased by 2.6% to ¥230,483 million, which represents 6.2% of net sales.

*Segment information*

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

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

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

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

**Table of Contents***Sales by segment*

Please refer to the table of sales by segment in Note 20 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

	2013 (Millions of yen, except percentage data)	Change	2012
Office	¥ 2,000,073	+13.8%	¥ 1,757,575
Imaging System	1,448,938	+3.1	1,405,971
Industry and Others	374,870	-8.1	407,840
Eliminations	(92,501)		(91,598)
<b>Total</b>	<b>¥ 3,731,380</b>	<b>+7.2%</b>	<b>¥ 3,479,788</b>

Within the Office Business Unit, as for office MFDs, sales of color models increased from 2012 led by the imageRUNNER ADVANCE C5200/C2200 series. Results for high speed continuous feed printers and wide-format printers, sales of the Océ ColorStream 3000 series showed solid growth. With regard to laser printers, laser multifunction models recorded strong growth contributing to a year-on-year increase in sales volume. As a result, along with the positive effects of favorable currency exchange rates offset primarily due to decreased sales in monochrome printers, sales for the business unit totaled ¥2,000.1 billion in 2013, an increase of 13.8% year on year, while operating profit totaled ¥266.9 billion, increasing 31.1%.

Within the Imaging System Business Unit, interchangeable-lens digital cameras maintained their top market share despite the challenging environment, which was marked by a drop in demand in Europe and China due to the economic downturn, although demand in Japan continued to expand. In particular, the EOS 5D Mark III and 70D advanced-amateur-model digital SLR cameras continued to realize healthy growth. Furthermore, in Japan, the new entry-level EOS Digital Rebel SL1 and T5i cameras proved popular. As for digital compact cameras, although total sales volume declined due to the market slowdown and the increasing popularity of smartphones, sales volume increased from 2012 for high-added-value models incorporating features that differentiate them from smartphones, such as large-size image sensors and models like the PowerShot SX50 HS and SX510 HS, which feature high-magnification zoom lenses. With regard to inkjet printers, despite the harsh market environment due to the rapid fall in demand in emerging markets, sales volume showed solid growth thanks to efforts to boost sales through the introduction of new products offering enhanced support for cloud services. As a result, along with the positive effects of favorable currency exchange rates offset primarily due to decreased sales in lower-end compact digital cameras, sales for the business unit increased by 3.1% to ¥1,448.9 billion in 2013, while operating profit totaled ¥203.8 billion, a decrease of 3.1%.

In the Industry and Others Business Unit, within semiconductor lithography equipment, despite an increase in sales volume for memory devices in the latter half of 2013 fueled by renewed investment in capital expenditure by memory manufacturers, sales volumes for the year decreased slightly owing to restrained capital expenditure in the first half. As for FPD lithography equipment, sales volume remained the same as for the previous year amid the recovery in investment for large-size panels. With respect to medical equipment, sales volume for Canon's mainstay digital radiography systems steadily increased. Consequently, sales for the business unit totaled ¥374.9 billion in 2013, a decrease of 8.1% year on year, while operating profit recorded a loss of ¥25.3 billion, declining by ¥31.2 billion from 2012.

Intersegment sales of ¥92,501 million, representing 2.4% of total sales, are eliminated from total sales for the three segments, and are described as Eliminations.

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

Please refer to the table of sales by geographic area in Note 20 of the Notes to Consolidated Financial Statements.

A summary of net sales by geographic area in 2013 and 2012 is provided below:

	2013 (Millions of yen, except percentage data)	Change	2012
Japan	¥ 715,863	-0.6%	¥ 720,286
Americas	1,059,501	+12.7	939,873
Europe	1,124,929	+10.9	1,014,038
Asia and Oceania	831,087	+3.2	805,591
<b>Total</b>	<b>¥ 3,731,380</b>	<b>+7.2%</b>	<b>¥ 3,479,788</b>

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 2013 increased in all areas except Japan.

In Japan, sales slightly decreased in 2013 due to the slowdown in the Industry and Others Business, although the interchangeable-lens digital cameras continued to expand.

In the Americas, despite the decline in sales of digital compact cameras from the previous year due to the significant slowdown in the market, the depreciation of the yen against the U.S. dollar along with increased sales of inkjet printers including consumable supplies, caused sales to increase by 12.7% in 2013.

In Europe, although sales of interchangeable lens digital cameras declined due to shifting to low-end models as well as declining sales of digital compact cameras owing to shrinking market, the effect of depreciation of the yen along with steady sales of inkjet printers and MFDs amid increasing uncertainty in European economy, caused sales to increase by 10.9% in 2013.

In Asia and Oceania, sales of interchangeable lens digital cameras, which have been an engine for solid growth in Asia and Oceania, showed a slowdown in growth. In addition sales of digital compact cameras and laser printers faced harsh conditions. Inkjet printers including consumable supplies, on the other hand, showed steady sales growth. Reflecting these factors and the effect of depreciation of the yen, net sales increased by 3.2% in 2013.

**Operating profit by segment**

Please refer to the table of segment information in Note 20 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in 2013 increased by ¥63,330 million to ¥266,908 million. This increase resulted from the sales increase.

Operating profit for the Imaging System Business Unit in 2013 decreased by ¥6,524 million to ¥203,794 million. This decrease resulted primarily from the increase in expense due to depreciation of the yen.

Operating profit for the Industry and Others Business Unit in 2013 declined by ¥31,241 million, largely owing to the decrease in sales.

**Table of Contents****2012 compared with 2011**

Summarized results of operations for 2012 and 2011 are as follows:

	2012	Change	2011
	(Millions of yen, except per share amounts and percentage data)		
Net sales	¥ 3,479,788	-2.2%	¥ 3,557,433
Operating profit	323,856	-14.3	378,071
Income before income taxes	342,557	-8.5	374,524
Net income attributable to Canon Inc.	224,564	-9.7	248,630
Net income attributable to Canon Inc. stockholders per share:			
Basic	191.34	-6.4	204.49
Diluted	191.34	-6.4	204.48

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

*Sales*

Canon's consolidated net sales in 2012 totaled ¥3,479,788 million, representing a 2.2% decrease from the previous year. This decrease of net sales was due primarily to economic slowdown mainly in Europe and the high valuation of the yen against the euro combined with the cooling off of demand in China during the latter half of the year. Canon Group faced increasingly challenging conditions across all of its businesses.

Overseas operations are significant to Canon's operating results and generated 79.3% of total net sales in 2012. 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 2012 was ¥79.96 to the U.S. dollar, and ¥102.80 to the euro, representing a slight depreciation to the U.S. dollar, and an appreciation of approximately ¥8 against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations negatively affected net sales by approximately ¥54,300 million in 2012. This impact consisted of approximately ¥69,200 million of unfavorable impact for euro denominated sales and favorable impact of ¥9,500 million for the U.S. dollar denominated sales and ¥5,400 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 foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratio of cost of sales to net sales for 2012 and 2011 was 52.6% and 51.2%, respectively.

*Gross profit*

Canon's gross profit in 2012 decreased by 5.0% to ¥1,649,966 million from 2011. The gross profit ratio declined by 1.4 points year on year to 47.4%. The deteriorated gross profit ratio was mainly the result of such factors as the sharp appreciation of the yen to the euro and falling product prices accompanied by the rise in prices of materials.

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### *Operating expenses*

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Owing to Group-wide efforts to thoroughly reduce spending, total operating expenses decreased by 2.4% to ¥1,326,110 million in 2012.

### *Operating profit*

Operating profit in 2012 decreased 14.3% to a total of ¥323,856 million from 2011. The ratio of operating profit to net sales decreased 1.3% to 9.3% from 2011.

### *Other income (deductions)*

Other income (deductions) for 2012 achieved a turnaround of ¥22,248 million, owing primarily to an improvement in foreign currency exchange gain.

### *Income before income taxes*

Income before income taxes in 2012 was ¥342,557 million, a decrease of 8.5% from 2011, and constituted 9.8% of net sales.

### *Income taxes*

Provision for income taxes in 2012 decreased by ¥10,303 million from 2011. The effective tax rate during 2012 remained consistent with 2011. The effective tax rate for 2012 was 32.1%, which was lower than the statutory tax rate in Japan. This was mainly due to the increase in tax credit for R&D expenses.

### *Net income attributable to Canon Inc.*

As a result, net income attributable to Canon Inc. in 2012 decreased by 9.7% to ¥224,564 million, which represents 6.5% of net sales.

### *Segment information*

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

The Office Business Unit mainly includes office MFDs, office copying machines, personal-use copying machines, laser MFDs, laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions. The Imaging System Business Unit\* mainly includes interchangeable-lens digital cameras, compact digital cameras, digital camcorders, digital cinema cameras, interchangeable lenses, inkjet printers, large-format inkjet printers, commercial photo printers, image scanners, broadcast equipment and calculators. The Industry and Others Business Unit mainly includes semiconductor lithography equipment, FPD lithography equipment, digital radiography systems, ophthalmic equipment, vacuum thin-film deposition equipment, organic LED panel manufacturing equipment, micromotors, computers, handy terminals and document scanners.

\* The Consumer Business Unit has been renamed the Imaging System Business Unit to be more consistent with its strategy to expand the business. This change in segment description has no impact on any financial information of this segment.

**Table of Contents****Sales by segment**

Please refer to the table of sales by segment in Note 20 of the Notes to Consolidated Financial Statements.

Canon's sales by segment are summarized as follows:

	2012 (Millions of yen, except percentage data)	Change	2011
Office	¥ 1,757,575	-8.4%	¥ 1,917,943
Imaging System	1,405,971	+7.2	1,312,044
Industry and Others	407,840	-3.1	420,863
Eliminations	(91,598)		(93,417)
<b>Total</b>	<b>¥ 3,479,788</b>	<b>-2.2%</b>	<b>¥ 3,557,433</b>

Sales of the Office Business Unit constituting 50.5% of consolidated net sales. Sales volume of both monochrome and color MFDs increased, favored by the continued strong demand for color MFDs, such as imageRUNNER ADVANCE C5000/C2000-series models. As for laser printers, sales volumes declined mainly in Europe due to deterioration in business sentiment. Consequently, combined with the appreciation of the yen, sales for the segment totaled ¥1,757,575 million, a decline of 8.4% in 2012.

Sales of the Imaging System Business Unit constituting 40.4% of consolidated net sales. Sales of interchangeable-lens digital cameras increased thanks to the competitively priced EOS Rebel series along with the EOS 5D Mark III and EOS 60D advanced-amateur models. As for compact digital cameras, despite the significant deterioration of market conditions, sales volume remained at the same level as the previous year thanks to robust sales of the PowerShot ELPH 110 HS and PowerShot A2300. With respect to inkjet printers, sales volume surpassed that for the year-ago period owing to the early restoration of production following the flooding in Thailand. Furthermore, the company successfully entered new markets with the launch of its CINEMA EOS SYSTEM lineup of professional cinematography products, targeting Hollywood and the broader motion picture and television production market, along with the new DreamLabo 5000, targeting the commercial photo printing market. As a result, amid the effects of the strong yen, sales for the segment increased by 7.2% year on year to ¥1,405,971 million in 2012.

Sales of the Industry and Others Business Unit constituted 11.7% of consolidated net sales in 2012. Among semiconductor lithography equipment, while sales of i-line steppers remained at the same level as the previous year owing to demand for image sensors and LED elements, sales volume overall decreased due to restrained capital expenditure for memory devices. As for FPD lithography equipment, unit sales dropped substantially in the face of shrinking demand for equipment used in the production of large-size panels, an area in which Canon is particularly strong. Consequently, combined with the appreciation of the yen, sales for the segment totaled ¥407,840 million, a decrease of 3.1% year on year in 2012.

Intersegment sales of ¥91,598 million, representing 2.6% of total sales, are eliminated from the total sales of the three segments, and are described as Eliminations.

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

Please refer to the table of sales by geographic area in Note 20 of the Notes to Consolidated Financial Statements.

A summary of net sales by geographic area in 2012 and 2011 is provided below:

	2012 (Millions of yen, except percentage data)	Change	2011
Japan	¥ 720,286	+3.7%	¥ 694,450
Americas	939,873	-2.3	961,955
Europe	1,014,038	-8.9	1,113,065
Asia and Oceania	805,591	+2.2	787,963
<b>Total</b>	<b>¥ 3,479,788</b>	<b>-2.2%</b>	<b>¥ 3,557,433</b>

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 2012 increased in Japan and Asia and Oceania while decreased in Americas and Europe.

In Japan, sales increased by 3.7% in 2012 supported by the moderate economic recovery.

In the Americas, despite the admirable sales performance of interchangeable-lens digital cameras and solid growth in MFDs, laser printer market weakness caused sales to decline by 2.3% in 2012.

In Europe, although interchangeable-lens digital cameras showed solid growth, weak demand for laser printers along with the sharp appreciation of the yen against the euro caused sales to decrease by 8.9% in 2012.

In Asia and Oceania, although the speed of economic expansion in China slowed down slightly in the latter half of the year, owing to the solid demand for interchangeable-lens digital cameras in emerging economies, net sales increased by 2.2% in 2012.

***Operating profit by segment***

Please refer to the table of segment information in Note 20 of the Notes to Consolidated Financial Statements.

Operating profit for the Office Business Unit in 2012 decreased by ¥55,687 million to ¥203,578 million. This decrease resulted from the decrease in sales and appreciation of the yen against the euro.

Operating profit for the Imaging System Business Unit in 2012 decreased by ¥976 million to ¥210,318 million. This decrease resulted primarily from the appreciation of the yen against the euro.

Operating profit for the Industry and Others Business Unit in 2012 declined by ¥18,390 million, largely owing to the decrease in sales.

**Foreign operations and foreign currency transactions**

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





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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 20 of the Notes to Consolidated Financial Statements.

### **B. Liquidity and capital resources**

Cash and cash equivalents in 2013 increased by ¥122,231 million to ¥788,909 million, compared with ¥666,678 million in 2012 and ¥773,227 million in 2011. Canon's cash and cash equivalents are typically denominated both in Japanese yen and in U.S. dollars, with the remainder denominated in foreign currencies.

Net cash provided by operating activities in 2013 increased by ¥123,565 million from the previous year to ¥507,642 million. Cash flow from operating activities consisted of the following key components: the major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, R&D expenses and income taxes.

For 2013, cash inflow from cash received from customers increased due to the increase in sales. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials decreased, as a result of our efforts to decrease inventory. Cash outflow for payments for selling, general and administrative expenses increased due to the impact of Japanese Yen on operating expenses denominated in foreign currencies. On the other hand, operation expenses in local currency base declined due to cost reduction activities of group companies. Cash outflow for income taxes increased due to the increase in taxable income.

Net cash used in investing activities in 2013 was ¥250,212 million, increasing by ¥37,472 million from ¥212,740 million in 2012, due to the increasing amount of time deposits included in short-term investments. Purchases of fixed assets were focused on items relevant to new products.

Canon defines "free cash flow" by deducting cash flows from investing activities from cash flows from operating activities. For 2013, free cash flow totaled ¥257,430 million as compared with ¥171,337 million for 2012. Canon's management recognizes that constant and intensive investment in facilities and R&D is required to maintain and strengthen the competitiveness of its products. Canon's management seeks to meet its capital requirements with cash flow principally earned from its operations. Therefore, its capital resources are primarily sourced from internally generated funds.

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

Net cash used in financing activities totaled ¥222,181 million in 2013, mainly resulting from repurchase of treasury stock of ¥50,007 million, and dividends of ¥155,627 million. The Company paid dividends in 2013 of ¥135.00 per share.

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

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Short-term loans (including the current portion of long-term debt) amounted to ¥1,299 million at December 31, 2013 compared with ¥1,866 million at December 31, 2012. Long-term debt (excluding the current portion) amounted to ¥1,448 million at December 31, 2013 compared with ¥2,117 million at December 31, 2012.

Canon's long-term debt mainly consists of lease obligations.

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

As of March 14, 2014, Canon's debt ratings are: Moody's: Aa1 (long-term); S&P: AA (long-term), A-1+ (short-term); and R&I: AA+ (long-term). Canon does not have any rating downgrade triggers that would accelerate the maturity of a material amount of its debt. A downgrade in Canon's credit ratings or outlook could, however, increase the cost of its borrowings.

Following the natural disasters which occurred in 2011, Canon determined that its concerted focus on decreasing levels of total inventory, even for competitive and strong-selling products, had resulted in shortages of finished goods, adversely affecting its ability to capitalize on selling opportunities. As a consequence, Canon re-evaluated its priorities for targeting levels of finished goods inventory, and decided on a new management policy to increase levels of finished goods inventories at sales locations as a buffer in order to increase its resilience in response to unexpected natural or man-made disasters and consequent production line stoppages. Canon's initiative in recent periods to optimize inventory levels is intended to maintain an appropriate balance among relevant imperatives, including minimizing working capital, avoiding undue exposure to the risk of inventory obsolescence, and maintaining the ability to sustain sales despite the occurrence of unexpected disasters.

Reflecting the foregoing circumstances, Canon's total inventory turnover ratios were 52, 57, and 46 days at the end of the fiscal years 2013, 2012, and 2011, respectively and the increases over the last three years are in line with Canon's expectations and its revised inventory management policy.

Increase in property, plant and equipment on an accrual basis in 2013 amounted to ¥188,826 million compared with ¥270,457 million in 2012 and ¥226,869 million in 2011. For 2014, Canon projects its increase in property, plant and equipment will be approximately ¥210,000 million.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥48,515 million in 2013, ¥30,421 million in 2012 and ¥30,510 million in 2011. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥14,383 million in 2013, ¥13,021 million in 2012, and ¥12,511 million in 2011.

Working capital in 2013 increased by ¥199,814 million to ¥1,437,635 million, compared with ¥1,237,821 million in 2012 and ¥1,259,457 million in 2011. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for 2013 was 2.69 compared to 2.47 for 2012 and to 2.41 for 2011.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 5.6% in 2013, compared to 5.7% in 2012 and 6.3% in 2011.

Return on Canon Inc. stockholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. stockholders' equity) was 8.4% in 2013 compared with 8.7% in 2012 and 9.6% in 2011.

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The debt to total assets ratio was 0.1%, 0.1% and 0.3% as of December 31, 2013, 2012 and 2011, respectively. Canon had short-term loans and long-term debt of ¥2,747 million as of December 31, 2013, ¥3,983 million as of December 31, 2012 and ¥11,711 million as of December 31, 2011.

### **C. Research and development, patents and licenses**

Year 2013 marks the third year of the Excellent Global Corporation Plan, its 5-year (2011-2015) management plan. The slogan of the fourth phase ( Phase IV ) is Aiming for the Summit-Speed & Sound Growth and there are three core strategies related to R&D:

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

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

- Achieve the overwhelming No.1 position in all core businesses and expand related and peripheral businesses: Continue to introduce competitive products through innovation and aim at gaining profit through solutions and services.
- Develop new business through globalized diversification and establish the Three Regional Headquarters management system: Reinforce the businesses of commercial printing sector, medical imaging sector, industrial equipment sector and security and safety sector to develop into Canon's new pillars. Seek talents in Japan, US, and Europe to foster promising technologies and enhance R&D capabilities in global-scale dimensions by enabling product development in specialized area of each region, with actively utilizing M&A.
- Build the foundations of an environmentally advanced corporation: Focus on energy- and resource-conserving technologies to create products with the highest environmental performance.

Canon is pursuing collaboration among the government, industry and academia, and has strengthened relationships with universities and other research institutes worldwide, such as Kyoto University, Tokyo Institute of Technology, Osaka University, Stanford University, the University of Arizona, and the New Energy and Industrial Technology Development Organization to assist with fundamental research and to develop cutting-edge technologies. Additionally, Canon is currently working on a collaborative research with Massachusetts General Hospital ( MGH ) and Brigham and Women's Hospital ( BWH ) to develop biomedical optical imaging and medical robotics technologies at the Healthcare Optics Research Laboratory in Cambridge, Massachusetts, founded in June of 2013.

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

Canon's consolidated R&D expenses were ¥306,324 million in 2013, ¥296,464 million in 2012 and ¥307,800 million in 2011. The ratios of R&D expenses to the consolidated total net sales for 2013, 2012 and 2011 were 8.2%, 8.5% and 8.7%, respectively.

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

Canon obtained the third greatest number of private sector patents in 2013, according to the United States patent annual list, released by IFI CLAIMS® Patent Services.

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### **D. Trend information**

As for the outlook in 2014, there are signs of brightness among developed countries with steady economic growth in the U.S. and Japan, and the European economy expected to realize a turnaround toward recovery. Although uncertainties remain in emerging countries such as China, since they are expected to maintain their course of moderate expansion, the global economy, having bottomed out in 2013, is also expected to realize a moderate recovery.

2014 represents the fourth year of Phase IV (2011-2015) of the Excellent Global Corporation Plan. The Canon Group will work in unity, taking steps to realize sound business growth and overcome challenges to firmly return to a path of growth.

In order to achieve its targets, Canon will implement various measures under a basic policy of carrying out further reforms in order to return to the growth track.

#### *Bolstering Strengths of Existing Core Businesses by Creating Outstanding Hit Products*

Canon aims to improve its market share for existing core businesses, developing appealing products that outperform the competition, not only in terms of basic performance, but also cost and usability. At the same time, Canon will strengthen the development of businesses derived from existing core businesses.

#### *Securely Launch and Steadily Expand New Businesses*

Canon will work to accelerate the business expansion of network camera systems for which significant growth is expected. The Company will also focus on strengthening its business foundation for 4K reference displays and mixed-reality systems, while also concentrating on the commercialization of Super Machine Vision. In the medical field, Canon aims to realize the early launch of DNA diagnostic systems.

#### *Holistically Developing Global Sales Forces*

In emerging markets, Canon will work to expand sales networks and enhance product lineups in accordance with conditions in each country. In developed countries, in addition to boosting the Company's ability to respond to Internet-based and other direct-order sales, Canon will strengthen its response to the centralized purchasing practices used by global corporations when procuring office products.

#### *Optimizing the Global Production System*

Based on such factors as changes in local conditions in each country, Canon will work to realize the optimized global allocation of its production assets. The Company will also work to maintain or expand its production in Japan through automation, while also accelerating localized production of mainly consumables in the Americas and Europe through automated production systems.

#### *Exploring a New Dimension of Cost Reductions*

Canon will strive to further accelerate procurement reforms as well as expand in-house production and promote automation. Additionally, the Company will work to significantly reduce product development times and achieve cost savings, promoting prototype-less production through the utilization of its super computer. Furthermore, it will move forward with the fundamental reform of manufacturing through the utilization of 3D printers.

In addition to the above, in order to return to a path of growth in the face of the dramatically changing business environment, Canon will select and concentrate on technological themes that will open the way to the future, further enhance product quality management, effectively make use of the Company's workforce, and carry out reforms such as thoroughly strengthening information security.



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

**E. Off-balance sheet arrangements**

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

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon will have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years in the case of employees with housing loans, and 1 year to 10 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥12,315 million at December 31, 2013. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2013 were insignificant.

**F. Contractual obligations**

The following summarizes Canon's contractual obligations at December 31, 2013.

	Total	Payments Due By Period			More than 5 years
		Less than 1 year	1-3 years (Millions of yen)	3-5 years	
Contractual obligations:					
Long-Term Debt:					
Capital Lease Obligations	¥ 2,482	¥ 1,213	¥ 1,098	¥ 171	¥
Other Long-Term Debt	211	32	101	48	30
Operating Lease Obligations	96,064	28,523	37,915	16,446	13,180
Purchase commitments for:					
Property, Plant and Equipment	26,218	26,218			
Parts and Raw Materials	73,914	73,914			
Other long-term liabilities					
Contribution to Defined Benefit Pension Plans	20,649	20,649			
<b>Total</b>	<b>¥ 219,538</b>	<b>¥ 150,549</b>	<b>¥ 39,114</b>	<b>¥ 16,665</b>	<b>¥ 13,210</b>

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 11, Income Taxes in the Notes to Consolidated Financial Statements for further details. Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2013, accrued product warranty costs amounted to ¥10,890 million.

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At December 31, 2013, commitments outstanding for the purchase of property, plant and equipment were approximately ¥26,218 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥73,914 million, both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During 2014, Canon expects to contribute ¥13,589 million to its Japanese defined benefit pension plans and ¥7,060 million to its foreign defined benefit pension plans.

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

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

Directors and Audit & Supervisory Board Members of the Company as of March 28, 2014 and their respective business experience are listed below.

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





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<b>Name</b>	<b>Position</b>	<b>Date of commencement</b>	<b>Business experience</b>
<b>(Date of birth)</b>	<b>(Group executive/function)</b>		<b>(*current position/function)</b>
Toshiaki Ikoma (Mar. 5, 1941)	Executive Vice President & CTO  (Group Executive of Corporate R&D HQ,  Group Executive of Medical Equipment Group)	4/1982  2/1997 2/2002  10/2004  4/2005  12/2008 1/2009 3/2009 7/2009 3/2011 1/2014	Professor of Institute of Industrial Science, the University of Tokyo President of Texas Instruments Japan Limited Chairman of the Board of Texas Instruments Japan Limited Director-General of Center for Research and Development Strategy (CRDS), Japan Science and Technology Agency (JST) Entered the Company Adviser of the Company President of Canon Foundation* Group Executive of Corporate R&D HQ* Director, Executive Vice President & CTO Chief Executive of Optical Products Operations Executive Vice President & CTO* Group Executive of Medical Equipment Group*
Yoroku Adachi (Jan. 11, 1948)	Senior Managing Director	4/1970 3/2001  4/2001 3/2005 4/2005 3/2009	Entered the Company Chairman of Canon Singapore Pte. Ltd. Chairman of Canon Hong Kong Co., Ltd. Director President of Canon (China) Co., Ltd. Managing Director President of Canon U.S.A., Inc.* Senior Managing Director*
Yasuo Mitsuhashi (Nov. 23, 1949)	Senior Managing Director (Chief Executive of Peripheral Products HQ)	4/1974 2/2001 3/2001 4/2003 3/2005 3/2009 4/2009	Entered the Company Chief Executive of Chemical Products HQ Director Chief Executive of Peripheral Products HQ* Managing Director Senior Managing Director* Chief Executive of Chemical Products Operations
Shigeyuki Matsumoto (Nov. 15, 1950)	Senior Managing Director (Group Executive of Device Technology Development HQ)	4/1977 1/2002  3/2004 3/2007 3/2011	Entered the Company Group Executive of Device Technology Development HQ*  Director Managing Director Senior Managing Director*

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<b>Name</b>	<b>Position</b>	<b>Date of commencement</b>	<b>Business experience</b>
<b>(Date of birth)</b>	<b>(Group executive/function)</b>		<b>(*current position/function)</b>
Toshio Honma	Senior Managing Director	4/1972 4/2001	Entered the Company Deputy Chief Executive of i Printer Products HQ
(Mar. 10, 1949)	(Group Executive of Global Procurement HQ)	3/2003 4/2003 7/2003	Director Group Executive of Business Promotion HQ Group Executive of L Printer Business Promotion HQ
		1/2007 3/2008 3/2012	Chief Executive of L Printer Products HQ Managing Director Senior Managing Director* Group Executive of Global Procurement HQ*
Hideki Ozawa	Senior Managing Director	4/1973	Entered Canon Sales Co., Inc. (renamed Canon Marketing Japan Inc.)
(Apr. 28, 1950)		7/1980 4/2005 3/2007 3/2010 3/2014	Entered the Company President of Canon (China) Co., Ltd.* Director Managing Director Senior Managing Director*
Masaya Maeda	Senior Managing Director	4/1975 1/2006	Entered the Company Group Executive of Digital Imaging Business Group
(Oct. 17, 1952)	(Chief Executive of Image Communication Products HQ)	3/2007 4/2007	Director Chief Executive of Image Communications Products HQ*
		3/2010 3/2014	Managing Director Senior Managing Director*
Yasuhiro Tani	Director (Group Executive of Digital System Technology Development HQ)	4/1980 1/2008	Entered the Company Group Executive of Digital Platform Technology Development HQ
(Jul. 30, 1956)		4/2008 3/2011 7/2012	Executive Officer Director* Group Executive of Digital System Technology Development HQ*
Kenichi Nagasawa	Director (Group Executive of Corporate Intellectual Property and Legal HQ)	4/1981 3/2010	Entered the Company Deputy Group Executive of Corporate Intellectual Property and Legal HQ
(Jan. 31, 1959)		4/2010 3/2012	Executive Officer Group Executive of Corporate Intellectual Property and Legal HQ* Director*

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<b>Name</b>	<b>Position</b>	<b>Date of commencement</b>	<b>Business experience</b>
<b>(Date of birth)</b>	<b>(Group executive/function)</b>		<b>(*current position/function)</b>
Naoji Otsuka (Apr. 24, 1958)	Director (Chief Executive of Inkjet Products Operations)	4/1981	Entered the Company
		1/2010	Group Executive of Inkjet Products Development Group
		4/2011	Executive Officer Deputy Chief Executive of Inkjet Products Operations
		3/2012	Director* Chief Executive of Inkjet Products Operations*
Masanori Yamada (Jul. 3, 1954)	Director (Group Executive of Network Visual Solution Business Promotion HQ)	4/1981	Entered the Company
		4/2005	Group Executive of Office Imaging Products Corporate System
		4/2008	Executive Officer Deputy Chief Executive of Office Imaging Products HQ
		4/2012	Senior Executive Officer
		1/2013	Group Executive of Network Visual Solution Business Promotion HQ*
3/2013	Director*		
Aitake Wakiya (Nov. 8, 1955)	Director (Deputy Group Executive of Finance & Accounting HQ)	4/1979	Entered the Company
		4/2011	Deputy Group Executive of Finance & Accounting HQ*
		4/2012	Executive Officer
		3/2013	Director*
Kazuto Ono (Jul. 20, 1957)	Director (Group Executive of Corporate Planning Development HQ)	4/1980	Entered the Company
		5/2011	Senior General Manager of Finance & Accounting HQ
		3/2012	Group Executive of Human Resources Management & Organization HQ
		4/2012	Executive Officer
		3/2013	Director*
3/2014	Group Executive of Corporate Planning Development HQ*		
Akiyoshi Kimura (Jul. 19, 1956)	Director (Chief Executive of Office Imaging Products HQ)	4/1980	Entered the Company
		1/2009	Group Executive of Office Imaging Products Production System HQ
		4/2011	Executive Officer Deputy Chief Executive of Office Imaging Products HQ
		1/2013	Group Executive of Office Imaging Products corporate system HQ* Group Executive of Office Imaging Products Development Group*
3/2014	Director* Chief Executive of Office Imaging Products HQ*		
Eiji Osanai (Feb. 17, 1959)	Director (Group Executive of Production Engineering HQ)	8/1983	Entered the Company
		7/2010	Senior General Manager of Production Engineering Research Laboratory
		4/2012	Executive Officer

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	Deputy Group Executive of Production Engineering HQ
1/2013	Senior Group Manager of Production Equipment Administration Center*
3/2014	Director* Group Executive of Production Engineering HQ*

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<b>Name</b>	<b>Position</b>	<b>Date of commencement</b>	<b>Business experience</b>
<b>(Date of birth)</b>	<b>(Group executive/function)</b>		<b>(*current position/function)</b>
Kunitaro Saida (May. 4, 1943)	Director	5/2006	Qualified for attorney*
		6/2007	Audit & Supervisory Board Member of NICHIREI CORPORATION*
		6/2008	Director of Sumitomo Osaka Cement Co., Ltd.*
		6/2010	Director of HEIWA REAL ESTATE CO., LTD.*
		3/2014	Director*
Haruhiko Kato (Jul. 21, 1952)	Director	7/2009	Commissioner of National Tax Agency
		1/2011	Senior Managing Director of Japan Securities Depository Center, Incorporated
		6/2011	President and CEO of Japan Securities Depository Center, Incorporated*
		6/2013	Director of Toyota Motor Corporation*
		3/2014	Director*
Kengo Uramoto (Aug. 23, 1953)	Audit & Supervisory Board Member	4/1978	Entered the Company
		10/2007	Deputy Group Executive of Human Resources Management & Organization HQ
		4/2008	Executive Officer Group Executive of Human Resources Management & Organization HQ
		1/2009	Deputy Group Executive of Human Resources Management & Organization HQ
		4/2010	Group Executive of Human Resources Management & Organization HQ
3/2012	Audit & Supervisory Board Member*		
Makoto Araki (Jul. 16, 1954)	Audit & Supervisory Board Member	4/1978	Entered the Company
		10/2009	Group Executive of Information & Communication Systems HQ
		4/2010	Executive Officer
		3/2011	Director
		3/2014	Audit & Supervisory Board Member*
Tadashi Ohe (May 20, 1944)	Audit & Supervisory Board Member	4/1969	Qualified for attorney*
		4/1989	Instructor of Judicial Research and Training Institute
		3/1994	Audit & Supervisory Board Member*
Osami Yoshida (Nov. 4, 1950)	Audit & Supervisory Board Member	9/1982	Registered as Certified Public Accountant*
		12/2011	Deputy Group Executive of Human Resources HQ, Deloitte Touche Tohmatsu LLC
		3/2014	Audit & Supervisory Board Member*

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<b>Name</b>	<b>Position</b>	<b>Date of commencement</b>	<b>Business experience</b>
<b>(Date of birth)</b>	<b>(Group executive/function)</b>		<b>(*current position/function)</b>
Kuniyoshi Kitamura  (Apr. 8, 1956)	Audit & Supervisory Board Member	4/1981 4/2002  4/2004  4/2006  11/2007  4/2009  3/2010	Entered The Dai-Ichi Mutual Life Insurance Co. General Manager of Network Service Management Department of The Dai-Ichi Mutual Life Insurance Co. General Manager of Corporate Relations Department No.2 of The Dai-Ichi Mutual Life Insurance Co. General Manager of Research Department of The Dai-Ichi Mutual Life Insurance Co. General Manager of Corporate Planning Department No.2 of The Dai-Ichi Mutual Life Insurance Co. General Manager of Corporate Relations Department No.8 of The Dai-Ichi Mutual Life Insurance Co. Audit & Supervisory Board Member*

*Term*

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

Tadashi Ohe, Osami Yoshida and Kuniyoshi Kitamura, are outside Audit & Supervisory Board Members as stipulated in Item 16, Article 2 of the Corporation Law of Japan. Kunitaro Saida and Haruhiko Kato are outside directors. The term of office of directors is one year. The current term of all directors expires in March 2014. The term of office of Audit & Supervisory Board Members is four years. The current term for Tadashi Ohe expires in March 2015, and the current term for Kuniyoshi Kitamura expires in March 2018, and the current term for Kengo Uramoto, who was elected in the general meeting of shareholders in March 2012, expires in March 2016, and the current term for Makoto Araki, Osami Yoshida who were elected in the general meeting of shareholders in March 2014, expires in March 2018.

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

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

*Board of Directors and Audit & Supervisory Board Members*

The Company's articles of incorporation provide for a board of directors of not more than 30 members and for not more than five Audit & Supervisory Board Members. Currently the number of board members is 19 and the number of Audit & Supervisory Board Members is five. There is no maximum age limit for members of the board. Board members and Audit & Supervisory Board Members may be removed from office at any time by a resolution of a general meeting of shareholders.

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

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

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

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

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

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

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

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

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

**Table of Contents***Executive Officer System*

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

Executive Officers of the Company appointed by the Board of Directors meeting held on January 29, 2014, whom are expected to take the assignment on April 1, 2014, are listed below.

<b>Name</b>	<b>Position</b>	<b>(Group executive/function)</b>
Hiroyuki Suematsu	Senior Executive Officers	Group Executive of Quality Management HQ
Shigeyuki Uzawa	Senior Executive Officers	Chief Executive of Optical Products Operations
Akio Noguchi	Senior Executive Officers	Group Executive of Mixed Reality Solution Business Promotion HQ
Seymour Liebman	Senior Executive Officers	Executive Vice President of Canon U.S.A., Inc.
Yuichi Ishizuka	Senior Executive Officers	Executive Vice President of Canon U.S.A., Inc.
Rokus van Iperen	Senior Executive Officers	President of Canon Europa N.V. and Canon Europe Ltd.
Masato Okada	Executive Officers	Deputy Chief Executive of Image Communication Products HQ
Kazuto Ogawa	Executive Officers	Executive Vice President of Canon (China) Co., LTD.
Ryuichi Ebinuma	Executive Officers	Deputy Group Executive of Corporate R&D HQ
Kazuhiko Noguchi	Executive Officers	Group Executive of Public Affairs HQ
Hiroaki Takeishi	Executive Officers	Group Executive of Semiconductor Production Equipment Group
Nobutoshi Mizusawa	Executive Officers	Deputy Group Executive of Corporate R&D HQ
Yoichi Iwabuchi	Executive Officers	Senior General Manager of Software Platform Technology Development Center
Masaaki Nakamura	Executive Officers	Deputy Group Executive of Facilities Management HQ Deputy Group Executive of Human Resources Management & Organization HQ
Takashi Takeya	Executive Officers	Senior General Manager of Global Logistics Management Center
Katsumi Iijima	Executive Officers	Group Executive of Information & Communication Systems HQ
Nobuyuki Tainaka	Executive Officers	Deputy Senior General Manager of Corporate Legal Center

**B. Compensation**

In the fiscal year ended December 31, 2013, Canon pays an aggregate of approximately ¥3,505 million to its directors and Audit & Supervisory Board Members. This amount includes bonuses, stock options and retirement allowances.

Directors are not covered by the Company's retirement program. However, in accordance with customary Japanese business practices, directors receive lump-sum retirement benefits, subject to shareholder approval. The retirement allowance system for Directors was abolished at the conclusion of the Ordinary General Meeting of Shareholders for the 112th Business Term held on March 28, 2013. At the same meeting, the Company received approval for the final retirement benefit for Directors. The retirement allowance for Directors represents the final retirement benefit for retired Director.



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Beginning from the fiscal year ended December 31, 2010, the Company is required to disclose the compensation of any director who receives total aggregate annual compensation exceeding ¥100 million in accordance with the Financial Instruments and Exchange Act of Japan and related ordinances. The following table sets forth the amount of compensation paid or planned to be paid directors whose aggregate compensation exceeded ¥100 million in 2013.

Name (Position)	Company	Category of remuneration					Total
		Basic Compensation	Bonus	SubTotal (Millions of yen)	Retirement Allowance	Stock Option	
Fujio Mitarai (Director)	Canon Inc.	¥ 227	¥ 32	¥ 259	¥ 841	¥ 5	¥ 1,105
Toshizo Tanaka (Director)	Canon Inc.	105	18	123	236	5	364
Toshiaki Ikoma (Director)	Canon Inc.	99	16	115	63	5	183
Kunio Watanabe (Director)	Canon Inc.	85	15	100	128	3	231
Yoroku Adachi (Director)	Canon Inc.	78	13	91	104	3	198
Yasuo Mitsuhashi (Director)	Canon Inc.	73	13	86	104	3	193
Shigeyuki Matsumoto (Director)	Canon Inc.	69	11	80	70	3	153
Toshio Honma (Director)	Canon Inc.	67	11	78	71	3	152
Masaki Nakaoka (Director)	Canon Inc.	66	12	78	65	3	146
Haruhisa Honda (Director)	Canon Inc.	66	12	78	65	3	146
Hideki Ozawa (Director)	Canon Inc.	72	8	80	40	3	123
Masaya Maeda (Director)	Canon Inc.	56	8	64	40	3	107

Notes:

- (1) Bonus amounts represent the increased portion of accrued directors' bonuses in fiscal year 2013.
- (2) The retirement allowance system for Directors was abolished at the conclusion of the Ordinary General Meeting of Shareholders for the 112th Business Term held on March 28, 2013. At the same meeting, the Company received approval for the final retirement benefit for Directors.
- (3) The stock option amounts represent an expense recognized during fiscal year 2013 determined based on the fair value on the date of grant using the Black-Scholes option pricing model.
- (4) Yoroku Adachi and Hideki Ozawa serve as president of Canon U.S.A. and Canon China, respectively. Compensation amounts to Yoroku Adachi and Hideki Ozawa from the subsidiaries are translated from U.S. dollars and Chinese yuan based on the average rate for fiscal year 2013 of ¥97.72 to the U.S. dollar and ¥15.91 to the yen, respectively and are included above.

The following three elements comprise remuneration to directors:

Basic Compensation: compensation for executing of business operations

Bonus: bonus links to business results of current fiscal year

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

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

The determination methods of remuneration are as follows:

*Basic Compensation*

Each maximum amount of total compensation to directors and Audit & Supervisory Board Members is determined by the Ordinary General Meeting of Shareholders. The remuneration to each director is determined

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by the meeting of the Board of Directors based on criteria set by the Company, and the remuneration to each Audit & Supervisory Board Member is determined by the meeting of Audit & Supervisory Board Members.

### *Bonus*

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

### *Retirement Allowance*

Retirement allowances are paid at the time of retirement in appreciation of their services during their terms in offices. The amount of allowance is calculated based on monthly basic compensation and the number of years of service, etc. to the Company and is proposed to and approved by the Ordinary General Meeting of Shareholders. The retirement allowance system for Directors was abolished at the conclusion of the Ordinary General Meeting of Shareholders for the 112th Business Term held on March 28, 2013. At the same meeting, the Company received approval for the final retirement benefit for Directors.

### *Stock Option*

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

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

The descriptions of the stock option plans are below.

#### *The Stock Option Plan Approved on March 28, 2008*

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

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

##### 2. Grantees of Share Options

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

##### 3. Number of Share Options

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

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4. Cash Payment for Share Options

No cash payment will be required for the share options.

5. Exercise Price

The exercise price is ¥5,502 per share.

6. Features of Share Options

The features of share options are as follows:

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

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

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

Allotted Number of Shares after Adjustment

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

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

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

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

The Exercise Price will be adjusted as follows:

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

Exercise Price after Adjustment

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

(ii) If, after the date of allotment of share options, the Company issues common shares at a price lower than the then market price thereof (other than by way of conversion of the third series of Unsecured Convertible Debentures Due 2008 of the Company) or disposes of common shares owned by it, the Exercise Price will be

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adjusted by the following calculation formula, with any fractional amount of less than one yen to be rounded up to one yen; however, the Exercise Price will not be adjusted in the case of the exercise of share options:

Exercise Price after Adjustment = Exercise Price before Adjustment ×

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

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

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

(3) Period during Which Share Options Are Exercisable

From May 1, 2010 to April 30, 2014.

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

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc.

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

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

(5) Restriction on Acquisition of Share Options by Transfer

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

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

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

(7) Handling of Fractions

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

(8) Other Conditions for Exercise of Share Options

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

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

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

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

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

### 7. Specific Method of Calculation of Remuneration to Directors

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

#### *The Stock Option Plan Approved on March 27, 2009*

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

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

##### 2. Grantees of Share Options

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

##### 3. Number of Share Options

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

##### 4. Cash Payment for Share Options

No cash payment will be required for the share options.

##### 5. Exercise Price

The exercise price is ¥3,287 per share.

##### 6. Features of Share Options

The features of share options are as follows:

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

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

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

Allotted Number of Shares after Adjustment

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

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

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

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

The Exercise Price will be adjusted as follows:

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

Exercise Price after Adjustment

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

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

Exercise Price after Adjustment = Exercise Price before Adjustment ×

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

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

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

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(3) Period during Which Share Options Are Exercisable

From May 1, 2011 to April 30, 2015.

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

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc.

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

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

(5) Restriction on Acquisition of Share Options by Transfer

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

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

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

(7) Handling of Fractions

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

(8) Other Conditions for Exercise of Share Options

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

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

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

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

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

7. Specific Method of Calculation of Remuneration to Directors

The amount of share options issued to the directors of the Company, as remuneration, is the amount obtained by multiplying the fair market value per share option as of the allotment date thereof by the total number of share

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options allotted to the directors existing as of such allotment date. The fair market value of a share option was calculated with the use of the Black-Scholes model on the basis of various conditions applicable on the allotment date.

### *The Stock Option Plan Approved on March 30, 2010*

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

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

#### 2. Grantees of Share Options

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

#### 3. Number of Share Options

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

#### 4. Cash Payment for Share Options

No cash payment will be required for the share options.

#### 5. Exercise Price

The exercise price is ¥4,573 per share.

#### 6. Features of Share Options

The features of share options are as follows:

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

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

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

Allotted Number of Shares after Adjustment

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

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

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

The amount of property to be contributed upon the exercise of each share option is the amount obtained by multiplying the amount to be paid in for one share (the Exercise Price ) to be delivered upon the exercise of a





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

The Exercise Price will be adjusted as follows:

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

Exercise Price after Adjustment

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

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

Exercise Price after Adjustment = Exercise Price before Adjustment ×

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

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

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

(3) Period during Which Share Options Are Exercisable

From May 1, 2012 to April 30, 2016.

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

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc.

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

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

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### (5) Restriction on Acquisition of Share Options by Transfer

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

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

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

### (7) Handling of Fractions

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

### (8) Other Conditions for Exercise of Share Options

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

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

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

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

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

## 7. Specific Method of Calculation of Remuneration to Directors

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

### *The Stock Option Plan Approved on March 30, 2011*

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

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

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### 2. Grantees of Share Options

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

### 3. Number of Share Options

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

### 4. Cash Payment for Share Options

No cash payment will be required for the share options.

### 5. Exercise Price

The exercise price is ¥3,990 per share.

### 6. Features of Share Options

The features of share options are as follows:

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

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

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

Allotted Number of Shares after Adjustment

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

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

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

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

The Exercise Price will be adjusted as follows:

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

Exercise Price after Adjustment

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

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

Exercise Price after Adjustment = Exercise Price before Adjustment ×

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

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

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

(3) Period during Which Share Options Are Exercisable

From May 1, 2013 to April 30, 2017.

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

(i) The increased amount of stated capital will be half of the maximum amount of increases of stated capital, etc.

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

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

(5) Restriction on Acquisition of Share Options by Transfer

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

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

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

(7) Handling of Fractions

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

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

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

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

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

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

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

**7. Specific Method of Calculation of Remuneration to Directors**

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

**C. Board practices**

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

**D. Employees**

The following table shows the numbers of Canon's employees as of December 31, 2013, 2012 and 2011.

	<b>Total</b>	<b>Japan</b>	<b>Americas</b>	<b>Europe</b>	<b>Asia and Oceania</b>
<b>December 31, 2013</b>					
Office	99,360	29,389	15,009	19,328	35,634
Imaging System	61,798	16,069	2,510	2,083	41,136
Industry and Others	22,401	14,606	1,225	1,166	5,404
Corporate	10,592	9,761			831
<b>Total</b>	<b>194,151</b>	<b>69,825</b>	<b>18,744</b>	<b>22,577</b>	<b>83,005</b>
<b>December 31, 2012</b>					
Office	97,275	29,027	15,451	20,094	32,703
Imaging System	64,320	15,842	2,300	1,838	44,340
Industry and Others	24,403	15,396	1,335	1,229	6,443
Corporate	10,970	9,969			1,001
<b>Total</b>	<b>196,968</b>	<b>70,234</b>	<b>19,086</b>	<b>23,161</b>	<b>84,487</b>
<b>December 31, 2011</b>					
Office	99,847	29,874	15,609	19,680	34,684
Imaging System	63,105	15,284	2,227	1,827	43,767
Industry and Others	24,779	15,664	1,369	1,232	6,514

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Corporate	10,576	9,524			1,052
Total	198,307	70,346	19,205	22,739	86,017



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

**E. Share ownership**

The following table shows the numbers of shares owned by the directors and Audit & Supervisory Board Members of the Company as of March 28, 2014. The total is 353,441 shares, constituting 0.03% of all outstanding shares.

<b>Name</b>	<b>Position</b>	<b>Number of shares</b>
Fujio Mitarai	Chairman & CEO	112,223
Toshizo Tanaka	Executive Vice President & CFO	21,410
Toshiaki Ikoma	Executive Vice President & CTO	14,700
Yoroku Adachi	Senior Managing Director	24,697
Yasuo Mitsuhashi	Senior Managing Director	19,757
Shigeyuki Matsumoto	Senior Managing Director	22,852
Toshio Honma	Senior Managing Director	31,552
Hideki Ozawa	Senior Managing Director	13,300
Masaya Maeda	Senior Managing Director	11,400
Yasuhiro Tani	Director	6,200
Kenichi Nagasawa	Director	2,200
Naoji Otsuka	Director	5,500
Masanori Yamada	Director	5,900
Aitake Wakiya	Director	3,300
Kazuto Ono	Director	2,300
Akiyoshi Kimura	Director	2,200
Eiji Osanai	Director	1,900
Kunitaro Saida	Director	0
Haruhiko Kato	Director	0
Kengo Uramoto	Audit & Supervisory Board Member	3,950
Makoto Araki	Audit & Supervisory Board Member	6,900
Tadashi Ohe	Audit & Supervisory Board Member	39,000
Osami Yoshida	Audit & Supervisory Board Member	0
Kuniyoshi Kitamura	Audit & Supervisory Board Member	2,200
	<b>Total</b>	<b>353,441</b>

The number of shares that may be subscribed for under rights granted to the Directors and the Audit & Supervisory Board Members, listed above, pursuant to the stock option plan approved by the stockholders on March 28, 2008 is 144,000 shares of common stock. The exercise price of the rights is ¥5,502 per share and the rights are exercisable from May 1, 2010 to April 30, 2014.

The number of shares that may be subscribed for under rights granted to the Directors and the Audit & Supervisory Board Members, listed above, pursuant to the stock option plan approved by the stockholders on March 27, 2009 is 256,000 shares of common stock. The exercise price of the rights is ¥3,287 per share and the rights are exercisable from May 1, 2011 to April 30, 2015.

The number of shares that may be subscribed for under rights granted to the Directors and the Audit & Supervisory Board Member, listed above, pursuant to the stock option plan approved by the stockholders on March 30, 2010 is 303,000 shares of common stock. The exercise price of the rights is ¥4,573 per share and the rights are exercisable from May 1, 2012 to April 30, 2016.

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The number of shares that may be subscribed for under rights granted to the Directors and the Audit & Supervisory Board Member, listed above, pursuant to the stock option plan approved by the stockholders on March 30, 2011 is 335,000 shares of common stock. The exercise price of the rights is ¥3,990 per share and the rights are exercisable from May 1, 2013 to April 30, 2017.

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

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

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

The table below shows the numbers of the Company's shares held by the top ten holders of the Company's shares and their ownership percentage as of December 31, 2013:

Name of major shareholder	Shares owned	Percentage Number of shares owned / Number of shares issued
The Master Trust Bank of Japan, Ltd. (Trust Account)	59,911,200	4.5%
Japan Trustee Services Bank, Ltd. (Trust Account)	53,302,300	4.0%
The Dai-Ichi Mutual Life Insurance Company, Limited	37,416,380	2.8%
State Street Bank and Trust Company	36,555,985	2.7%
Barclays Capital	30,000,000	2.3%
Moxley and Co.	23,634,424	1.8%
Bank of Mizuho	22,558,173	1.7%
Northern Trust Company (AVFC) Sub Account American Client	20,191,600	1.5%
Sompo Japan Insurance Inc.	18,799,987	1.4%
Nomura Securities CO., LTD	18,562,600	1.4%

Notes:

- 1: Moxley and Co. is a nominee of JPMorgan Chase Bank, which is the depository of Canon's ADRs (American Depositary Receipts).
- 2: Apart from the above shares, The Dai-Ichi Mutual Life Insurance Company, Limited held 6,180,000 shares contributed to a trust fund for its retirement and severance plans.
- 3: Apart from the above shares, the Company owns 196,764,060 shares (14.75% of total issued shares) of treasury stock.
- 4: Apart from the above shares, The Bank of Mizuho, Limited held 9,057,000 shares contributed to a trust fund for its retirement and severance plans.

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

As of December 31, 2013, 14.7% of the issued shares of common stock, including the Company's treasury stock, were held of record by 234 residents of the United States of America.

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

**B. Related party transactions**

During the latest three fiscal years, Canon has not transacted with, nor does Canon currently plan to transact with a related party (other than certain transactions with subsidiaries and affiliates of the Company). For purposes of this paragraph, a related party includes: (a) enterprises that directly or indirectly through one or more



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intermediaries, control or are controlled by, or are under common control with, Canon; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of Canon that gives them significant influence over Canon, and close members of any such individual's family; (d) key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of Canon, including directors and senior management of companies and close member of such individual's families; (e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of Canon and enterprises that have a member of key management in common with Canon. Close members of an individual's family are those that may be expected to influence, or be influenced by, that person in their dealings with Canon. An associate is an unconsolidated enterprise in which Canon has a significant influence or which has significant influence over Canon. Significant influence over an enterprise is the power to participate in the financial and operating policy decisions of the enterprise but is less than control over those policies. Shareholders beneficially owning a 10% interest in the voting power of the Company are presumed to have a significant influence on Canon.

To the Company's knowledge, no person owned a 10% interest in the voting power of the Company as of March 28, 2014.

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

### **C. Interests of experts and counsel**

Not applicable.

## **Item 8. Financial Information**

### **A. Consolidated financial statements and other financial information**

#### **Consolidated financial statements**

This Annual Report contains consolidated financial statements as of December 31, 2013 and 2012 and for each of the three years in the period ended December 31, 2013 prepared in accordance with U.S. generally accepted accounting principles and audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) by an Independent Registered Public Accounting Firm. The financial statements as of and for the years ended December 31, 2011, 2012, and 2013 have been audited by Ernst & Young ShinNihon LLC, and their audit report covering each of the periods is included in Item 18 of this report.

Refer to Item 18 Financial Statements.

#### **Legal proceedings**

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

#### **Dividend policy**

Dividends are proposed by the Board of Directors of the Company based on the year-end non-consolidated financial statements of the Company, and are approved at the ordinary general meeting of shareholders, which is held in March of each year. Recordholders of the Company's ADSs on the dividends' record dates are entitled to receive payment in full of the declared dividends. In addition to annual dividends, by resolution of the Board of

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Directors, the Company may declare a cash distribution as an interim dividend. The record date for the Company's year-end dividends and for the interim dividends are December 31 and June 30, respectively.

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

In 2013, despite the challenging business environment characterized by the prolonged European recession, Canon was able to generate adequate cash on hand thanks to comprehensive cash flow management and subsequent improvements in management efficiency. In light of this situation, Canon plans to distribute a full-year dividend totaling ¥130 per share (interim dividend of ¥65 per share [already distributed], and year-end dividend of ¥65 per share), the same dividend amount as the previous year (including the commemorative dividend).

### B. Significant changes

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

## Item 9. The Offer and Listing

### A. Offer and listing details

#### Trading in domestic markets

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

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

Period	TSE (Canon Inc.) (Japanese yen)		TOPIX (Reference data) (Points)		Nikkei Stock Average (Reference data) (Japanese yen)	
	High	Low	High	Low	High	Low
	2009 Year	¥ 4,070	¥ 2,115	987.27	698.46	¥ 10,767.00
2010 Year	4,520	3,205	1,001.77	799.64	11,408.17	8,796.45
2011 Year	4,280	3,220	976.28	703.88	10,891.60	8,135.79
2012 1(st) quarter	4,015	3,230	872.42	722.85	10,255.15	8,349.33
2(nd) quarter	4,005	2,880	863.23	692.18	10,190.35	8,238.96
3(rd) quarter	3,240	2,308	781.94	703.31	9,288.53	8,328.02
4(th) quarter	3,455	2,328	861.57	710.32	10,433.63	8,488.14
2012 Year	4,015	2,308	872.42	692.18	10,433.63	8,238.96
2013 1(st) quarter	3,670	3,185	1,061.75	862.62	12,650.26	10,398.61
2(nd) quarter	4,115	3,070	1,289.77	971.33	15,942.60	11,805.78
3(rd) quarter	3,480	2,913	1,232.02	1,103.94	14,953.29	13,188.14
4(th) quarter	3,410	3,035	1,302.87	1,138.75	16,320.22	13,748.94
2013 Year	4,115	2,913	1,302.87	862.62	16,320.22	10,398.61

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Period	TSE (Canon Inc.) (Japanese yen)		TOPIX (Reference data) (Points)		Nikkei Stock Average (Reference data) (Japanese yen)	
	High	Low	High	Low	High	Low
2013 July	¥ 3,480	¥ 3,005	1,232.02	1,127.01	¥ 14,953.29	¥ 13,562.70
August	3,210	2,929	1,196.17	1,103.94	14,466.16	13,188.14
September	3,260	2,913	1,223.12	1,107.90	14,817.50	13,407.53
October	3,220	3,035	1,222.56	1,138.75	14,799.28	13,748.94
November	3,410	3,060	1,261.04	1,171.20	15,729.09	14,026.17
December	3,410	3,240	1,302.87	1,222.20	16,320.22	15,112.54
2014 January	3,330	2,995	1,308.08	1,211.22	16,164.01	14,764.57
February	3,197	2,889	1,234.54	1,139.27	15,094.54	13,995.86

**Trading in foreign markets**

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

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

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

Period	NYSE (Canon Inc.) (U.S. dollars)	
	High	Low
2009 Year	\$ 43.950	\$ 21.230
2010 Year	52.150	36.800
2011 Year	52.300	41.700
2012 1(st) quarter	48.340	42.460
2(nd) quarter	48.480	37.820
3(rd) quarter	40.270	31.210
4(th) quarter	40.940	29.810
2012 Year	48.480	29.810
2013 1(st) quarter	40.430	34.690
2(nd) quarter	38.890	32.090
3(rd) quarter	34.800	29.820
4(th) quarter	33.550	31.110
2013 Year	40.430	29.820

Period	(Canon Inc.) (U.S. dollars)	
	High	Low
2013 July	\$ 34.800	\$ 30.710
August	32.630	29.820
September	33.060	30.950
October	33.000	31.190
November	33.550	31.110
December	33.440	31.540
2014 January	31.950	29.020
February	31.390	28.670



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

**B. Plan of distribution**

Not applicable.

**C. Markets**

See Item 9A Offer and listing details .

**D. Selling shareholders**

Not applicable.

**E. Dilution**

Not applicable.

**F. Expenses of the issue**

Not applicable.

**Item 10. Additional Information**

**A. Share capital**

Not applicable.

**B. Memorandum and articles of association**

*Objects and Purposes in the Company s Articles of Incorporation*

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

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



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

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

*Provisions Regarding Directors*

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

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

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

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

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

*Holding of Shares by Foreign Investors*

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

*Rights of Shareholders*

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

*General*

The Company's authorized share capital is 3,000,000,000 shares, of which 1,333,763,464 shares were issued, including the Company's treasury stock, as of December 31, 2013. On January 5, 2009, a new central clearing system for shares of Japanese listed companies was established pursuant to the Law Concerning Book-Entry Transfer of Corporate Bonds, Shares, etc. (including regulations promulgated thereunder; the "Book-Entry Law"), and the shares of all Japanese companies listed on any Japanese stock exchange, including the Company's shares, became subject to this new system. On the same day, all existing share certificates for such shares became null and void. At present, the Japan Securities Depository Center, Inc. ("JASDEC") is the only

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

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

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

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

*Distributions of Surplus*

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

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

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

*Restriction on Distributions of Surplus*

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

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

$$A + B + C + D \quad (E + F + G)$$

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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### *Stock Splits*

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

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

### *Japanese Unit Share System*

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

### *Transferability of Shares Representing Less than One Unit*

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

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

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

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

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

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

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

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

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

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

### *Ordinary and Extraordinary General Meeting of Shareholders*

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

### *Voting Rights*

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

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

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

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

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

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

### *Subscription Rights*

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

### *Stock Acquisition Rights*

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

### *Liquidation Rights*

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

### *Liability to Further Calls or Assessments*

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

### *Share Registrar*

Mizuho Trust & Banking Co., Ltd. ( Mizuho Trust ) is the share registrar for the Company's shares. Mizuho Trust's office is located at 2-1, Yaesu 1-chome, Chuo-ku, Tokyo, Japan. Under the clearing system,

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Mizuho Trust maintains the Company's register of shareholders and records transfers of record ownership upon the Company's receipt of necessary information from JASDEC and other information in the register of shareholders, as described under "Record Date" below.

### *Record Date*

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

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

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

### *Repurchase by the Company of Shares*

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

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

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

## **C. Material contracts**

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



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### **D. Exchange controls**

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

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

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

#### *Issuance of Securities by the Company*

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

#### *Acquisition of Shares*

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

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

#### *Acquisition of Shares upon Exercise of Rights for Subscription of Shares*

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

#### *Dividends and Proceeds of Sales*

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

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## (b) Reporting of Substantial Shareholdings:

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

**E. Taxation**

## 1. Taxation in Japan

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

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

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

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Taking this Withholding Tax Rate into account, the treaty rates such as the 15% rate (or 10% for eligible U.S. residents subject to the Treaty and/or eligible residents subject to other similarly renewed treaties mentioned above) will apply, in general, except for dividends paid to any individual holder who holds 3% or more of the total issued shares, in which case the applicable rate is 20.42% (standard tax rate of 20% imposed by Surtax). The treaty rate normally overrides the domestic rate, but due to the so-called preservation doctrine under Article 1(2) of the Treaty, and/or due to Article 3-2 of the Special Measures Law for the Income Tax Law, Corporation Tax Law and Local Taxes Law with respect to the Implementation of Tax Treaties, if the tax rate under the domestic tax law is lower than that promulgated under the applicable income tax treaty, then the domestic tax rate is still applicable. Due to the abolishment of the lower tax rate, such as the 7.147% rate under the domestic tax law as of December 31, 2013, the tax rate under the applicable tax treaty will normally be lower than that under the domestic tax law and, if so, the treaty override treatment will apply. As such, the tax rate under the Treaty will normally apply for most holders of shares or ADSs who are U.S. residents or corporation. In the case where the treaty rate is applicable, no Surtax is imposed but in order to enjoy the lower treaty rate, the treaty application filing is required in advance through the Company. Gains derived from the sale outside Japan of Japanese corporations' shares or ADSs by Non-Resident Holders, or from the sale of Japanese corporations' shares or ADSs within Japan by a non-resident of Japan as an occasional transaction or by a non-Japanese corporation not having a permanent establishment in Japan, are generally not subject to Japanese income or corporation taxes, provided that the seller is a portfolio investor. Japanese inheritance and gift taxes at progressive rates may apply to an individual who has acquired Japanese corporations' shares or ADSs as a distributee, legatee or donee.

## 2. Taxation in the United States

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

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

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

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

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

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

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

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

This discussion assumes that the Company was not a passive foreign investment company for 2013, as described below.

### *Taxation of Distributions*

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

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

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

### *Sale or Other Disposition of the Company Shares or ADSs*

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

### *Passive Foreign Investment Company Rules*

The Company believes that it was not a passive foreign investment company (PFIC) for U.S. federal income tax purposes for its 2013 fiscal year. However, since PFIC status depends upon the composition of the Company's income and assets and the market value of its assets (including, among others, goodwill and equity investments in less than 25% owned entities) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. holder owned the Company shares or ADSs, certain adverse tax consequences could apply to such U.S. holder.

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

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

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

### *Information Reporting and Backup Withholding*

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

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

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

### **F. Dividends and paying agents**

Not applicable.

### **G. Statement by experts**

Not applicable.

### **H. Documents on display**

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

Securities Exchange Commission (Public Reference Room):

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

New York Stock Exchange, Inc.:

20 Broad Street, New York, New York 10005

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

Securities Exchange Commission Home Page:

<http://www.sec.gov>

### **I. Subsidiary information**

Not applicable.

## **Item 11. Quantitative and Qualitative Disclosures about Market Risk**

### **Market risk exposures**

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

### **Equity price risk**

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

Maturities and fair values of such marketable securities and investments with original maturities of more than three months, all of which were classified as available-for-sale securities, were as follows at December 31, 2013.



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Available-for-sale securities

	2013 Cost	Fair value
	(Millions of yen)	
Debt securities		
Due within one year	¥	¥
Due after one year through five years	10	10
Due after five years	819	778
Fund trusts	68	68
Equity securities	18,112	34,536
	¥ 19,009	¥ 35,392

**Foreign currency exchange rate and interest rate risk**

Canon operates internationally, exposing it to the risk of changes in foreign currency exchange rates. Derivative financial instruments are comprised principally of foreign currency exchange contracts utilized by the Company and certain of its subsidiaries to reduce the risk. Canon assesses foreign currency exchange rate risk by continually monitoring changes in the exposures and by evaluating hedging opportunities. Canon does not hold or issue derivative financial instruments for trading purposes. Canon is also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations. Most of the counterparties are internationally recognized financial institutions and selected by Canon taking into account their financial condition, and contracts are diversified across a number of major financial institutions.

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

The following table provides information about Canon's major derivative financial instruments related to foreign currency exchange transactions existing at December 31, 2013. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2014.

	U.S.\$	Euro	Others	Total
	(Millions of yen)			
Forwards to sell foreign currencies:				
Contract amounts	¥ 198,039	¥ 147,729	¥ 28,931	¥ 374,699
Estimated fair value	(7,299)	(6,795)	(598)	(14,692)
Forwards to buy foreign currencies:				
Contract amounts	¥ 40,844	¥ 3,882	¥	¥ 44,726
Estimated fair value	(27)	28		1

All of Canon's long-term debt is fixed rate debt. Canon expects that fair value changes and cash flows resulting from reasonable near-term changes in interest rates will be immaterial. Accordingly, Canon believes interest rate risk is insignificant. See also Note 8 of the Notes to Consolidated Financial Statements.

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign currency exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings through other



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income (deductions) in the same period as the hedged items affect earnings. Substantially all such amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next twelve months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign currency exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2013, 2012 and 2011. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥111 million, ¥221 million and ¥457 million for the years ended December 31, 2013, 2012 and 2011, respectively.

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

**Item 12. Description of Securities Other than Equity Securities**

**A. Debt securities**

Not applicable.

**B. Warrants and rights**

Not applicable.

**C. Other securities**

Not applicable.

**D. American Depositary Shares**

3. (a) Depositing or substituting the underlying shares

Not applicable.

(b) Receiving or distributing dividends

Not applicable.

(c) Selling or exercising rights

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

(d) Withdrawing an underlying security

Not applicable.

(e) Transferring, splitting or grouping receipts

Not applicable.

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

(g) Expenses of the depositary  
Not applicable.

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**PART II**

**Item 13. Defaults, Dividend Arrearages and Delinquencies**

None.

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

None.

**Item 15. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Canon's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and Canon's chief executive officer and chief financial officer concluded that Canon's disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, are effective at the reasonable assurance level as of December 31, 2013.

*Management's Report on Internal Control over Financial Reporting*

The management of Canon is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Exchange Act, as amended, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

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

Canon's management assessed the effectiveness of internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria established in internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria).

Based on its assessment, management concluded that, as of December 31, 2013, Canon's internal control over financial reporting was effective based on the COSO criteria.

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

*Changes in Internal Control over Financial Reporting*

There has been no change in Canon's internal control over financial reporting that occurred during the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

**Table of Contents****Item 16A. Audit Committee Financial Expert**

Canon's Audit & Supervisory Board has determined that Shunji Onda and Kazunori Watanabe each qualify as an audit committee financial expert as defined by the rules of the SEC. Shunji Onda began his career at Canon in 1972, and since that time has worked in the field of finance and accounting for more than thirty years. From 2006 to 2007, Shunji Onda served as a Deputy Group Executive of Finance & Accounting HQ, the division responsible for Canon's consolidated reporting. Kazunori Watanabe registered as a Certified Public Accountant in Japan in 1978, and since that time has worked in the field of audit as independent auditor of several companies such as electric industry areas for more than thirty years. Shunji Onda and Kazunori Watanabe were elected as one of Canon's Audit & Supervisory Board Members at an ordinary general meeting of shareholders held in March 2010. Shunji Onda and Kazunori Watanabe met the independence requirements imposed on Audit & Supervisory Board Members as set forth by Japanese legal provisions.

**Item 16B. Code of Ethics**

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

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

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

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

All services provided to Canon necessary to perform an annual audit or review to comply with the standards of the Public Company Accounting Oversight Board (United States), in any jurisdiction, including tax services and accounting consultation necessary to comply with the standards of the Public Company Accounting Oversight Board (United States) in those jurisdictions, and any engagement of an Independent Registered Public Accounting Firm for any audit or non-audit service involving estimated fees exceeding ¥10,000,000 per single engagement must be pre-approved by the majority of Audit & Supervisory Board. Certain other services may be pre-approved under detailed categories of audit and non-audit services established annually by the Audit & Supervisory Board, as long as those services do not exceed

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specified maximum yen limits for aggregate fees relating to each of those categories. Any engagement of an Independent Registered Public Accounting Firm by this means must be reported to the Audit & Supervisory Board at its next regularly scheduled meeting. For services that are not covered by the above two means of pre-approval, the Audit & Supervisory Board has delegated pre-approval authority to any of the standing Audit & Supervisory Board Members of the board. Any engagement of an Independent Registered Public Accounting Firm pre-approved by one of the standing Audit & Supervisory Board Members is required to be reported to the Audit & Supervisory Board at its next regularly scheduled meeting.

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

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

*Fees and services*

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

	Year ended December 31, 2013	Year ended December 31, 2012
	(Millions of yen)	
Audit fees	¥ 2,444	¥ 2,194
Audit-related fees	57	25
Tax fees	189	250
All other fees	275	177
<b>Total</b>	<b>¥ 2,965</b>	<b>¥ 2,646</b>

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

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

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

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

Ernst & Young ShinNihon LLC served as Canon's principal accountant for 2013 and 2012.

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

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

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

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

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

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

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

Period	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans	(d) Maximum number of shares that may yet be purchased under the plans
	(Shares)	(Yen)	or programs	or programs
<b>2013</b>				
January 1 - January 31	192	3,297		
February 1 - February 28	507	3,314		
March 1 - March 31	926	3,445		
April 1 - April 30	1,031	3,617		
May 1 - May 31	1,656	3,607		
June 1 - June 30	944	3,248		
July 1 - July 31	1,024	3,371		
August 1 - August 31	681	3,106		
September 1 - September 30	15,790,848	3,167	15,790,000	
October 1 - October 31	1,070	3,110		
November 1 - November 30	1,106	3,158		
December 1 - December 31	2,976	3,314		

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### Notes:

- (1) On September 3, a resolution approved at the meeting of our board directors authorized the Company to acquire to up to 18 million shares with an aggregate purchase price of ¥50 billion during the period from September 4, 2013 through November 1, 2013.
  - (2) The Company has completed all of its share repurchase plans or programs listed above by December 31, 2013.
- Column (a) represents the total number of shares purchased as fractional shares from fractional shareowners in accordance with the Corporation Law of Japan, and the purchase of shares from publicly announced plans which is shown in column (c). During 2013, the Company purchased 12,961 shares for a total purchase price of 43,179,805 yen upon requests from holders of shares consisting less than one full unit.

### **Item 16F. Change in Registrant's Certifying Accountant**

Not applicable.

### **Item 16G. Corporate Governance**

#### 1. Directors

Currently, the Company's board of directors does not have any director who could be regarded as an independent director under the NYSE Corporate Governance Rules for U.S. listed companies. Unlike the NYSE Corporate Governance Rules, the Corporation Law of Japan (the Corporation Law) does not require Japanese companies with the Audit & Supervisory Board such as the Company, to appoint independent directors as members of the board of directors. The NYSE Corporate Governance Rules require non-management directors of U.S. listed companies to meet at regularly scheduled executive sessions without the presence of management. Unlike the NYSE Corporate Governance Rules, however, the Corporation Law does not require companies to implement an internal corporate organ or committee comprised solely of independent directors. Thus, the Company does not have such internal corporate organ or committee.

The Company currently has two outside directors under the Corporation Law. Under the Corporation Law, an outside director is any person who is not, and was not at any time during the past, an executive director (a director who engages in the execution of business), executive officer, manager or employee of the Company or its subsidiaries. Such qualifications for an outside director are different from the director independence requirements under the NYSE Corporate Governance Rules.

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

#### 2. Committees

Under the Corporation Law, the Company may choose to:(i) have an audit committee, nomination committee and compensation committee and abolish the post of the Audit & Supervisory Board Members; or (ii) have the Audit & Supervisory Board. The Company has elected to have the Audit & Supervisory Board, whose duties include monitoring and reviewing the management and reporting the results of these activities to the shareholders or board of directors of the Company. While the NYSE Corporate Governance Rules provide that U.S. listed companies must have an audit committee, nominating committee and compensation committee,

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each composed entirely of independent directors, the Corporation Law does not require companies to have specified committees, including those that are responsible for director nomination, corporate governance and executive compensation.

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

**3. Audit Committee**

The Company avails itself of paragraph (c)(3) of Rule 10A-3 of the Security Exchange Act, which provides that a foreign private issuer which has established the Audit & Supervisory Board shall be exempt from the audit committee requirements, subject to certain requirements which continue to be applicable under Rule 10A-3. Pursuant to the requirements of the Corporation Law, the shareholders elect the Audit & Supervisory Board Members by resolution of a general meeting of shareholders. The Company currently has five Audit & Supervisory Board Members, although the minimum number of Audit & Supervisory Board Members required pursuant to the Corporation Law is three. Unlike the NYSE Corporate Governance Rules, Japanese laws and regulations, including the Corporation Law, do not require the Audit & Supervisory Board Members to be Experts in accounting or to have any other area of expertise. Under the Corporation Law, the Audit & Supervisory Board may determine the auditing policies and methods for investigating the business and assets of a Company, and may resolve other matters concerning the execution of the Audit & Supervisory Board Member's duties. The Audit & Supervisory Board prepares auditors' reports and may veto a proposal for the nomination of the Audit & Supervisory Board Members, accounting auditors and the determination of the amount of compensation for the accounting auditors put forward by the board of directors. Under the Corporation Law, the half or more of a company's Audit & Supervisory Board Members must be outside Audit & Supervisory Board Members. These are individuals who are prohibited to have ever been a director, executive officer, manager, or employee of the Company or its subsidiaries. The Company's current Audit & Supervisory Board Member system meets these requirements. In addition, pursuant to the regulations of the Japanese stock exchanges, the Company is required to have one or more independent director(s) or independent Audit & Supervisory Board Member(s) which terms are defined under the relevant regulations of the Japanese stock exchanges as outside directors or outside Audit & Supervisory Board Members (each of which terms is defined under the Corporation Law) who are unlikely to have any conflict of interests with shareholders of the Company. Among the five members on the Company's board of auditors, three are outside Audit & Supervisory Board Members. In addition, all such three outside Audit & Supervisory Board Members are also qualified as independent Audit & Supervisory Board Members under the regulations of the Japanese stock exchanges. The qualifications for an outside or independent Audit & Supervisory Board Member under the Corporation Law or the regulations of the Japanese stock exchanges are different from the audit committee independence requirement under the NYSE Corporate Governance Rules.

**4. Shareholder Approval of Equity Compensation Plans**

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



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**PART III**

**Item 17. Financial Statements**

Not applicable.

**Item 18. Financial Statements**

	<b>Page number</b>
Consolidated financial statements of Canon Inc. and Subsidiaries:	
<u>Reports of Ernst &amp; Young ShinNihon LLC, Independent Registered Public Accounting Firm</u>	95
<u>Consolidated Balance Sheets as of December 31, 2013 and 2012</u>	97
<u>Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011</u>	98
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All other schedules are omitted as permitted by the rules and regulations of the Securities and Exchange Commission as not applicable.	

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Canon Inc.

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2013. Our audits also included the financial statement schedule listed in the Index at Item 18. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated March 28, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan

March 28, 2014

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

Canon Inc.

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2013, and our report dated March 28, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young ShinNihon LLC

Tokyo, Japan

March 28, 2014

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Canon Inc. and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2013	2012
	(Millions of yen)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents <i>(Note 1)</i>	¥ 788,909	¥ 666,678
Short-term investments <i>(Note 2)</i>	47,914	28,322
Trade receivables, net <i>(Note 3)</i>	608,741	573,375
Inventories <i>(Note 4)</i>	553,773	551,623
Prepaid expenses and other current assets <i>(Notes 6, 11 and 16)</i>	286,605	262,258
<b>Total current assets</b>	<b>2,285,942</b>	<b>2,082,256</b>
Noncurrent receivables <i>(Note 17)</i>	19,276	19,702
Investments <i>(Note 2)</i>	70,358	56,617
Property, plant and equipment, net <i>(Notes 5 and 6)</i>	1,278,730	1,260,364
Intangible assets, net <i>(Note 7)</i>	145,075	135,736
Other assets <i>(Notes 6, 7, 10 and 11)</i>	443,329	400,828
<b>Total assets</b>	<b>¥ 4,242,710</b>	<b>¥ 3,955,503</b>
<b>Liabilities and equity</b>		
Current liabilities:		
Short-term loans and current portion of long-term debt <i>(Note 8)</i>	¥ 1,299	¥ 1,866
Trade payables <i>(Note 9)</i>	307,157	325,235
Accrued income taxes <i>(Note 11)</i>	53,196	60,057
Accrued expenses <i>(Notes 10 and 17)</i>	315,536	291,348
Other current liabilities <i>(Notes 5, 11 and 16)</i>	171,119	165,929
<b>Total current liabilities</b>	<b>848,307</b>	<b>844,435</b>
Long-term debt, excluding current installments <i>(Note 8)</i>	1,448	2,117
Accrued pension and severance cost <i>(Note 10)</i>	229,664	272,131
Other noncurrent liabilities <i>(Note 11)</i>	96,514	82,518
<b>Total liabilities</b>	<b>1,175,933</b>	<b>1,201,201</b>
Commitments and contingent liabilities <i>(Note 17)</i>		
Equity:		
Canon Inc. stockholders' equity:		
Common stock		
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2013 and 2012	174,762	174,762
Additional paid-in capital	402,029	401,547
Legal reserve <i>(Note 12)</i>	63,091	61,663
Retained earnings <i>(Note 12)</i>	3,212,692	3,138,976
Accumulated other comprehensive income (loss) <i>(Note 13)</i>	(80,646)	(367,249)
Treasury stock, at cost; 196,764,060 shares in 2013 and 180,972,173 shares in 2012	(861,666)	(811,673)
<b>Total Canon Inc. stockholders' equity</b>	<b>2,910,262</b>	<b>2,598,026</b>
Noncontrolling interests	156,515	156,276
<b>Total equity</b>	<b>3,066,777</b>	<b>2,754,302</b>

Total liabilities and equity	<b>¥ 4,242,710</b>	¥ 3,955,503
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*See accompanying Notes to Consolidated Financial Statements.*

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## Canon Inc. and Subsidiaries

## Consolidated Statements of Income

	Years ended December 31		
	2013	2012	2011
	(Millions of yen)		
Net sales	¥ 3,731,380	¥ 3,479,788	¥ 3,557,433
Cost of sales ( <i>Notes 5, 7, 10 and 17</i> )	1,932,959	1,829,822	1,820,670
Gross profit	1,798,421	1,649,966	1,736,763
Operating expenses ( <i>Notes 1, 5, 7, 10, 14 and 17</i> ):			
Selling, general and administrative expenses	1,154,820	1,029,646	1,050,892
Research and development expenses	306,324	296,464	307,800
	1,461,144	1,326,110	1,358,692
Operating profit	337,277	323,856	378,071
Other income (deductions):			
Interest and dividend income	6,579	6,792	8,432
Interest expense	(550)	(1,022)	(988)
Other, net ( <i>Notes 1, 2, 16 and 19</i> )	4,298	12,931	(10,991)
	10,327	18,701	(3,547)
Income before income taxes	347,604	342,557	374,524
Income taxes ( <i>Note 11</i> )	108,088	110,112	120,415
Consolidated net income	239,516	232,445	254,109
Less: Net income attributable to noncontrolling interests	9,033	7,881	5,479
Net income attributable to Canon Inc.	¥ 230,483	¥ 224,564	¥ 248,630
		(Yen)	
Net income attributable to Canon Inc. stockholders per share ( <i>Note 15</i> ):			
Basic	¥ 200.78	¥ 191.34	¥ 204.49
Diluted	200.78	191.34	204.48
Cash dividends per share	130.00	130.00	120.00

See accompanying Notes to Consolidated Financial Statements.

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## Canon Inc. and Subsidiaries

## Consolidated Statements of Comprehensive Income

	Years ended December 31		
	2013	2012	2011
	(Millions of yen)		
Consolidated net income	¥ 239,516	¥ 232,445	¥ 254,109
Other comprehensive income (loss), net of tax <i>(Note 13)</i> :			
Foreign currency translation adjustments	251,576	133,735	(54,086)
Net unrealized gains and losses on securities	6,612	3,265	(2,116)
Net gains and losses on derivative instruments	2,056	(4,880)	(449)
Pension liability adjustments	32,669	(12,787)	(38,377)
	292,913	119,333	(95,028)
Comprehensive income	532,429	351,778	159,081
Less: Comprehensive income attributable to noncontrolling interests	14,688	10,824	1,765
Comprehensive income attributable to Canon Inc.	¥ 517,741	¥ 340,954	¥ 157,316

*See accompanying Notes to Consolidated Financial Statements.*

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## Canon Inc. and Subsidiaries

## Consolidated Statements of Equity

	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss) (Millions of yen)	Treasury stock	Total Canon Inc. stockholders equity	Non- controlling interests	Total equity
<b>Balance at December 31, 2010</b>	¥ 174,762	¥ 400,425	¥ 57,930	¥ 2,965,237	¥ (390,459)	¥ (562,113)	¥ 2,645,782	¥ 163,855	¥ 2,809,637
Equity transactions with noncontrolling interests and other		1,193		(609)			584	(247)	337
Dividends paid to Canon Inc. stockholders				(152,784)			(152,784)		(152,784)
Dividends paid to noncontrolling interests								(2,838)	(2,838)
Transfer to legal reserve			1,074	(1,074)					
Comprehensive income:									
Net income				248,630			248,630	5,479	254,109
Other comprehensive income (loss), net of tax ( <i>Note 13</i> ):									
Foreign currency translation adjustments					(53,251)		(53,251)	(835)	(54,086)
Net unrealized gains and losses on securities					(2,017)		(2,017)	(99)	(2,116)
Net gains and losses on derivative instruments					(462)		(462)	13	(449)
Pension liability adjustments					(35,584)		(35,584)	(2,793)	(38,377)
<b>Total comprehensive income</b>							157,316	1,765	159,081
Repurchase of treasury stock, net		(46)		(102)		(99,618)	(99,766)		(99,766)
<b>Balance at December 31, 2011</b>	174,762	401,572	59,004	3,059,298	(481,773)	(661,731)	2,551,132	162,535	2,713,667
Equity transactions with noncontrolling interests and other		(16)		152	(1,866)		(1,730)	(13,591)	(15,321)
Dividends paid to Canon Inc. stockholders				(142,362)			(142,362)		(142,362)
Dividends paid to noncontrolling interests								(3,492)	(3,492)
Transfer to legal reserve			2,659	(2,659)					
Comprehensive income:									
Net income				224,564			224,564	7,881	232,445
Other comprehensive income (loss), net of tax ( <i>Note 13</i> ):									
Foreign currency translation adjustments					132,704		132,704	1,031	133,735
Net unrealized gains and losses on securities					3,148		3,148	117	3,265
Net gains and losses on derivative instruments					(4,882)		(4,882)	2	(4,880)
Pension liability adjustments					(14,580)		(14,580)	1,793	(12,787)
<b>Total comprehensive income</b>							340,954	10,824	351,778
Repurchase of treasury stock, net		(9)		(17)		(149,942)	(149,968)		(149,968)
<b>Balance at December 31, 2012</b>	¥ 174,762	¥ 401,547	¥ 61,663	¥ 3,138,976	¥ (367,249)	¥ (811,673)	¥ 2,598,026	¥ 156,276	¥ 2,754,302





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## Canon Inc. and Subsidiaries

## Consolidated Statements of Equity (continued)

	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss) (Millions of yen)	Treasury stock	Total Canon Inc. stockholders equity	Non- controlling interests	Total equity
<b>Balance at December 31, 2012</b>	¥ 174,762	¥ 401,547	¥ 61,663	¥ 3,138,976	¥ (367,249)	¥ (811,673)	¥ 2,598,026	¥ 156,276	¥ 2,754,302
Equity transactions with noncontrolling interests and other		489		295	(655)		129	(11,182)	(11,053)
Dividends to Canon Inc. stockholders				(155,627)			(155,627)		(155,627)
Dividends to noncontrolling interests								(3,267)	(3,267)
Transfer to legal reserve			1,428	(1,428)					
Comprehensive income:									
Net income				230,483			230,483	9,033	239,516
Other comprehensive income, net of tax ( <i>Note 13</i> ):									
Foreign currency translation adjustments					249,791		249,791	1,785	251,576
Net unrealized gains and losses on securities					6,097		6,097	515	6,612
Net gains and losses on derivative instruments					2,056		2,056		2,056
Pension liability adjustments					29,314		29,314	3,355	32,669
<b>Total comprehensive income</b>							<b>517,741</b>	<b>14,688</b>	<b>532,429</b>
Repurchase of treasury stock, net		(7)		(7)		(49,993)	(50,007)		(50,007)
<b>Balance at December 31, 2013</b>	¥ 174,762	¥ 402,029	¥ 63,091	¥ 3,212,692	¥ (80,646)	¥ (861,666)	¥ 2,910,262	¥ 156,515	¥ 3,066,777

See accompanying Notes to Consolidated Financial Statements.

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## Canon Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

	Years ended December 31		
	2013	2012	2011
	(Millions of yen)		
Cash flows from operating activities:			
Consolidated net income	¥ 239,516	¥ 232,445	¥ 254,109
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	275,173	258,133	261,343
Loss on disposal of fixed assets	10,638	11,242	8,937
Impairment loss of fixed assets		7	598
Impairment loss of investments	39	1,527	8,130
Equity in (earnings) losses of affiliated companies	664	(610)	7,368
Deferred income taxes	16,791	7,487	29,129
Decrease in trade receivables	45,040	5,030	9,991
(Increase) decrease in inventories	85,577	(24,805)	(109,983)
Increase (decrease) in trade payables	(108,622)	(102,293)	35,766
Increase (decrease) in accrued income taxes	(9,432)	12,427	(25,653)
Increase (decrease) in accrued expenses	(15,635)	(30,089)	8,938
Increase (decrease) in accrued (prepaid) pension and severance cost	(15,568)	5,515	(2,315)
Other, net	(16,539)	8,061	(16,796)
Net cash provided by operating activities	507,642	384,077	469,562
Cash flows from investing activities:			
Purchases of fixed assets (Note 5)	(233,175)	(316,211)	(238,129)
Proceeds from sale of fixed assets (Note 5)	1,763	4,861	3,273
Purchases of available-for-sale securities	(5,771)	(417)	(2,160)
Proceeds from sale and maturity of available-for-sale securities	4,528	344	1,934
(Increase) decrease in time deposits, net	(12,483)	103,137	(34,111)
Acquisitions of subsidiaries, net of cash acquired	(4,914)	(704)	29
Purchases of other investments	(296)	(796)	(373)
Other, net	136	(2,954)	12,994
Net cash used in investing activities	(250,212)	(212,740)	(256,543)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	1,483	614	725
Repayments of long-term debt	(2,334)	(3,732)	(4,670)
Increase (decrease) in short-term loans, net	(547)	(5,055)	2,466
Dividends paid	(155,627)	(142,362)	(152,784)
Repurchases of treasury stock, net	(50,007)	(149,968)	(99,766)
Other, net	(15,149)	(19,236)	(3,484)
Net cash used in financing activities	(222,181)	(319,739)	(257,513)
Effect of exchange rate changes on cash and cash equivalents	86,982	41,853	(22,858)
Net change in cash and cash equivalents	122,231	(106,549)	(67,352)
Cash and cash equivalents at beginning of year	666,678	773,227	840,579
Cash and cash equivalents at end of year	¥ 788,909	¥ 666,678	¥ 773,227

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Supplemental disclosure for cash flow information:

Cash paid during the year for:

Interest	¥	<b>500</b>	¥	1,084	¥	914
Income taxes		<b>108,950</b>		98,096		120,696

*See accompanying Notes to Consolidated Financial Statements.*

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

**1. Basis of Presentation and Significant Accounting Policies****(a) Description of Business**

Canon Inc. (the Company) and subsidiaries (collectively Canon) is one of the world's leading manufacturers in such fields as office products, imaging system products and industry and other products. Office products consist mainly of office multifunction devices (MFDs), laser multifunction printers (MFPs), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions. Imaging system products consist mainly of interchangeable lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, inkjet printers, large-format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators. Industry and other products consist mainly of semiconductor lithography equipment, flat panel display (FPD) lithography equipment, digital radiography systems, ophthalmic equipment, vacuum thin-film deposition equipment, organic LED (OLED) panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners. Canon's consolidated net sales for the years ended December 31, 2013, 2012 and 2011 were distributed as follows: the Office Business Unit 53.6%, 50.5% and 53.9%, the Imaging System Business Unit 38.8%, 40.4% and 36.9%, the Industry and Others Business Unit 10.0%, 11.7% and 11.8%, and elimination between segments 2.4%, 2.6% and 2.6%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 20.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. 80.8%, 79.3% and 80.5% of consolidated net sales for the years ended December 31, 2013, 2012 and 2011 were generated outside Japan, with 28.4%, 27.0% and 27.0% in the Americas, 30.1%, 29.1% and 31.3% in Europe, and 22.3%, 23.2% and 22.2% in Asia and Oceania, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted 17.6%, 17.0% and 19.3% of consolidated net sales for the years ended December 31, 2013, 2012 and 2011, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 28 plants in Japan and 18 overseas plants which are located in countries or regions such as the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and Philippines.

**(b) Basis of Presentation**

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

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

**(c) Principles of Consolidation**

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

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

(d) Use of Estimates

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

(e) Translation of Foreign Currencies

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

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses was a net loss of ¥1,992 million for the year ended December 31, 2013, a net gain of ¥9,130 million for the year ended December 31, 2012 and a net loss of ¥3,287 million for the year ended December 31, 2011, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months, classified as available-for-sale securities of ¥183,078 million and ¥141,729 million at December 31, 2013 and 2012, respectively, are included in cash and cash equivalents in the consolidated balance sheets.

(g) Investments

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

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

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



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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

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

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

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

**(h) Allowance for Doubtful Receivables**

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

**(i) Inventories**

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

**(j) Impairment of Long-Lived Assets**

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





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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

(k) Property, Plant and Equipment

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

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

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

(l) Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value.

Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful life of 3 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years. Certain costs incurred in connection with developing or obtaining internal-use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal-use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(m) Environmental Liabilities

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

(n) Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and



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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Canon records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not realizable.

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

(o) Stock-Based Compensation

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

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

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

(q) Revenue Recognition

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

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

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

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



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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

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

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions to sales are based upon historical trends and other known factors at the time of sale. Canon regularly adjusts its estimates each period in the ordinary course of establishing sales incentive program accruals based on current information. During the year ended December 31, 2012, Canon revised its estimates for sales incentive program accruals based on new information which was not available at the time that the accrual was established due to unique circumstances, such as the earthquake in Japan and the flooding in Thailand that occurred in 2011 as well as a recent shift in usage of incentive programs from mail-in rebates to instant rebates. This change in estimate caused an increase in net income attributable to Canon Inc. of ¥10,785 million, and an increase in basic and diluted net income attributable to Canon Inc. stockholders per share of ¥9.19 each. During the years ended December 31, 2013 and 2011, such adjustments were not significant. Canon also provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

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

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

**(r) Research and Development Costs**

Research and development costs are expensed as incurred.

**(s) Advertising Costs**

Advertising costs are expensed as incurred. Advertising expenses were ¥86,398 million, ¥83,134 million and ¥81,232 million for the years ended December 31, 2013, 2012 and 2011, respectively.

**(t) Shipping and Handling Costs**

Shipping and handling costs totaled ¥47,460 million, ¥38,499 million and ¥43,308 million for the years ended December 31, 2013, 2012 and 2011, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.



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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

(u) Derivative Financial Instruments

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

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

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

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

(v) Guarantees

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

(w) Recently Issued Accounting Guidance

In February 2013, the FASB issued an amendment which requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component, and to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. Canon adopted this amended guidance from the quarter beginning January 1, 2013. This adoption did not have a material impact on Canon s consolidated results of operations and financial condition. See Note 13 of the Notes to Consolidated Financial Statements.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**2. Investments**

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in short-term investments and investments by major security type at December 31, 2013 and 2012 were as follows:

	Cost	December 31, 2013		Fair value
		Gross unrealized holding gains	Gross unrealized holding losses	
(Millions of yen)				
Noncurrent:				
Government bonds	¥ 338	¥	¥ 31	¥ 307
Corporate bonds	491	16	26	481
Fund trusts	68			68
Equity securities	18,112	16,450	26	34,536
	¥ 19,009	¥ 16,466	¥ 83	¥ 35,392

	Cost	December 31, 2012		Fair value
		Gross unrealized holding gains	Gross unrealized holding losses	
(Millions of yen)				
Current:				
Corporate bonds	¥ 30	¥	¥	¥ 30
Noncurrent:				
Government bonds	¥ 181	¥	¥	¥ 181
Corporate bonds	590		30	560
Fund trusts	1,192	43	1	1,234
Equity securities	14,866	7,033	564	21,335
	¥ 16,829	¥ 7,076	¥ 595	¥ 23,310

Maturities of available-for-sale debt securities included in investments in the accompanying consolidated balance sheets were as follows at December 31, 2013:

	Cost	Fair value
(Millions of yen)		
Due within one year	¥	¥
Due after one year through five years	10	10
Due after five years	819	778
	¥ 829	¥ 788

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Gross realized gains were ¥2,360 million, ¥238 million and ¥204 million for the years ended December 31, 2013, 2012 and 2011, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥2 million, ¥1,545 million and ¥4,281 million for the years ended December 31, 2013, 2012 and 2011, respectively.

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**2. Investments (continued)**

At December 31, 2013, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months are ¥47,914 million and ¥28,292 million at December 31, 2013 and 2012, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥14,794 million and ¥14,808 million at December 31, 2013 and 2012, respectively. These investments were not evaluated for impairment at December 31, 2013 and 2012, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥18,937 million and ¥17,345 million at December 31, 2013 and 2012, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), were losses of ¥664 million, earnings of ¥610 million and losses of ¥7,368 million for the years ended December 31, 2013, 2012 and 2011, respectively.

**3. Trade Receivables**

Trade receivables are summarized as follows:

	December 31	
	2013	2012
	(Millions of yen)	
Notes	¥ 15,461	¥ 17,207
Accounts	606,010	569,138
	621,471	586,345
Less allowance for doubtful receivables	(12,730)	(12,970)
	¥ 608,741	¥ 573,375

**4. Inventories**

Inventories are summarized as follows:

December 31	
2013	2012
(Millions of yen)	

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Finished goods	<b>¥ 406,443</b>	¥ 391,194
Work in process	<b>128,120</b>	139,923
Raw materials	<b>19,210</b>	20,506
	<b>¥ 553,773</b>	¥ 551,623

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**5. Property, Plant and Equipment**

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

	December 31	
	2013	2012
	(Millions of yen)	
Land	¥ 282,484	¥ 272,233
Buildings	1,570,024	1,447,838
Machinery and equipment	1,736,107	1,586,827
Construction in progress	73,645	112,919
	<b>3,662,260</b>	3,419,817
Less accumulated depreciation	(2,383,530)	(2,159,453)
	<b>¥ 1,278,730</b>	¥ 1,260,364

Depreciation expenses for the years ended December 31, 2013, 2012 and 2011 were ¥223,158 million, ¥211,973 million and ¥210,179 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥33,585 million and ¥38,893 million at December 31, 2013 and 2012, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

**6. Finance Receivables and Operating Leases**

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

	December 31	
	2013	2012
	(Millions of yen)	
Total minimum lease payments receivable	¥ 278,621	¥ 231,221
Unguaranteed residual values	9,566	8,863
Executory costs	(2,184)	(2,598)
Unearned income	(29,875)	(27,521)
	<b>256,128</b>	209,965
Less allowance for credit losses	(7,323)	(6,908)
	<b>248,805</b>	203,057
Less current portion	(91,025)	(74,168)



**Table of Contents**

## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**6. Finance Receivables and Operating Leases (continued)**

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

	Years ended December 31	
	2013	2012
	(Millions of yen)	
Balance at beginning of year	¥ 6,908	¥ 7,039
Charge-offs	(1,278)	(1,304)
Provision	212	1,922
Other	1,481	(749)
<b>Balance at end of year</b>	<b>¥ 7,323</b>	<b>¥ 6,908</b>

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or individually evaluated for impairment at December 31, 2013 and 2012 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2013 and 2012 was ¥103,403 million and ¥80,186 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2013 and 2012 was ¥78,821 million and ¥58,433 million, respectively.

The following is a schedule by year of the future minimum lease payments to be received under financing leases and noncancelable operating leases at December 31, 2013.

Year ending December 31:	Financing leases	Operating leases
	(Millions of yen)	
2014	¥ 109,408	¥ 7,639
2015	82,900	4,154
2016	51,963	2,148
2017	25,423	1,070
2018	8,427	309
Thereafter	500	419
	¥ 278,621	¥ 15,739

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**7. Goodwill and Other Intangible Assets**

Intangible assets subject to amortization acquired during the years ended December 31, 2013 and 2012 totaled ¥42,630 million and ¥34,196 million, which primarily consist of software of ¥37,419 million and ¥33,985 million, respectively. The weighted average amortization periods for intangible assets in total acquired during the years ended December 31, 2013 and 2012 are approximately 4 years. The weighted average amortization periods for software acquired during the years ended December 31, 2013 and 2012 are approximately 4 years.

The components of intangible assets subject to amortization at December 31, 2013 and 2012 were as follows:

	December 31, 2013		December 31, 2012	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
	(Millions of yen)			
Software	¥ 271,425	¥ 167,411	¥ 225,894	¥ 131,875
Customer relationships	50,792	39,957	39,615	26,938
Patented technologies	29,067	24,027	25,900	19,028
License fees	13,194	7,902	20,142	14,573
Other	32,319	16,094	22,776	9,382
	¥ 396,797	¥ 255,391	¥ 334,327	¥ 201,796

Aggregate amortization expense for the years ended December 31, 2013, 2012 and 2011 was ¥52,015 million, ¥46,160 million and ¥51,164 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥46,573 million in 2014, ¥31,898 million in 2015, ¥21,241 million in 2016, ¥12,464 million in 2017, and ¥7,371 million in 2018.

Intangible assets not subject to amortization other than goodwill at December 31, 2013 and 2012 were not significant.

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



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**7. Goodwill and Other Intangible Assets (continued)**

The changes in the carrying amount of goodwill by segment, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2013 and 2012 were as follows:

	Year ended December 31, 2013			
	Office	Imaging System	Industry and Others	Total
	(Millions of yen)			
Balance at beginning of year	¥ 111,348	¥ 12,674	¥ 6,821	¥ 130,843
Goodwill acquired during the year	4,083			4,083
Translation adjustments and other	23,981	1,203	1,530	26,714
Balance at end of year	¥ 139,412	¥ 13,877	¥ 8,351	¥ 161,640

	Year ended December 31, 2012			
	Office	Imaging System	Industry and Others	Total
	(Millions of yen)			
Balance at beginning of year	¥ 102,060	¥ 12,088	¥ 4,873	¥ 119,021
Goodwill acquired during the year			961	961
Translation adjustments and other	9,288	586	987	10,861
Balance at end of year	¥ 111,348	¥ 12,674	¥ 6,821	¥ 130,843

**8. Short-Term Loans and Long-Term Debt**

Short-term loans consisting of bank borrowings at December 31, 2013 and 2012 were ¥54 million and ¥319 million, respectively. The weighted average interest rates on short-term loans outstanding at December 31, 2013 and 2012 were 3.75% and 4.00%, respectively.

Long-term debt consisted of the following:

	December 31	
	2013	2012
	(Millions of yen)	
Loans, principally from banks, maturing in installments through 2024; bearing weighted average interest of 1.15% and 1.94% at December 31, 2013 and 2012, respectively	¥ 211	¥ 132
Capital lease obligations	2,482	3,532
	2,693	3,664

Less current portion	(1,245)	(1,547)
	<b>¥ 1,448</b>	<b>¥ 2,117</b>

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**8. Short-Term Loans and Long-Term Debt (continued)**

The aggregate annual maturities of long-term debt outstanding at December 31, 2013 were as follows:

	(Millions of yen)	
<b>Year ending December 31:</b>		
2014	¥	1,245
2015		880
2016		319
2017		171
2018		48
Thereafter		30
	¥	2,693

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

**9. Trade Payables**

Trade payables are summarized as follows:

	December 31	
	2013	2012
	(Millions of yen)	
Notes	¥ 8,005	¥ 11,971
Accounts	299,152	313,264
	¥ 307,157	¥ 325,235

**10. Employee Retirement and Severance Benefits**

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

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2013, 2012 and 2011 were ¥14,383 million, ¥13,021 million and ¥12,511 million, respectively.



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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

	Japanese plans December 31		Foreign plans December 31	
	2013 (Millions of yen)	2012	2013 (Millions of yen)	2012
Change in benefit obligations:				
Benefit obligations at beginning of year	¥ 651,520	¥ 626,924	¥ 364,609	¥ 262,130
Service cost	26,005	25,738	9,448	5,884
Interest cost	11,655	11,788	14,299	13,176
Plan participants' contributions			2,617	2,315
Actuarial loss	14,959	6,049	8,981	45,145
Benefits paid	(19,297)	(18,979)	(9,415)	(10,407)
Curtailments and settlements			(2,868)	
Foreign currency exchange rate changes			98,901	46,366
Benefit obligations at end of year	684,842	651,520	486,572	364,609
Change in plan assets:				
Fair value of plan assets at beginning of year	495,452	448,736	249,534	192,033
Actual return on plan assets	84,382	41,593	20,640	25,290
Employer contributions	19,810	22,589	28,705	7,832
Plan participants' contributions			2,617	2,315
Benefits paid	(17,648)	(17,466)	(9,106)	(9,825)
Settlements			(2,656)	
Foreign currency exchange rate changes			70,793	31,889
Fair value of plan assets at end of year	581,996	495,452	360,527	249,534
Funded status at end of year	¥ (102,846)	¥ (156,068)	¥ (126,045)	¥ (115,075)

Amounts recognized in the consolidated balance sheets at December 31, 2013 and 2012 are as follows:

	Japanese plans December 31		Foreign plans December 31	
	2013 (Millions of yen)	2012	2013 (Millions of yen)	2012
Other assets	¥ 559	¥	¥ 1,106	¥ 1,371
Accrued expenses			(892)	(383)

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Accrued pension and severance cost	<b>(103,405)</b>	(156,068)	<b>(126,259)</b>	(116,063)
	<b>¥ (102,846)</b>	¥ (156,068)	<b>¥ (126,045)</b>	¥ (115,075)

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)**

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2013 and 2012 before the effect of income taxes are as follows:

	Japanese plans December 31		Foreign plans December 31	
	2013	2012	2013	2012
	(Millions of yen)		(Millions of yen)	
Actuarial loss	¥ 186,052	¥ 253,748	¥ 50,344	¥ 50,417
Prior service credit	(105,327)	(117,633)	(118)	(261)
	¥ 80,725	¥ 136,115	¥ 50,226	¥ 50,156

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

	Japanese plans December 31		Foreign plans December 31	
	2013	2012	2013	2012
	(Millions of yen)		(Millions of yen)	
Accumulated benefit obligation	¥ 631,887	¥ 620,589	¥ 464,195	¥ 328,736

The projected benefit obligations and the fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows:

	Japanese plans December 31		Foreign plans December 31	
	2013	2012	2013	2012
	(Millions of yen)		(Millions of yen)	
Plans with projected benefit obligations in excess of plan assets:				
Projected benefit obligations	¥ 676,308	¥ 651,520	¥ 485,466	¥ 360,742
Fair value of plan assets	572,903	495,452	358,315	244,296
Plans with accumulated benefit obligations in excess of plan assets:				
Accumulated benefit obligations	¥ 611,602	¥ 615,551	¥ 463,089	¥ 324,869
Fair value of plan assets	560,093	489,929	358,315	244,296

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

Net periodic benefit cost for Canon's employee retirement and severance defined benefit plans for the years ended December 31, 2013, 2012 and 2011 consisted of the following components:

	Japanese plans			Foreign plans		
	Years ended December 31			Years ended December 31		
	2013	2012	2011	2013	2012	2011
	(Millions of yen)			(Millions of yen)		
Service cost	¥ 26,005	¥ 25,738	¥ 25,875	¥ 9,448	¥ 5,884	¥ 5,756
Interest cost	11,655	11,788	12,354	14,299	13,176	12,748
Expected return on plan assets	(15,273)	(13,791)	(16,485)	(13,949)	(11,806)	(12,112)
Amortization of net transition obligation			722			
Amortization of prior service credit	(12,306)	(13,079)	(13,674)	(143)	(116)	(93)
Amortization of actuarial loss	13,546	16,277	14,462	2,005	1,351	621
Loss on curtailments and settlements				146		
	¥ 23,627	¥ 26,933	¥ 23,254	¥ 11,806	¥ 8,489	¥ 6,920

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2013, 2012 and 2011 are summarized as follows:

	Japanese plans			Foreign plans		
	Years ended December 31			Years ended December 31		
	2013	2012	2011	2013	2012	2011
	(Millions of yen)			(Millions of yen)		
Current year actuarial (gain) loss	¥ (54,150)	¥ (21,753)	¥ 48,615	¥ 2,290	¥ 31,661	¥ 13,649
Amortization of actuarial loss	(13,546)	(16,277)	(14,462)	(2,005)	(1,351)	(621)
Prior service credit due to amendments			(1,913)			
Amortization of prior service credit	12,306	13,079	13,674	143	116	93
Amortization of net transition obligation			(722)			
Curtailments and settlements				(358)		
	¥ (55,390)	¥ (24,951)	¥ 45,192	¥ 70	¥ 30,426	¥ 13,121

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

Japanese plans (Millions of yen)	Foreign plans (Millions of yen)
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Prior service credit	¥	(12,801)	¥	(51)
Actuarial loss		9,989		1,800
<i>Assumptions</i>				

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

	Japanese plans December 31		Foreign plans December 31	
	2013	2012	2013	2012
Discount rate	1.6%	1.8%	3.8%	3.6%
Assumed rate of increase in future compensation levels	3.0%	3.0%	2.3%	2.2%

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)**

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

	Japanese plans			Foreign plans		
	Years ended December 31			Years ended December 31		
	2013	2012	2011	2013	2012	2011
Discount rate	1.8%	1.9%	2.1%	3.6%	4.6%	4.9%
Assumed rate of increase in future compensation levels	3.0%	3.0%	3.0%	2.2%	2.4%	2.9%
Expected long-term rate of return on plan assets	3.1%	3.1%	3.6%	5.2%	5.4%	5.7%

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

**Plan assets**

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

Canon's model portfolio for Japanese plans consists of three major components: approximately 20% is invested in equity securities, approximately 55% is invested in debt securities, and approximately 25% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 30% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 20% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

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

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)**

The three levels of input used to measure fair value are more fully described in Note 19. The fair values of Canon's pension plan assets at December 31, 2013 and 2012, by asset category, are as follows:

	December 31, 2013							
	Level 1	Japanese plans		Total	Level 1	Foreign plans		Total
		Level 2	Level 3	(Millions of yen)		Level 2	Level 3	
Equity securities:								
Japanese companies (a)	¥ 51,159	¥	¥	¥ 51,159	¥	¥	¥	¥
Foreign companies	10,347			10,347	43,681			43,681
Pooled funds (b)		145,417		145,417		104,933		104,933
Debt securities:								
Government bonds (c)	124,800			124,800	44,192			44,192
Municipal bonds		1,027		1,027		2,246		2,246
Corporate bonds		10,543		10,543		32,921		32,921
Pooled funds (d)		101,583		101,583		57,518		57,518
Mortgage backed securities (and other asset backed securities)		9,569		9,569		5,098		5,098
Life insurance company general accounts		109,097		109,097		15,420		15,420
Other assets		17,636	818	18,454		54,518		54,518
	¥ 186,306	¥ 394,872	¥ 818	¥ 581,996	¥ 87,873	¥ 272,654	¥	¥ 360,527

	December 31, 2012							
	Level 1	Japanese plans		Total	Level 1	Foreign plans		Total
		Level 2	Level 3	(Millions of yen)		Level 2	Level 3	
Equity securities:								
Japanese companies (e)	¥ 34,387	¥	¥	¥ 34,387	¥	¥	¥	¥
Foreign companies	6,560			6,560	13,149			13,149
Pooled funds (f)		99,631		99,631		60,142		60,142
Debt securities:								
Government bonds (g)	20,301			20,301	4,345			4,345
Municipal bonds		1,064		1,064		21		21
Corporate bonds		8,425		8,425				
Pooled funds (h)		192,386		192,386		128,647		128,647
Mortgage backed securities (and other asset backed securities)		8,400		8,400		236		236
Life insurance company general accounts		113,179		113,179		1,857		1,857
Other assets		9,813	1,306	11,119		41,137		41,137
	¥ 61,248	¥ 432,898	¥ 1,306	¥ 495,452	¥ 17,494	¥ 232,040	¥	¥ 249,534

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- (a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥572 million.

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**10. Employee Retirement and Severance Benefits (continued)**

- (b) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (c) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
- (d) These funds invest in approximately 30% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 15% corporate bonds for Japanese plans. These funds invest in approximately 85% foreign government bonds and 15% corporate bonds for foreign plans.
- (e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥565 million.
- (f) These funds invest in listed equity securities consisting of approximately 20% Japanese companies and 80% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
- (g) This class includes approximately 30% Japanese government bonds and 70% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
- (h) These funds invest in approximately 65% Japanese government bonds, 25% foreign government bonds, 5% Japanese municipal bonds, and 5% corporate bonds for Japanese plans. These funds invest in approximately 30% foreign government bonds and 70% corporate bonds for foreign plans.

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

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

The fair value of Level 3 assets, consisting of hedge funds, was ¥818 million and ¥1,306 million at December 31, 2013 and 2012, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the years ended December 31, 2013 and 2012 were not significant.

**Contributions**

Canon expects to contribute ¥13,589 million to its Japanese defined benefit pension plans and ¥7,060 million to its foreign defined benefit pension plans for the year ending December 31, 2014.

**Estimated future benefit payments**

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

	Japanese plans (Millions of yen)		Foreign plans (Millions of yen)	
<b>Year ending December 31:</b>				
2014	¥	16,846	¥	11,782
2015		18,489		11,417
2016		20,242		12,144
2017		21,713		12,713
2018		23,688		13,322

2019 2023

153,224

78,655

122

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**11. Income Taxes**

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

	Year ended December 31, 2013		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 251,351	¥ 96,253	¥ 347,604
Income taxes:			
Current	¥ 75,134	¥ 16,163	¥ 91,297
Deferred	4,005	12,786	16,791
	¥ 79,139	¥ 28,949	¥ 108,088

	Year ended December 31, 2012		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 257,640	¥ 84,917	¥ 342,557
Income taxes:			
Current	¥ 73,573	¥ 29,052	¥ 102,625
Deferred	13,900	(6,413)	7,487
	¥ 87,473	¥ 22,639	¥ 110,112

	Year ended December 31, 2011		
	Japanese	Foreign	Total
	(Millions of yen)		
Income before income taxes	¥ 287,592	¥ 86,932	¥ 374,524
Income taxes:			
Current	¥ 67,671	¥ 23,615	¥ 91,286
Deferred	21,047	8,082	29,129
	¥ 88,718	¥ 31,697	¥ 120,415

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 38% for the year ended December 31, 2013 and approximately 40% for the years ended December 31, 2012 and 2011, respectively.

Amendments to the Japanese tax regulations were enacted into law on November 30, 2011. As a result of these amendments, the statutory income tax rate has been reduced from approximately 40% to 38% effective from the year ended December 31, 2013, and will be reduced to

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approximately 35% effective from the year ending December 31, 2016. Consequently, the statutory income tax rate utilized for deferred tax assets and liabilities which were or are expected to be settled or realized in the period from January 1, 2013 to December 31, 2015 is approximately 38% and for periods subsequent to December 31, 2015 the rate is approximately 35%. The adjustments of deferred tax assets and liabilities for this change in the tax rate amounted to ¥6,599 million and were reflected in income taxes in the consolidated statement of income for the year ended December 31, 2011.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

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

	Years ended December 31		
	2013	2012	2011
Japanese statutory income tax rate	<b>38.0%</b>	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	<b>0.9</b>	0.8	0.6
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	<b>(3.3)</b>	(4.3)	(4.3)
Tax credit for research and development expenses	<b>(5.4)</b>	(5.7)	(3.9)
Change in valuation allowance	<b>0.2</b>	(1.7)	(0.5)
Effect of enacted changes in tax laws and rates on Japanese tax			1.8
Other	<b>0.7</b>	3.0	(1.5)
Effective income tax rate	<b>31.1%</b>	32.1%	32.2%

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

	December 31	
	2013	2012
	(Millions of yen)	
Prepaid expenses and other current assets	<b>¥ 61,902</b>	¥ 62,358
Other assets	<b>103,539</b>	121,934
Other current liabilities	<b>(3,621)</b>	(2,662)
Other noncurrent liabilities	<b>(63,129)</b>	(44,712)
	<b>¥ 98,691</b>	¥ 136,918

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are presented below:

	December 31	
	2013	2012
	(Millions of yen)	
Deferred tax assets:		
Inventories	¥ 12,988	¥ 13,040
Accrued business tax	4,448	4,754
Accrued pension and severance cost	59,964	86,442
Research and development costs capitalized for tax purposes	10,978	12,658
Property, plant and equipment	26,626	28,780
Accrued expenses	37,153	36,528
Net operating losses carried forward	38,439	32,494
Other	44,482	41,366
	<b>235,078</b>	256,062
Less valuation allowance	<b>(35,055)</b>	(32,167)
Total deferred tax assets	<b>200,023</b>	223,895
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	<b>(10,876)</b>	(8,235)
Net unrealized gains on securities	<b>(5,740)</b>	(2,437)
Tax deductible reserve	<b>(6,160)</b>	(6,417)
Financing lease revenue	<b>(50,605)</b>	(41,417)
Prepaid pension and severance cost	<b>(671)</b>	(1,073)
Other	<b>(27,280)</b>	(27,398)
Total deferred tax liabilities	<b>(101,332)</b>	(86,977)
Net deferred tax assets	<b>¥ 98,691</b>	¥ 136,918

The net changes in the total valuation allowance were an increase of ¥2,888 million for the year ended December 31, 2013, and decreases of ¥1,621 million and ¥1,519 million for the years ended December 31, 2012 and 2011, respectively.

Based upon the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the existing valuation allowance, at December 31, 2013.

At December 31, 2013, Canon had net operating losses which can be carried forward for income tax purposes of ¥167,138 million to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to an indefinite period as follows:

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	<b>(Millions of yen)</b>
Within one year	¥ 1,453
After one year through five years	23,656
After five years through ten years	46,346
After ten years through twenty years	62,054
Indefinite period	33,629
 Total	 ¥ 167,138

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**11. Income Taxes (continued)**

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

Canon has not recognized deferred tax liabilities of ¥29,833 million for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2013 and prior years because Canon currently does not expect to have such amounts distributed or paid as dividends to the Company in the foreseeable future. Deferred tax liabilities will be recognized when Canon expects that it will realize those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. At December 31, 2013, such undistributed earnings of these subsidiaries were ¥939,460 million.

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

	Years ended December 31		
	2013	2012	2011
	(Millions of yen)		
Balance at beginning of year	¥ 7,711	¥ 2,933	¥ 6,035
Additions for tax positions of the current year	312	869	149
Additions for tax positions of prior years	388	4,903	431
Reductions for tax positions of prior years	(3,141)	(1,546)	(2,139)
Settlements with tax authorities	(347)	(41)	(1,264)
Other	1,278	593	(279)
Balance at end of year	¥ 6,201	¥ 7,711	¥ 2,933

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥6,201 million and ¥7,711 million at December 31, 2013 and 2012, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in the future period. Based on each of the items of which Canon is aware at December 31, 2013, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2013 and 2012, and interest and penalties included in income taxes for the years ended December 31, 2013, 2012 and 2011 are not significant.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2012. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2006. In other major foreign tax jurisdictions, including the United States and the Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2006 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2005 in major foreign tax jurisdictions.

**12. Legal Reserve and Retained Earnings**

The Corporation Law of Japan provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**12. Legal Reserve and Retained Earnings (continued)**

required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law of Japan also provides that additional paid-in capital and legal reserve are available for appropriations by the resolution of the stockholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of the respective countries.

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2013, 2012 and 2011 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2013 did not reflect current year-end dividends in the amount of ¥73,905 million which were approved by the stockholders in March 2014.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥1,055,590 million at December 31, 2013.

Retained earnings at December 31, 2013 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥16,423 million.

**13. Other Comprehensive Income (Loss)**

Changes in accumulated other comprehensive income (loss) for the years ended December 31, 2012 and 2011 are as follows:

	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments (Millions of yen)	Pension liability adjustments	Total
<b>Balance at December 31, 2010</b>	¥ (325,612)	¥ 3,020	¥ 917	¥ (68,784)	¥ (390,459)
Adjustments for the year	(53,251)	(2,017)	(462)	(35,584)	(91,314)
<b>Balance at December 31, 2011</b>	(378,863)	1,003	455	(104,368)	(481,773)
Adjustments for the year	131,129	3,143	(4,917)	(14,831)	114,524
<b>Balance at December 31, 2012</b>	¥ (247,734)	¥ 4,146	¥ (4,462)	¥ (119,199)	¥ (367,249)

Changes in accumulated other comprehensive income (loss) for the year ended December 31, 2013 are as follows:

	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments (Millions of yen)	Pension liability adjustments	Total
<b>Balance at December 31, 2012</b>	¥ (247,734)	¥ 4,146	¥ (4,462)	¥ (119,199)	¥ (367,249)
Equity transaction with noncontrolling interests and other	(323)	(1)	(2)	(329)	(655)

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Other comprehensive income(loss) before reclassifications	249,791	7,449	(7,551)	27,153	276,842
Amounts reclassified from accumulated other comprehensive income (loss)		(1,352)	9,607	2,161	10,416
Net change during the year	249,468	6,096	2,054	28,985	286,603
<b>Balance at December 31, 2013</b>	¥ 1,734	¥ 10,242	¥ (2,408)	¥ (90,214)	¥ (80,646)

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**13. Other Comprehensive Income (Loss) (continued)**

Reclassifications out of accumulated other comprehensive income (loss) at December 31, 2013 are as follows:

	Amount reclassified from accumulated other comprehensive income (loss) *1 (Millions of yen)	Year ended December 31, 2013 Affected line items in consolidated statements of income
Unrealized gains and losses on securities	¥ (2,358)	Other, net
	613	Income taxes
	(1,745)	Consolidated net income
	393	Net income attributable to noncontrolling interests
	(1,352)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	15,387	Other, net
	(5,780)	Income taxes
	9,607	Consolidated net income
		Net income attributable to noncontrolling interests
	9,607	Net income attributable to Canon Inc.
Pension liability adjustments	3,460	See Note 10
	(1,037)	Income taxes
	2,423	Consolidated net income
	(262)	Net income attributable to noncontrolling interests
	2,161	Net income attributable to Canon Inc.
Total amount reclassified, net of tax and noncontrolling interests	¥ 10,416	

\*1 Amounts in parentheses indicate gains in consolidated statements of income.





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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**13. Other Comprehensive Income (Loss) (continued)**

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments, including amounts attributable to noncontrolling interests, are as follows:

	Years ended December 31		
	Before-tax amount	Tax (expense) or benefit (Millions of yen)	Net-of-tax amount
<b>2013:</b>			
Foreign currency translation adjustments	¥ 253,707	¥ (2,131)	¥ 251,576
Net unrealized gains and losses on securities:			
Amount arising during the year	12,669	(4,312)	8,357
Reclassification adjustments for gains and losses realized in net income	(2,358)	613	(1,745)
Net change during the year	10,311	(3,699)	6,612
Net gains and losses on derivative instruments:			
Amount arising during the year	(12,145)	4,594	(7,551)
Reclassification adjustments for gains and losses realized in net income	15,387	(5,780)	9,607
Net change during the year	3,242	(1,186)	2,056
Pension liability adjustments:			
Amount arising during the year	51,860	(21,614)	30,246
Reclassification adjustments for gains and losses realized in net income	3,460	(1,037)	2,423
Net change during the year	55,320	(22,651)	32,669
Other comprehensive income (loss)	¥ 322,580	¥ (29,667)	¥ 292,913
<b>2012:</b>			
Foreign currency translation adjustments	¥ 134,930	¥ (1,195)	¥ 133,735
Net unrealized gains and losses on securities:			
Amount arising during the year	3,418	(1,004)	2,414
Reclassification adjustments for gains and losses realized in net income	1,307	(456)	851
Net change during the year	4,725	(1,460)	3,265
Net gains and losses on derivative instruments:			
Amount arising during the year	(10,647)	4,041	(6,606)
Reclassification adjustments for gains and losses realized in net income	2,440	(714)	1,726
Net change during the year	(8,207)	3,327	(4,880)
Pension liability adjustments:			
Amount arising during the year	(13,888)	(1,738)	(15,626)
Reclassification adjustments for gains and losses realized in net income	4,433	(1,594)	2,839

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Net change during the year	(9,455)	(3,332)	(12,787)
Other comprehensive income (loss)	¥ 121,993	¥ (2,660)	¥ 119,333

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**13. Other Comprehensive Income (Loss) (continued)**

	Years ended December 31		
	Before-tax amount	Tax (expense) or benefit (Millions of yen)	Net-of-tax amount
<b>2011:</b>			
Foreign currency translation adjustments	¥ (53,839)	¥ (247)	¥ (54,086)
Net unrealized gains and losses on securities:			
Amount arising during the year	(7,571)	3,010	(4,561)
Reclassification adjustments for gains and losses realized in net income	4,077	(1,632)	2,445
Net change during the year	(3,494)	1,378	(2,116)
Net gains and losses on derivative instruments:			
Amount arising during the year	4,221	(1,708)	2,513
Reclassification adjustments for gains and losses realized in net income	(5,006)	2,044	(2,962)
Net change during the year	(785)	336	(449)
Pension liability adjustments:			
Amount arising during the year	(59,928)	20,252	(39,676)
Reclassification adjustments for gains and losses realized in net income	2,038	(739)	1,299
Net change during the year	(57,890)	19,513	(38,377)
Other comprehensive income (loss)	¥ (116,008)	¥ 20,980	¥ (95,028)

**14. Stock-Based Compensation**

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

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

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

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



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**14. Stock-Based Compensation (continued)**

The compensation cost recognized for these stock options for the years ended December 31, 2013, 2012 and 2011 was ¥95 million, ¥364 million and ¥748 million, respectively, and is included in selling, general and administrative expenses in the consolidated statements of income.

The fair value of each option award was estimated on the date of grant using the Black-Scholes option pricing model that incorporates the assumptions presented below:

	Year ended December 31, 2011
Expected term of option (in years)	4.0
Expected volatility	36.44%
Dividend yield	3.16%
Risk-free interest rate	0.44%

A summary of option activity under the stock option plans as of and for the years ended December 31, 2013, 2012 and 2011 is presented below:

	Shares	Weighted average exercise price (Yen)	Weighted average remaining contractual term (Year)	Aggregate intrinsic value (Millions of yen)
Outstanding at January 1, 2011	2,220,000	¥ 4,354	2.5	¥ 722
Granted	912,000	3,990		
Exercised	(65,800)	3,287		
Forfeited	(24,000)	4,282		
Outstanding at December 31, 2011	3,042,200	4,268	2.0	88
Exercised	(10,800)	3,287		
Forfeited	(305,000)	4,493		
Outstanding at December 31, 2012	2,726,400	4,247	1.6	37
Exercised	(8,600)	3,287		
Forfeited	(60,400)	4,461		
Outstanding at December 31, 2013	<b>2,657,400</b>	<b>¥ 4,245</b>	<b>1.0</b>	<b>¥ 28</b>
Exercisable at December 31, 2013	<b>2,657,400</b>	<b>¥ 4,245</b>	<b>1.0</b>	<b>¥ 28</b>

At December 31, 2013, all outstanding option awards were vested.

A summary of the status of the Company's nonvested shares at December 31, 2013, and changes during the year ended December 31, 2013, is presented below:

	Year ended December 31, 2013	
	Shares	Weighted-average grant-date fair value (Yen)
Nonvested at beginning of year	738,000	¥ 772
Vested	(738,000)	772
Forfeited		
Nonvested at end of year		

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**14. Stock-Based Compensation (continued)**

The total fair value of shares vested during the years ended December 31, 2013, 2012 and 2011 was ¥570 million, ¥848 million and ¥547 million, respectively. Cash received from the exercise of stock options for the years ended December 31, 2013, 2012 and 2011 was ¥28 million, ¥35 million and ¥216 million, respectively.

**15. Net Income Attributable to Canon Inc. Stockholders per Share**

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

	2013	Years ended December 31	
		2012	2011
		(Millions of yen)	
Net income attributable to Canon Inc.	¥ 230,483	¥ 224,564	¥ 248,630
		(Number of shares)	
Average common shares outstanding	1,147,933,835	1,173,647,835	1,215,832,419
Effect of dilutive securities:			
Stock options	8,466	20,574	60,552
Diluted common shares outstanding	1,147,942,301	1,173,668,409	1,215,892,971
		(Yen)	
Net income attributable to Canon Inc. stockholders per share:			
Basic	¥ 200.78	¥ 191.34	¥ 204.49
Diluted	200.78	191.34	204.48

The computation of diluted net income attributable to Canon Inc. stockholders per share for the years ended December 31, 2013, 2012 and 2011 excludes certain outstanding stock options because the effect would be anti-dilutive.

**16. Derivatives and Hedging Activities***Risk management policy*

Canon operates internationally, exposing it to the risk of changes in foreign currency exchange rates. Derivative financial instruments are comprised principally of foreign exchange contracts utilized by the Company and certain of its subsidiaries to reduce the risk. Canon assesses foreign currency exchange rate risk by continually monitoring changes in the exposures and by evaluating hedging opportunities. Canon does not hold or issue derivative financial instruments for trading purposes. Canon is also exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, but it is not expected that any counterparties will fail to meet their obligations. Most of the counterparties are internationally recognized financial institutions and selected by Canon taking into account their financial condition, and contracts are diversified across a number of major financial institutions.



*Foreign currency exchange rate risk management*

Canon's international operations expose Canon to the risk of changes in foreign currency exchange rates. Canon uses foreign exchange contracts to manage certain foreign currency exchange exposures principally from the

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**16. Derivatives and Hedging Activities (continued)**

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

***Cash flow hedge***

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

***Derivatives not designated as hedges***

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

Contract amounts of foreign exchange contracts at December 31, 2013 and 2012 are set forth below:

	December 31	
	2013	2012
	(Millions of yen)	
To sell foreign currencies	¥ 374,699	¥ 420,272
To buy foreign currencies	44,726	66,563

***Fair value of derivative instruments in the consolidated balance sheets***

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at December 31, 2013 and 2012.

**Derivatives designated as hedging instruments**

	Balance sheet location	Fair value December 31	
		2013	2012
		(Millions of yen)	
<b>Assets:</b>			
Foreign exchange contracts	Prepaid expenses and other current assets	¥ 44	¥ 443

Liabilities:

Foreign exchange contracts	Other current liabilities	2,267	4,472
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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**16. Derivatives and Hedging Activities (continued)**Derivatives not designated as hedging instruments

	Balance sheet location	Fair value December 31	
		2013 (Millions of yen)	2012
<b>Assets:</b>			
Foreign exchange contracts	Prepaid expenses and other current assets	¥ 210	¥ 388
<b>Liabilities:</b>			
Foreign exchange contracts	Other current liabilities	12,678	21,021
<i>Effect of derivative instruments in the consolidated statements of income</i>			

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the years ended December 31, 2013, 2012 and 2011.

Derivatives in cash flow hedging relationships

	Gain (loss) recognized in OCI (effective portion) Amount	Years ended December 31		Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)	
		Gain (loss) reclassified from accumulated OCI into income (effective portion) Location	Amount (Millions of yen)	Location	Amount
<b>2013:</b>					
Foreign exchange contracts	¥ 3,242	Other, net	¥ (15,387)	Other, net	¥ (111)
<b>2012:</b>					
Foreign exchange contracts	(8,207)	Other, net	(2,440)	Other, net	(221)
<b>2011:</b>					
Foreign exchange contracts	(785)	Other, net	5,006	Other, net	(457)
<u>Derivatives not designated as hedging instruments</u>					

	Location	Gain (loss) recognized in income on derivative Years ended December 31		
		2013	2012 (Millions of yen)	2011
Foreign exchange contracts	Other, net	¥ (61,787)	¥ (30,602)	¥ 11,168

**17. Commitments and Contingent Liabilities***Commitments*

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At December 31, 2013, commitments outstanding for the purchase of property, plant and equipment approximated ¥26,218 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥73,914 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥13,448 million and ¥13,313 million at December 31, 2013

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**17. Commitments and Contingent Liabilities (continued)**

and 2012, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under such operating lease arrangements amounted to ¥44,562 million, ¥40,273 million and ¥38,167 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Future minimum lease payments required under noncancelable operating leases that have initial or remaining lease terms in excess of one year at December 31, 2013 are as follows:

	(Millions of yen)	
<b>Year ending December 31:</b>		
2014	¥	28,523
2015		20,337
2016		17,578
2017		10,046
2018		6,400
Thereafter		13,180
Total future minimum lease payments	¥	96,064

**Guarantees**

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

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and of 1 year to 10 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥12,315 million at December 31, 2013. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2013 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued product warranty cost for the years ended December 31, 2013 and 2012 are summarized as follows:

	Years ended December 31	
	2013	2012
	(Millions of yen)	
Balance at beginning of year	¥ 12,163	¥ 11,691
Addition	13,467	13,553
Utilization	(12,922)	(12,503)
Other	(1,818)	(578)

Balance at end of year	¥ 10,890	¥ 12,163
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***Legal proceedings***

Canon is involved in various claims and legal actions arising in the ordinary course of business. Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**17. Commitments and Contingent Liabilities (continued)**

can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, although litigation is inherently unpredictable, Canon believes that any damage amounts claimed in outstanding matters are not a meaningful indicator of Canon's potential liability. In the opinion of management, any reasonably possible range of losses from outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows.

**18. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk*****Fair value of financial instruments***

The estimated fair values of Canon's financial instruments at December 31, 2013 and 2012 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses for which fair values approximate their carrying amounts. The summary also excludes investments which are disclosed in Note 2.

	December 31			
	2013	2012		
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(Millions of yen)			
Long-term debt, including current installments	¥ (2,693)	¥ (2,693)	¥ (3,664)	¥ (3,654)
Foreign exchange contracts:				
Assets	254	254	831	831
Liabilities	(14,945)	(14,945)	(25,493)	(25,493)

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

**Long-term debt**

Canon's long-term debt instruments are classified as Level 2 instruments and valued based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity. The levels are more fully described in Note 19.

**Foreign exchange contracts**

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

**Limitations of fair value estimates**

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





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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**18. Disclosures about the Fair Value of Financial Instruments and Concentrations of Credit Risk (continued)***Concentrations of credit risk*

At December 31, 2013 and 2012, one customer accounted for approximately 15% and 18% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

**19. Fair Value Measurements**

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

Level 1 - Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

*Assets and liabilities measured at fair value on a recurring basis*

The following tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at December 31, 2013 and 2012.

	Level 1	December 31, 2013 Level 2      Level 3 (Millions of yen)		Total
<b>Assets:</b>				
Cash and cash equivalents	¥	¥ 183,078	¥	¥ 183,078
<b>Available-for-sale (noncurrent):</b>				
Government bonds	307			307
Corporate bonds		141	340	481
Fund trusts	11	57		68
Equity securities	34,536			34,536
Derivatives		254		254
<b>Total assets</b>	<b>¥ 34,854</b>	<b>¥ 183,530</b>	<b>¥ 340</b>	<b>¥ 218,724</b>
<b>Liabilities:</b>				
Derivatives	¥	¥ 14,945	¥	¥ 14,945

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Total liabilities	¥	¥ 14,945	¥	¥ 14,945
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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**19. Fair Value Measurements (continued)**

	Level 1	December 31, 2012 Level 2      Level 3 (Millions of yen)		Total
<b>Assets:</b>				
Cash and cash equivalents	¥	¥ 141,729	¥	¥ 141,729
<b>Available-for-sale (current):</b>				
Corporate bonds	30			30
<b>Available-for-sale (noncurrent):</b>				
Government bonds	181			181
Corporate bonds		116	444	560
Fund trusts	159	1,075		1,234
Equity securities	21,335			21,335
Derivatives		831		831
<b>Total assets</b>	<b>¥ 21,705</b>	<b>¥ 143,751</b>	<b>¥ 444</b>	<b>¥ 165,900</b>
<b>Liabilities:</b>				
Derivatives	¥	¥ 25,493	¥	¥ 25,493
<b>Total liabilities</b>	<b>¥</b>	<b>¥ 25,493</b>	<b>¥</b>	<b>¥ 25,493</b>

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

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

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the years ended December 31, 2013 and 2012.

	Years ended December 31 2013      2012 (Millions of yen)	
Balance at beginning of year	¥ 444	¥ 454
<b>Total gains or losses (realized or unrealized):</b>		
Included in earnings	1	3
Included in other comprehensive income (loss)	36	2
Purchases, issuances, and settlements	(141)	(15)
<b>Balance at end of year</b>	<b>¥ 340</b>	<b>¥ 444</b>

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Gains and losses included in earnings are mainly related to corporate bonds still held at December 31, 2013 and 2012, and are reported in Other, net in the consolidated statements of income.

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Canon Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**19. Fair Value Measurements (continued)**

*Assets and liabilities measured at fair value on a nonrecurring basis*

During the years ended December 31, 2013 and 2012, there were no circumstances that required any significant assets or liabilities to be measured at fair value on a nonrecurring basis.

**20. Segment Information**

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

The primary products included in each segment are as follows:

Office Business Unit: Office multifunction devices (MFDs) / Laser multifunction printers (MFPs) / Laser printers / Digital production printing systems / High speed continuous feed printers / Wide-format printers / Document solutions

Imaging System Business Unit: Interchangeable lens digital cameras / Digital compact cameras / Digital camcorders / Digital cinema cameras / Interchangeable lenses / Inkjet printers / Large-format inkjet printers / Commercial photo printers / Image scanners / Multimedia projectors / Broadcast equipment / Calculators

Industry and Others Business Unit: Semiconductor lithography equipment / Flat panel display (FPD) lithography equipment / Digital radiography systems / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

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

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**20. Segment Information (continued)**

Information about operating results and assets for each segment as of and for the years ended December 31, 2013, 2012 and 2011 is as follows:

	Office	Imaging System	Industry and Others (Millions of yen)	Corporate and eliminations	Consolidated
<b>2013:</b>					
Net sales:					
External customers	¥ 1,993,898	¥ 1,448,186	¥ 289,296	¥	¥ 3,731,380
Intersegment	6,175	752	85,574	(92,501)	
Total	2,000,073	1,448,938	374,870	(92,501)	3,731,380
Operating cost and expenses	1,733,165	1,245,144	400,201	15,593	3,394,103
Operating profit(loss)	¥ 266,908	¥ 203,794	¥ (25,331)	¥ (108,094)	¥ 337,277
Total assets	¥ 954,803	¥ 584,856	¥ 328,202	¥ 2,374,849	¥ 4,242,710
Depreciation and amortization	88,344	56,564	37,072	93,193	275,173
Capital expenditures	54,644	44,112	27,040	101,682	227,478
<b>2012:</b>					
Net sales:					
External customers	¥ 1,751,960	¥ 1,404,394	¥ 323,434	¥	¥ 3,479,788
Intersegment	5,615	1,577	84,406	(91,598)	
Total	1,757,575	1,405,971	407,840	(91,598)	3,479,788
Operating cost and expenses	1,553,997	1,195,653	401,930	4,352	3,155,932
Operating profit	¥ 203,578	¥ 210,318	¥ 5,910	¥ (95,950)	¥ 323,856
Total assets	¥ 927,543	¥ 614,328	¥ 337,899	¥ 2,075,733	¥ 3,955,503
Depreciation and amortization	77,660	53,664	34,264	92,545	258,133
Capital expenditures	58,402	58,142	44,086	146,031	306,661
<b>2011:</b>					
Net sales:					
External customers	¥ 1,912,112	¥ 1,311,023	¥ 334,298	¥	¥ 3,557,433
Intersegment	5,831	1,021	86,565	(93,417)	
Total	1,917,943	1,312,044	420,863	(93,417)	3,557,433
Operating cost and expenses	1,658,678	1,100,750	396,563	23,371	3,179,362
Operating profit	¥ 259,265	¥ 211,294	¥ 24,300	¥ (116,788)	¥ 378,071
Total assets	¥ 907,433	¥ 452,809	¥ 362,638	¥ 2,207,847	¥ 3,930,727

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Depreciation and amortization	93,196	45,609	29,685	92,853	261,343
Capital expenditures	53,888	48,192	37,648	122,753	262,481

Intersegment sales are recorded at the same prices used in transactions with third parties. Expenses not directly associated with specific segments are allocated based on the most reasonable measures applicable. Corporate expenses include certain corporate research and development expenses. Segment assets are based on those directly associated with each segment. Corporate assets primarily consist of cash and cash equivalents, investments, deferred tax assets, goodwill and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis. In 2013, based on the realignment of Canon's internal reporting structure, certain financial assets have been transferred from Corporate to the Office Business Unit. Corresponding amounts of total assets as of December 31, 2012 and 2011 have been reclassified to conform with the current year presentation.



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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**20. Segment Information (continued)**

Information about product sales to external customers by business unit for the years ended December 31, 2013, 2012 and 2011 is as follows:

	Years ended December 31		
	2013	2012	2011
	(Millions of yen)		
Office			
Monochrome copiers	¥ 312,973	¥ 274,021	¥ 276,225
Color copiers	381,848	324,851	322,321
Printers	841,436	766,382	902,756
Others	457,641	386,706	410,810
<b>Total</b>	<b>1,993,898</b>	<b>1,751,960</b>	<b>1,912,112</b>
Imaging System			
Cameras	973,517	990,549	928,047
Inkjet printers	363,070	312,429	315,526
Others	111,599	101,416	67,450
<b>Total</b>	<b>1,448,186</b>	<b>1,404,394</b>	<b>1,311,023</b>
Industry and Others			
Lithography equipment	62,116	62,892	81,556
Others	227,180	260,542	252,742
<b>Total</b>	<b>289,296</b>	<b>323,434</b>	<b>334,298</b>
<b>Consolidated</b>	<b>¥ 3,731,380</b>	<b>¥ 3,479,788</b>	<b>¥ 3,557,433</b>

Information by major geographic area as of and for the years ended December 31, 2013, 2012 and 2011 is as follows:

	2013	2012	2011
	(Millions of yen)		
Net sales:			
Japan	¥ 715,863	¥ 720,286	¥ 694,450
Americas	1,059,501	939,873	961,955
Europe	1,124,929	1,014,038	1,113,065
Asia and Oceania	831,087	805,591	787,963
<b>Total</b>	<b>¥ 3,731,380</b>	<b>¥ 3,479,788</b>	<b>¥ 3,557,433</b>
Long-lived assets:			
Japan	¥ 984,231	¥ 1,032,598	¥ 1,070,412
Americas	131,660	112,163	85,824
Europe	111,609	91,904	83,296

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Asia and Oceania	<b>196,305</b>	159,435	89,334
Total	<b>¥ 1,423,805</b>	¥ 1,396,100	¥ 1,328,866

Net sales are attributed to areas based on the location where the product is shipped to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States were ¥960,213 million, ¥763,870 million and ¥779,652 million for the years ended December 31, 2013, 2012 and 2011, respectively.

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## Canon Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**20. Segment Information (continued)**

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

The following information is based on the location of the Company and its subsidiaries as of and for the years ended December 31, 2013, 2012 and 2011. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information in order to provide financial statements users with useful information.

	Japan	Americas	Europe	Asia and Oceania	Corporate and eliminations	Consolidated
	(Millions of yen)					
<b>2013:</b>						
Net sales:						
External customers	¥ 797,501	¥ 1,056,096	¥ 1,124,603	¥ 753,180	¥	¥ 3,731,380
Intersegment	1,855,181	11,774	53,281	881,765	(2,802,001)	
Total	2,652,682	1,067,870	1,177,884	1,634,945	(2,802,001)	3,731,380
Operating cost and expenses	2,326,351	1,043,487	1,171,357	1,574,125	(2,721,217)	3,394,103
Operating profit	¥ 326,331	¥ 24,383	¥ 6,527	¥ 60,820	¥ (80,784)	¥ 337,277
Total assets	¥ 1,152,398	¥ 447,039	¥ 496,549	¥ 631,827	¥ 1,514,897	¥ 4,242,710
<b>2012:</b>						
Net sales:						
External customers	¥ 834,406	¥ 932,987	¥ 1,010,922	¥ 701,473	¥	¥ 3,479,788
Intersegment	1,829,834	23,767	5,650	781,836	(2,641,087)	
Total	2,664,240	956,754	1,016,572	1,483,309	(2,641,087)	3,479,788
Operating cost and expenses	2,336,536	937,111	972,585	1,437,527	(2,527,827)	3,155,932
Operating profit	¥ 327,704	¥ 19,643	¥ 43,987	¥ 45,782	¥ (113,260)	¥ 323,856
Total assets	¥ 1,206,702	¥ 339,918	¥ 457,592	¥ 548,583	¥ 1,402,708	¥ 3,955,503
<b>2011:</b>						
Net sales:						
External customers	¥ 807,883	¥ 952,833	¥ 1,109,256	¥ 687,461	¥	¥ 3,557,433
Intersegment	1,873,157	16,217	4,681	744,179	(2,638,234)	
Total	2,681,040	969,050	1,113,937	1,431,640	(2,638,234)	3,557,433
Operating cost and expenses	2,273,336	948,593	1,069,489	1,388,580	(2,500,636)	3,179,362
Operating profit	¥ 407,704	¥ 20,457	¥ 44,448	¥ 43,060	¥ (137,598)	¥ 378,071

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Total assets	¥ 1,236,468	¥ 250,131	¥ 427,030	¥ 442,263	¥ 1,574,835	¥ 3,930,727
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### **21. Subsequent Event**

On February 18, 2014, the Board of Directors of the Company approved and implemented a plan to repurchase up to 18 million shares of the Company's common stock at a cost of up to ¥50,000 million for the period from February 19, 2014 to April 4, 2014. Such repurchases are intended to improve capital efficiency and ensure flexible capital strategy. Common stock repurchased in the Tokyo Stock Exchange between February 19, 2014 and March 4, 2014 under the aforementioned plan was 15,957,600 shares at a cost of ¥50,000 million.

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## Canon Inc. and Subsidiaries

## Schedule II Valuation and Qualifying Accounts

	Balance at beginning of period	Addition- charged to income	Deduction bad debts written off (Millions of yen)	Translation adjustments and other	Balance at end of period
Year ended December 31, 2013:					
Allowance for doubtful receivables					
Trade receivables	¥ 12,970	¥ 1,235	¥ (4,173)	¥ 2,698	¥ 12,730
Finance receivables	6,908	212	(1,278)	1,481	7,323
Year ended December 31, 2012:					
Allowance for doubtful receivables					
Trade receivables	¥ 11,563	¥ 2,149	¥ (2,382)	¥ 1,640	¥ 12,970
Finance receivables	7,039	1,922	(1,304)	(749)	6,908
Year ended December 31, 2011:					
Allowance for doubtful receivables					
Trade receivables	¥ 14,920	¥ 492	¥ (3,995)	¥ 146	¥ 11,563
Finance receivables	7,983	2,052	(1,937)	(1,059)	7,039

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**Item 19. Exhibits**

List of exhibits

- 1.1 Articles of Incorporation of Canon Inc. (Translation)
- 1.2 Regulations of the Board of Directors of Canon Inc. (Translation)
- 2 Regulations for Handling of Shares of Canon Inc. (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 0-15122) filed on March 27, 2009
- 8 List of Significant Subsidiaries (See Organizational Structure in Item 4.C. of this Form 20-F)
- 11.1 Canon Group Code of Conduct (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 0-15122) filed on March 28, 2013
- 11.2 Code of Ethics (Supplement to The Canon Group Code of Conduct) (Translation), incorporated by reference from the annual report on Form 20-F (Commission file number 0-15122) filed on June 10, 2004
- 12 Certifications of Chairman and CEO and Executive Vice President and CFO pursuant to Section 302 of the Sarbanes-Oxley Act
- 13 Certification of Chairman and CEO and Executive Vice President and CFO pursuant to Section 906 of the Sarbanes-Oxley Act
- 101 INSTANCE DOCUMENT
- 101 SCHEMA DOCUMENT
- 101 CALCULATION LINKBASE DOCUMENT
- 101 LABELS LINKBASE DOCUMENT
- 101 PRESENTATION LINKBASE DOCUMENT
- 101 DEFINITION LINKBASE DOCUMENT

Canon has not included as exhibits certain instruments with respect to its long-term debt. The total amount of its long-term debt authorized under any instrument does not exceed 10% of its total assets, and Canon agrees to furnish a copy of any instrument defining the rights of holders of its long-term debt to the Securities and Exchange Commission upon request.



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SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, as amended, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANON INC.  
(Registrant)

/s/ Toshizo Tanaka  
Toshizo Tanaka  
Executive Vice President & CFO

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

Date March 28, 2014



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<b>Exhibit number</b>	<b>Title</b>
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Exhibit 101	DEFINITION LINKBASE DOCUMENT