CANON ANNUAL REPORT 2007

Fiscal Year Ended December 31, 2007

CORPORATE PROFILE

Canon develops, manufactures and sells a wide lineup of copying machines, printers, cameras, optical products and other products to meet a diverse range of customer needs. The Canon brand is well recognized and trusted worldwide by individuals, families, in offices and industrial circles.

Canon first began implementing its Excellent Global Corporation Plan in 1996, and has since delivered a series of strong performances. In fiscal 2007, the 2nd year of Phase III of the Plan, Canon achieved record earnings and marked its eighth consecutive year of growth in both sales and net income.

With the spread of globalization and broadband networks, Canon stands poised to lead a new era, promoting cross-media imaging through advanced synergies among digital imaging equipment. In addition to strengthening business results for enhanced corporate value, the Company engages in a number of environmental and social contribution activities and focuses on fulfilling its duties to investors and society by stressing good corporate governance.

CORPORATE PHILOSOPHY: *Kyosei*

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

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

CORPORATE GOAL

In fiscal 2008, the Company aims to strengthen existing businesses, expand business operations through diversification and identify next-generation business domains to assure sustained growth beyond 2010, while maintaining a high profit margin structure. Canon will make every effort to join the ranks of the global top 100 companies by 2010 in terms of key performance indicators. The Company's goals for 2010 include net sales of ¥6 trillion and a net income to sales ratio of 10% or more.

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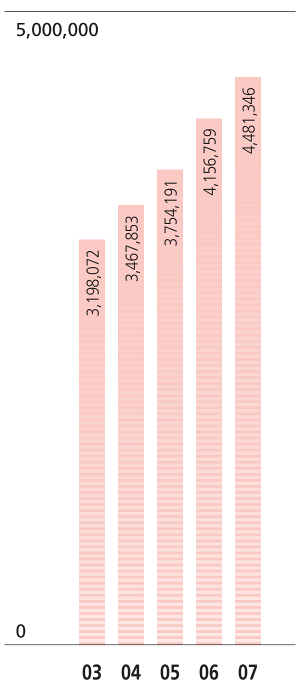
Cover Photo:
Canon launched its new digital SLR camera, EOS 40D, which attracted high praise from the market. Utilizing a Live View function, users can check images on a real time basis while taking photographs.

FINANCIAL HIGHLIGHTS

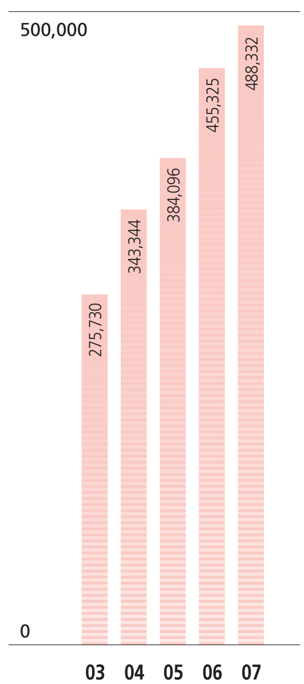
	Millions of yen (except per share amounts)			Thousands of U.S. dollars (except per share amounts)
	2007	2006	Change (%)	**2007**
Net sales	**¥4,481,346**	¥4,156,759	+7.8	**$39,310,053**
Operating profit	**756,673**	707,033	+7.0	**6,637,482**
Income before income taxes and minority interests	**768,388**	719,143	+6.8	**6,740,246**
Net income	**488,332**	455,325	+7.2	**4,283,614**
Net income per share:				
-Basic	**¥ 377.59**	¥ 341.95	+10.4	**$ 3.31**
-Diluted	**377.53**	341.84	+10.4	**3.31**
Total assets	**¥4,512,625**	¥4,521,915	-0.2	**$39,584,430**
Stockholders' equity	**¥2,922,336**	¥2,986,606	-2.2	**$25,634,526**

Notes:
1. Canon's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles.
2. U.S. dollar amounts are translated from yen at the rate of JPY114=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 28, 2007, solely for the convenience of the reader.

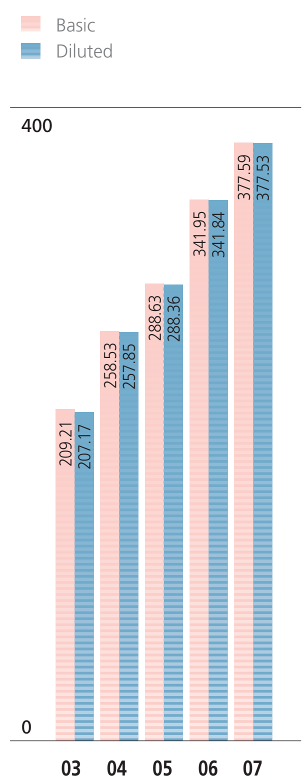
Net Sales
(Millions of yen)



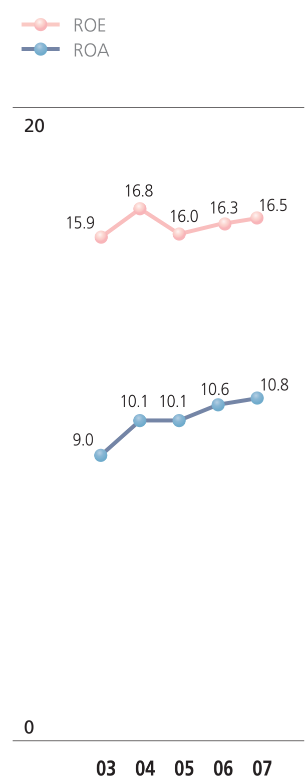
Net Income
(Millions of yen)



Net Income per Share
(Yen)



ROE / ROA
(%)



Setting Our Sights even Higher

Overview of Fiscal 2007

Canon celebrated its 70th anniversary in 2007 with record-high consolidated net sales and net income. This represents our eighth consecutive year of sales and profit growth.

In fiscal 2007, Canon's operating environment was generally favorable. The global economy continued on a growth path despite steep rises in raw material and fuel costs and a slowdown in the U.S. economy stemming from financial uncertainty surrounding the sub-prime loan crisis. Under these conditions, the corporate sector stood firm and employment conditions remained stable. In Europe, which saw European Union expansion, healthy exports and steady internal demand kept the economy on track. Turning to Asia, China continued to boast remarkable growth rates and ASEAN countries grew steadily. Japan's moderate but stable growth continued, supported by robust exports, dynamic capital investment and strong employment conditions.

Fiscal 2007 Performance Results

Canon recorded sales and profit growth during fiscal 2007. Compared to the previous year, consolidated net sales rose 7.8% to ¥4,481.3 billion and net income climbed 7.2% to ¥488.3 billion. By product category, sales increased 9.1% to ¥2,935.5 billion for business machines and 10.6% to ¥1,152.7 billion for cameras, but fell 7.2% to ¥393.1 billion for optical and other products. By operating region, sales were particularly strong in Europe, where Canon marked its 50th anniversary in 2007, rising 14.1% to ¥1,499.3 billion. Sales also increased in the Americas, climbing 4.1% to ¥1,336.1 billion. In Japan, sales were up 1.6% to ¥947.6 billion, and elsewhere in Asia and Oceania, sales jumped 11.5% to ¥698.3 billion.

Turning to operating expenses, the Company's selling, general and administrative expenses rose 7.4% year on year to ¥1,122.0 billion. We increased R&D expenses by 19.4% to ¥368.3 billion, which is equivalent to 8.2% of net sales—a high percentage that demonstrates the Company's commitment to maintaining its competitive edge through advanced research and development. The gross profit ratio improved 0.5 percentage points to 50.1%, and free cash flow amounted to ¥406.8 billion, compared to ¥234.4 billion at the previous year-end.

From a stockholders' return perspective, Canon set its full-year dividend per share at ¥110, an increase of ¥10 compared with the previous year, moving closer to the Company's targeted stockholder return ratio of around 30%.

Progressing toward Phase III Targets

Canon has set the goal of joining the world's top 100 companies in terms of key performance indicators by 2010, the end of Phase III of the Excellent Global Corporation Plan. In addition to this goal, we envision ourselves carrying on for another century of sustained development and prosperity. To this end, we will keep our sights firmly fixed on pursuing higher profits, offering attractive and timely products, and effectively reducing costs. In particular, Canon is pursuing key innovation activities, namely: strengthening supply chain management (SCM), increasing in-house production, enhancing automated production and improving the efficiency of procurement processes in order to reduce costs. Based on the Company's progress in 2007, we are confident that Canon is now poised to take great strides forward in the final three years of Phase III.

The Company undertook aggressive investment in infrastructure during 2007, with the view to ensuring the future growth of the Canon Group. As one example, capital expenditure was directed toward boosting the automated production of toner, toner cartridges and ink cartridges. The Company successfully introduced a newly designed automated production line for its toner cartridges in 2007 and has significantly increased the volume and quality of production. Toward the establishment of fully automated production systems, the Company will continue to work toward the Group-wide development of production technologies from a long-term perspective.

New Management Challenges

After considering the accumulated capabilities of the Group and future world market conditions, we decided to set our sights even higher. We raised our 2010 target for consolidated net sales from ¥5.5 trillion to ¥6 trillion while targeting a net income to sales ratio of 10% or more.

Our strategies for joining the global top 100 companies include boosting sales in high-growth emerging markets. At the same time, we will work toward creating new businesses, which in certain cases will entail timely mergers and acquisitions. In the year under review, Canon acquired majority ownership of Tokki Corporation, and expects Tokki's

advanced technology related to production equipment for organic light-emitting diode (OLED) displays to contribute considerably toward the development of Canon products. Canon also reached an agreement with Hitachi, Ltd. to acquire shares in Hitachi Displays, Ltd., with the aims of advancing display technologies, ensuring stable procurement of LCD panels used in Canon products, accelerating its OLED display development and facilitating product development. Phase III is an expansion period for Canon, and we will pursue M&A as a means to strengthen related fields in existing business operations, sales networks and the solutions business.

Looking beyond Phase III, we recognize that the cultivation of next-generation business domains is vital for Canon's future growth. Accordingly, the Company is accumulating technologies and conducting highly advanced research internally or in collaboration with leading universities and institutes. We have also identified medical imaging and robotics as new business domains. In medical imaging, the Company is advancing collaborative research with Kyoto University in Japan with the aim of developing innovative diagnostic imaging devices.

On a final note, to become a company worthy of admiration and respect worldwide, Canon is strengthening its Group-wide compliance systems and internal controls. In accordance with our corporate philosophy of *kyosei,* we believe that an excellent global corporation ultimately places compliance above corporate profit. Therefore, with the aim of ensuring Group-wide compliance, the Company is reinforcing its auditing processes for compliance-related issues and promoting greater awareness among all employees.

Looking back on our 70-year history, we recognize that the Company's continuous prosperity is founded upon the values that make up its corporate DNA: respect for human dignity, an emphasis on technology and an enterprising spirit. We are envisioning the next 30 years until Canon's 100th anniversary with confidence in the depth and strength of these values, which we will refine and pass on to the next generation of employees.

Seventy years into a remarkable forward-looking journey, Canon has never been stronger. We ask for your continued support and understanding of the Company's endeavors and objectives.

Fujio Mitarai
Chairman and CEO
Canon Inc.

Our priority goals for fiscal 2008 attest to Canon's ambition and commitment to become a ¥6 trillion company

Priority Goals for Fiscal 2008

2008 marks the third year of Phase III. Driven by the overarching aim of joining the global top 100 companies by the final year of Phase III, we are therefore entering an important period. Recognizing that all measures have been put in place for improving profit generation and that the Group is committed to all-out efforts, we are confident that Canon will achieve sales and profit growth for a ninth consecutive year.

The first of our priority goals in 2008 is to implement sound strategies designed to secure the overwhelming No. 1 position in the Company's core businesses. Ultimately, this means delivering superior products that are rooted in innovative technologies. Canon is well prepared to further solidify its No. 1 share of the rapidly expanding digital single lens reflex (SLR) camera market, as well as the compact digital camera, copying machine and laser beam printer (LBP) markets in 2008. As for other markets, while we have many products positioned among the top three, we will work to further boost our ranking. In addition, we are building on the innovative concept of cross-media imaging, a sophisticated combination of input and output devices. Cross-media imaging will further increase synergies among Canon's products and raise their added value. Furthermore, by leveraging Canon's strengths in advanced technologies for optics, sensing, image processing, simulation, and software, we are aiming to become the world's premier digital imaging company.

We have also set the priority goal of ensuring the highest level of product quality. With the expansion of the global market, and in line with substantial growth in production volumes of Canon's products, product quality risk factors are increasing. We recognize that a single recall of a defective product or part could result in massive costs and, more importantly, a loss of the trust built up over the years among customers and society. Therefore, we are implementing stringent measures for ensuring the highest standards of product quality. In addition to product quality, Canon is basically revising and improving safety and risk controls.

We will reinforce environmental management as a priority goal. To this end, we will introduce broad measures that effectively bind the Company's responsibility to society and the environment with the aim of raising product competitiveness. As environmental problems intensify across the globe, Canon will make every effort to raise awareness and promote environmentally friendly product development and operations throughout the Group.

Another priority goal is strengthening our research and development structure through strategic reforms. Measures include enhancing project leadership and raising the efficiency of management and resources distribution. Furthermore, given the centrality of proprietary technologies to the Company's core businesses, we will expand the scope of R&D and focus efforts on exploratory research geared toward future market development.

Along with these priority goals, we aim to decrease our cost to sales ratio, develop new businesses, implement an information system for Companywide development and production, and reinforce compliance systems. We will do our utmost to realize these objectives on the way to becoming a ¥6 trillion company.

Tsuneji Uchida

Tsuneji Uchida
President and COO
Canon Inc.

film output
color separations
in color.
micropage
mounting
PET PAD

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EXCELLENT GLOBAL CORPORATION PLAN—PHASE III

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Photo:
The imagePRESS C7000VP, a digital color press, has been well received by the POD market. Adopted by MicroPage, a New York-based printing company, this system has contributed to greater printing efficiency and quality.

The image in the print sample was designed by Europa Quality & Style Inc. N.Y.

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Canon is setting the stage for an even faster rate of growth to join the global top 100 companies

In 1996, Canon launched its medium- and long-term Excellent Global Corporation Plan, which laid out the following vision: "In accordance with the philosophy of *kyosei*, Canon will continue contributing to society through technological innovation, aiming to be a corporation worthy of admiration and respect worldwide." Guided by the criteria of "total optimization" and "focus on profit," Canon pressed forward with reforms in every aspect of its business. The Company was rewarded with steadily improving performance results in each of the Excellent Global Corporation Plan's five-year terms, Phase I and Phase II. 2007 was the second year of Phase III of the Plan.

Overview of Phase I

Phase I transformed the Company mindset, emphasizing a total optimization strategy and focus on profit underpinned by the selection and concentration of business areas. Canon particularly endeavored to strengthen its financial health, achieving impressive results including improvements in its equity ratio and increased retained earnings.

Canon recorded consolidated net sales of ¥2,696.4 billion and net income of ¥134.1 billion at the end of Phase I in fiscal 2000, the beginning of the Company's eighth consecutive year of sales and profit growth.

Overview of Phase II

Canon opened the 21st century with Phase II, and set out to become No. 1 worldwide in all of its major areas of business. Working from the solid financial foundation realized in Phase I, the Company bolstered the competitiveness of its products—with core products capturing top global market share—and continued to enjoy continuous growth in revenues.

At the close of Phase II in fiscal 2005, Canon's consolidated net sales amounted to ¥3,754.2 billion and net income reached ¥384.1 billion. Compared to results in fiscal 1995, the year before the Excellent Global Corporation Plan was implemented, net sales surged 80.0% while net income expanded sevenfold.

Goal of Phase III

Under Phase III of the Excellent Global Corporation Plan, Canon aims to join the global top 100 companies in terms of all key performance indicators. Having recorded continuous growth since fiscal 2000, the Company re-examined its 2010 target for net sales and raised it from ¥5.5 trillion to ¥6 trillion.

To reach this new target, Canon regards the efficient implementation of the following five key strategies as essential.

5 KEY STRATEGIES

- 1. Achieving the overwhelming No.1 position worldwide in all current core businesses
- 2. Expanding business operations through diversification
- 3. Identifying new business domains and accumulating required technologies
- 4. Establishing new production systems to sustain international competitiveness
- 5. Nurturing truly autonomous individuals and promoting effective corporate reforms

External Ratings

- **Financial Times Global 500** (June 30/July 1, 2007 issue)
  Market value ranking: 100
  (7th in the Technology Hardware and Equipment category)
- **FORTUNE Global 500** (July 23, 2007 issue)
  Revenues ranking: 182
  (6th in the Computers, Office Equipment category)
  Profits ranking: 124
  (3rd in the Computers, Office Equipment category)
- **BusinessWeek "Best Global Brands" of 2007** (August 6, 2007 issue)
  Ranking: 36
  (4th among all Japanese companies)

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

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PricewaterhouseCoopers, a major international accounting and auditing company in Zurich, Switzerland, has decided to use Canon's MFD security systems for document management

Canon has achieved global No. 1 market positions for various core products and will strive to further its market leadership.

In the office imaging business, riding the momentum of the market shift to color imaging models, Canon is strengthening its color network products in the world. Canon will continue to leverage its Multifunctional Embedded Application Platform (MEAP) to expand its solutions business in global markets.

In cameras, the Company capitalized on the remarkable growth of the digital SLR camera market. With a lineup of products for a broad range of users from beginners to professionals, Canon will strive to maintain its commanding lead in the digital camera market. The Company is taking major steps to bolster in-house production of Complementary Metal Oxide Semiconductor (CMOS) sensors, a key component in digital cameras and digital video camcorders. Specifically, Canon will establish a new facility for CMOS development through production in Kawasaki, Japan. This move will further expand Canon's in-house production capacity as well as reduce costs.

In semiconductor exposure equipment, Canon released the FPA-7000AS7 immersion lithography scanning stepper. The Company will reinforce its lineup of ArF scanning steppers, including dry and immersion types, in an aim to expand market share.

Furthermore, the Company will promote cross-media imaging as a fundamental concept for the continuous expansion of its businesses. In specific terms, the Company will realize high-level synergies through the consolidation of input and output, image processing and color management and other imaging technologies.

Canon's FPA-7000AS7 immersion lithography scanning stepper was launched in 2007

2. Expanding business operations through diversification

Canon is aggressively working to bring OLED displays to market

Canon is forging ahead with measures to realize commercial opportunities in SEDs

Large-format inkjet printers are working at SPECTOR, a photographic company in Belgium. This printer is effective across a variety of materials including canvas

Canon is pursuing diversification to ensure further growth. For example, the Company entered the print-on-demand (POD) market and the market for large-format printers as new business areas.

The display business is indispensable to the promotion of the cross-media imaging concept. In this context, Canon has improved its infrastructure for the mass production of surface-conduction electron-emitter displays (SEDs). As a means of accelerating the growth of its display technologies, Canon has also joined an alliance with Hitachi, Ltd. and Matsushita Electric Industrial Co., Ltd. through an acquisition that enables the Company to stably procure LCD panels for use in its products and accelerate development of organic light-emitting diode (OLED) displays.

Canon also acquired Tokki Corporation, whose advanced technology related to OLED displays will significantly contribute to the Company's future mass production of OLED displays.

Canon continues to promote the Group's business expansion. Canon Marketing Japan has been actively expanding its solutions business and has acquired Argo 21 Corporation, a systems integrator. In the United States, Canon plans to commercialize molecular diagnostic equipment.

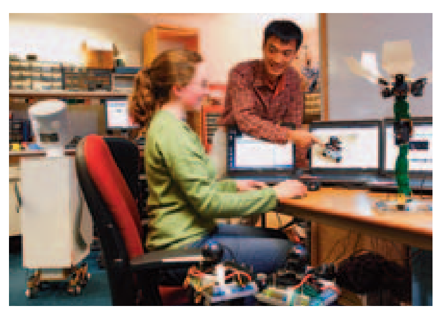
3. Identifying new business domains and accumulating required technologies

In collaboration with Kyoto University in Japan, Canon is engaging in medical imaging technology research as a next-generation business domain

Canon is targeting medical imaging and industrial robotics as new business domains after 2010. The Company selects new business domains based on their prospects for significant market growth, potential progress of innovative technology, consistency with Canon's core capabilities and effect on sound growth.

Canon engages in leading-edge collaborative research in areas with potential, including next-generation business domains. In the field of medical imaging, the Company is working with Stanford University in the United States, Kyoto University in Japan and other institutes.

From the long-term perspective, research is essential for further growth, and we will therefore continue to devote attention to global research involving international investigative studies in a number of technical fields. Canon also dispatches researchers to major international universities and research institutes that engage in the development of cutting-edge technologies.



Research at the Robotics Institute of Carnegie Melon University in the United States

■ 4. Establishing new production systems to sustain international competitiveness

To compete with the world's top companies, Canon is raising production efficiency to even higher levels through in-house production, automation and procurement reforms.

In 2007, Canon concentrated its production engineering bases in Kawasaki, Japan. This will further accelerate research and development and reinforce production-engineering capabilities related to automated production.

Canon installed new concept automated production lines for toner cartridges at Oita Canon Materials Inc. in 2007. Canon Machinery Inc. is well advanced in the manufacture of automated production lines for cartridges. Looking ahead, Canon will continue its endeavors to establish next-generation, fully automated production lines.

Production engineering development for automated production at Kawasaki, Japan

■ 5. Nurturing truly autonomous individuals and promoting effective corporate reforms

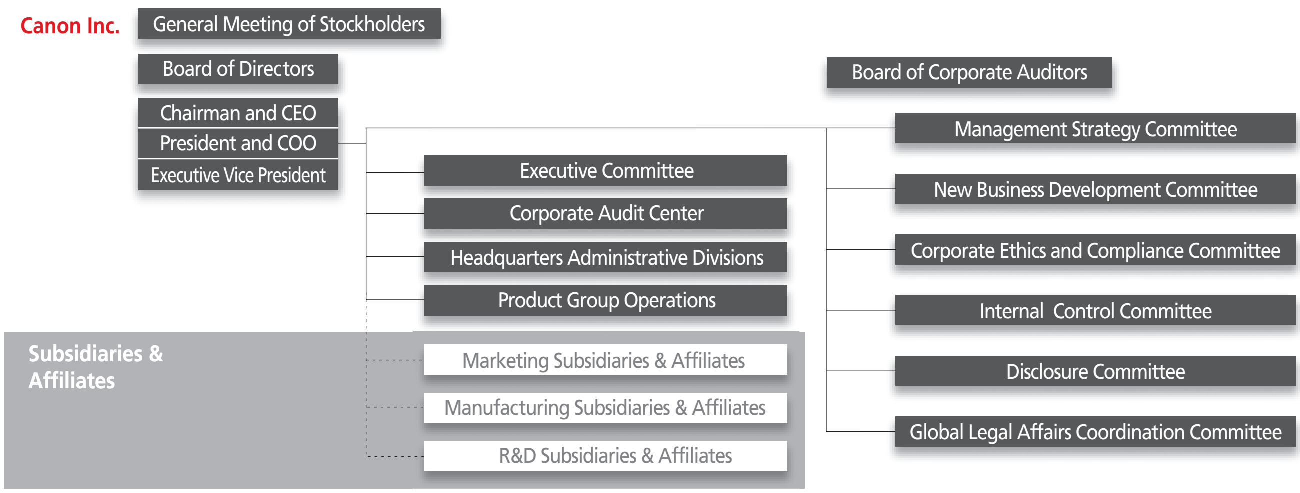
Canon recognizes the necessity of nurturing employees who can lead on the global stage. To this end, the Company established the Canon Global Management Institute (CGMI) in Tokyo in 2006. As a strategy for Phase III of the Excellent Global Corporation Plan, the Institute functions as a development center for future leaders and executives of the Group worldwide.

As it continually strives to maintain the integrity of a first-rate global company, Canon holds employee compliance in the highest regard. Canon is strengthening compliance by further improving its inspection processes and promoting awareness among employees and executive officers alike.

A presentation meeting on the results of global leader training at the CGMI in Meguro, Tokyo

Positioning itself for the future, Canon is bolstering corporate governance commensurate with business growth

Governance Structure (as of December 31, 2007)



Boards of Directors & Corporate Auditors (as of December 31, 2007)

Chairman & CEO

Fujio Mitarai

President & COO

Tsuneji Uchida

Executive Vice President

Toshizo Tanaka
Group Executive, Policy & Economy Research Headquarters

Senior Managing Directors

Nobuyoshi Tanaka
Group Executive, Corporate Intellectual Property & Legal Headquarters

Junji Ichikawa
Chief Executive, Optical Products Operations

Hajime Tsuruoka
President, Canon Europa N.V.;
President & CEO, Canon Europe Ltd.

Managing Directors

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

Kunio Watanabe
Group Executive, Corporate Planning Development Headquarters;
Deputy Group Executive, Policy & Economy Research Headquarters

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

Yasuo Mitsuhashi
Chief Executive, Peripheral Products Operations

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

Masahiro Osawa
Group Executive, Finance & Accounting Headquarters

Shigeyuki Matsumoto
Group Executive, Device Technology Development Headquarters

Directors

Katsuichi Shimizu
Chief Executive, Inkjet Products Operations

Ryoichi Bamba
Executive Vice President, Canon U.S.A., Inc.

Toshio Homma
Chief Executive, L Printer Products Operations

Keijiro Yamazaki
Group Executive, General Affairs Headquarters

Shunichi Uzawa
Group Executive, Core Technology Development Headquarters

Masaki Nakaoka
Chief Executive, Office Imaging Products Operations

Toshiyuki Komatsu
Group Executive, Leading-Edge Technology Research Headquarters

Haruhisa Honda
Group Executive, Production Engineering Headquarters

Tetsuro Tahara
Group Executive, Global Manufacturing & Logistics Headquarters

Seijiro Sekine
Group Executive, Information & Communication Systems Headquarters

Shunji Onda
Group Executive, Global Procurement Headquarters

Kazunori Fukuma
President & CEO, SED Inc.

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

Masaya Maeda
Chief Executive, Image Communication Products Operations

Corporate Auditors

Teruomi Takahashi
Kunihiro Nagata
Tadashi Ohe
Yoshinobu Shimizu
Minoru Shishikura

Canon compliance cards

Basic Policy and Corporate Governance Structure

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

Board of Directors

Important business matters are discussed and ratified during meetings of the Board of Directors and Executive Committee, which are attended, in principle, by all directors. As of December 31, 2007, the Board consisted of 27 directors. In order to realize a more streamlined and efficient management decision-making process, Canon has not adopted an outside director system. The main reason why directors are chosen from among Canon personnel is that they have followed these same codes of behavior and have been subject to close scrutiny within the Group over many years.

Auditing System

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

Internal Control Committee

The Internal Control Committee, established in 2004, ensures the reliability of financial reporting. It also conducts reviews of the Group's internal controls in order to gauge the true efficiency of business operations, supports compliance with all related laws and internal regulations, and implements sound internal controls. In response to the Sarbanes-Oxley Act, including Section 404 that came into force during 2006, Canon continues to reinforce internal control systems and implement all appropriate measures.

In order to strengthen internal controls, Canon conducts comprehensive evaluations of internal controls across areas including accounting, management oversight, legal compliance, IT systems, and promotion of corporate ethics.

Internal controls over financial reporting as of December 31, 2007, have been assessed as effective by the management and the independent registered public accounting firm. (Please refer to p.95 and p.97)

Other Corporate Governance Committees

Canon's management committees are integral to its overall governance system. Key among these are the Corporate Ethics and Compliance Committee, which discusses and approves compliance and corporate ethics policies; the Global Legal Affairs Coordination Committee, which analyzes trends in legal developments and works to raise the level of employee awareness regarding important legal issues facing the Group; and the Disclosure Committee, which is dedicated to ensuring the dissemination of accurate and thorough information.

Compliance

Since its founding, employee education has been based on the guiding principles of the *San-Ji*, or "Three Selfs" spirit, namely "self-motivation," or taking the initiative and being proactive in all things; "self-management," or conducting oneself responsibly and being accountable for all one's actions; and "self-awareness," or understanding one's situation and role in it. Based upon these principles, the Canon Group Code of Conduct was established as a standard for executives and employees.

Canon holds a Compliance Week twice per year to give employees a chance to discuss issues related to compliance and corporate ethics and to recognize the importance of their individual actions in the workplace.

Disclosure

Canon makes every effort to disclose information on its management and business strategies as well as its performance results to all stakeholders in an accurate, fair and timely manner. To this end, Canon holds regular briefings and posts the latest information on its Website together with a broad range of disclosure materials. Canon has established its own Disclosure Guidelines, in addition to a Disclosure Committee that serves to ensure strict compliance with disclosure regulations prescribed by stock exchanges.

With 43.5% of Canon's shares owned by non-Japanese investors as of December 31, 2007, the Group goes to great lengths to promote close relations with non-Japanese institutional investors, maintaining IR bases in Europe and the United States and working to ensure that investors inside and outside of Japan have access to the same information. Canon will continue to promote transparency and understanding of its activities by practicing thoroughgoing disclosure.

Introduction of an Executive Officer System

At a Board of Directors meeting held on January 30, 2008, Canon resolved to introduce 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. The number of Executive Officers has initially been set at eight.

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 will gradually increase the number of Executive Officers and further solidify its management systems.

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

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

1. Directors

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

2. Committees

Under the Corporation Law, the Company may choose to:
(i) have an audit committee, nomination committee and compensation committee and abolish the post of corporate auditors; or
(ii) have a board of corporate auditors.

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

The Company's board of directors nominates the candidates for directorship and submits a proposal at the general meeting of shareholders for shareholder approval. Pursuant to the Corporation Law, the shareholders then vote to elect directors at the meeting. The Corporation Law requires that the total amount or calculation method of compensation for directors and corporate auditors be determined by a resolution of the general meeting of shareholders respectively, unless the amount or calculation method is provided under the Articles of Incorporation. As the Articles of Incorporation of the Company do not stipulate the requirements as expressed under the Corporation Law, the amount of compensation for the directors and corporate auditors of the Company is determined by a resolution of the general meeting of shareholders. The allotment of compensation for each director from the total amount of compensation is determined by the Company's board of directors, and the allotment of compensation to each corporate auditor is determined by consultation among the Company's corporate auditors.

3. Audit Committee

The Company plans to avail itself of paragraph (c)(3) of Rule 10A-3 of the Security Exchange Act, which provides that a foreign private issuer which has established a board of corporate auditors shall be exempt from the audit committee requirements, subject to certain requirements which continue to be applicable under Rule 10A-3.

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

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

Under the Corporation Law, more than half of a company's corporate auditors must be "outside" corporate auditors. These are individuals who are prohibited to have ever been a director, executive officer, manager, or employee of the Company or its subsidiaries. The Company's current corporate auditor system meets these requirements. Among the five members on the Company's board of auditors, three are outside corporate auditors. The qualifications for an "outside" corporate auditor under the Corporation Law are different from the audit committee independence requirement under the NYSE Corporate Governance Rules.

4. Shareholder Approval of Equity Compensation Plans

The NYSE Corporate Governance Rules require that shareholders be given the opportunity to vote on all equity compensation plans and any material revisions of such plans, with certain limited exceptions. Under the Corporation Law, a Company is required to obtain shareholder approval regarding the details of an equity-compensation plan. Stock acquisition rights to be issued to directors and corporate auditors are recognized as part of remuneration of directors and corporate auditors, and the issuance of stock acquisition rights must be approved by shareholders as part of their approval regarding remuneration of directors and corporate auditors.

CORPORATE FUNCTIONS

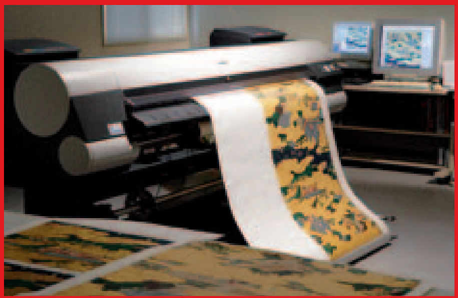
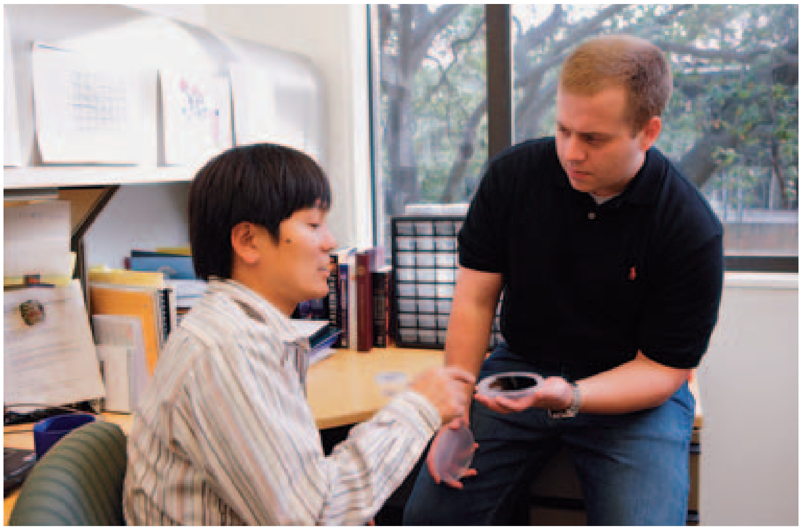


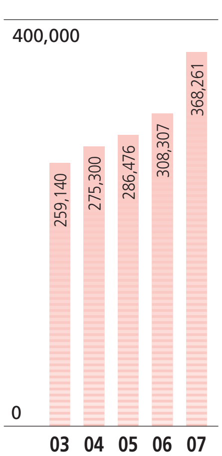
Photo:
The *Tsuzuri Project*, a collaborative initiative between Canon and the Kyoto International Culture Foundation, aims to preserve and pass on important Japanese cultural properties using the latest digital technologies. Canon's large-format inkjet printers contributed to the faithful reproduction of original works.

While focusing on the development of proprietary products, Canon will strengthen R&D activities in an effort to identify next-generation domains.



Canon is conducting collaborative research with leading institutions such as Stanford University in the United States

R&D Expenditure
(Millions of yen)



R&D Expenditure and Patents

Canon is committed to the pursuit of cutting-edge R&D as a vital means to deliver unique, proprietary products. In fiscal 2007, the Company increased R&D expenditure by ¥60.0 billion from the previous fiscal year to ¥368.3 billion, accounting for 8.2% of net sales. From this total, ¥122.6 billion, or 33.3%, was allocated to the Business Machines segment, ¥44.3 billion, or 12.0%, went to the Cameras segment, ¥42.3 billion, or 11.5% went to the Optical and Other Products segment, and ¥159.1 billion, or 43.2%, was used for basic R&D not belonging to any one business segment.

In 2007, the Company was granted 1,989* patents in the United States, placing third among all corporations. This marked the 16th consecutive year Canon has ranked among the top three.

*Source: U.S. Patent and Trademark Office; Calculated based upon announcements of weekly totals.

Strengthening the Company's R&D Infrastructure

Canon continues to improve its R&D capabilities by strengthening its infrastructure. As a part of these endeavors, the Company established the Technology Strategy Committee, the Strategic Product Research Headquarters and the Frontier Research Headquarters on January 1, 2008. The Technology Strategy Committee formulates Companywide R&D strategy proposals significant to its future. The Strategic Product Research Headquarters, pursuing both technological and market-based endeavors, develops the essential technologies required to create innovative products beyond the scope of Product Operations. The Frontier Research Headquarters, in collaboration with global institutes, conducts research into emerging technologies as the basis for cultivating future businesses.

Bolstering Product Strength

In order to deliver a consistent stream of unique products, Canon is strengthening its activities in the development of such key components and devices as CMOS sensors and DigitalImagingIC (DIGIC) imaging processors for digital cameras, and iR controllers for multifunction devices (MFDs). Further enhancing and accelerating development, the Company successfully incorporated such key components and devices into new products throughout 2007.

To raise product prowess even further, Canon is developing and promoting "cross-media imaging," a concept that, through interactive connectivity, enables advanced synergies between such input and output devices as cameras, printers and displays. Cross-media imaging allows users to realistically communicate and reproduce at will a variety of images and information. In focusing on this link between its input and output devices, Canon will continue to promote the development of Companywide digital platform technologies that include user-interface, communication and image processing across its entire product lineup.

Concurrent processes bring together development and production divisions for multifunction devices at the Company's Toride Plant

The development of digital SLR cameras using the 3D-CAD system at the Company's Shimomaruko Headquarters, Tokyo

Raising Development Efficiency

By linking its development and production divisions, Canon promotes concurrent processes to ensure cooperation from the initial product concept stage. The early-stage consideration of production processes and identification of problem areas has led to shorter lead times as well as cost reductions.

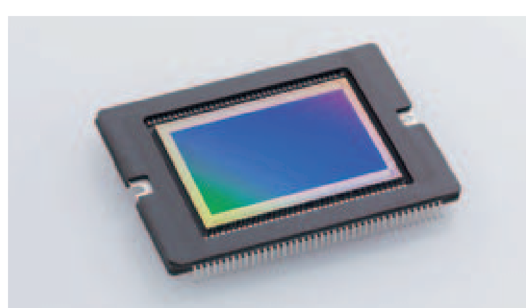
Canon also aims to establish an integrated IT system based on 3D-CAD systems to better utilize design information and enhance the links among design, trial, verification and production stages. Representing a key measure in the Company's efforts to innovate the development process, 3D-CAD systems were introduced Companywide, dramatically speeding up product development and reducing trial times. Looking ahead, Canon plans to standardize 3D-CAD and other information systems throughout all business operations by 2010.

Researching Next-Generation Technologies

The Company is pursuing the development of next-generation technologies in fields that exhibit significant potential. These include such new domains as biotechnology, nanotechnology and life sciences.

Canon actively conducts leading-edge research activities on a global scale to access and acquire the latest technologies necessary for cultivating new markets. The Company also dispatches researchers and conducts collaborative research with the world's leading universities and institutes.

As next-generation business domains beyond 2010, Canon is focusing its sights on medical imaging and robotics. In medical imaging, Canon is developing advanced diagmatic imaging technologies that enable the detection of metabolic changes and the structure of human subjects. This development aims to facilitate the early detection of disease to improve the quality of life. As an example, the Company is undertaking a joint research project with Kyoto University in Japan.



Canon announced the development of a 50 million-pixel CMOS sensor prototype in 2007

Proceeding with in-house and automated production, Canon is expanding capacity to meet growing global demand.

At Canon Vietnam Co., Ltd., inkjet printer production reforms are advancing

Establishment of New Production Methods

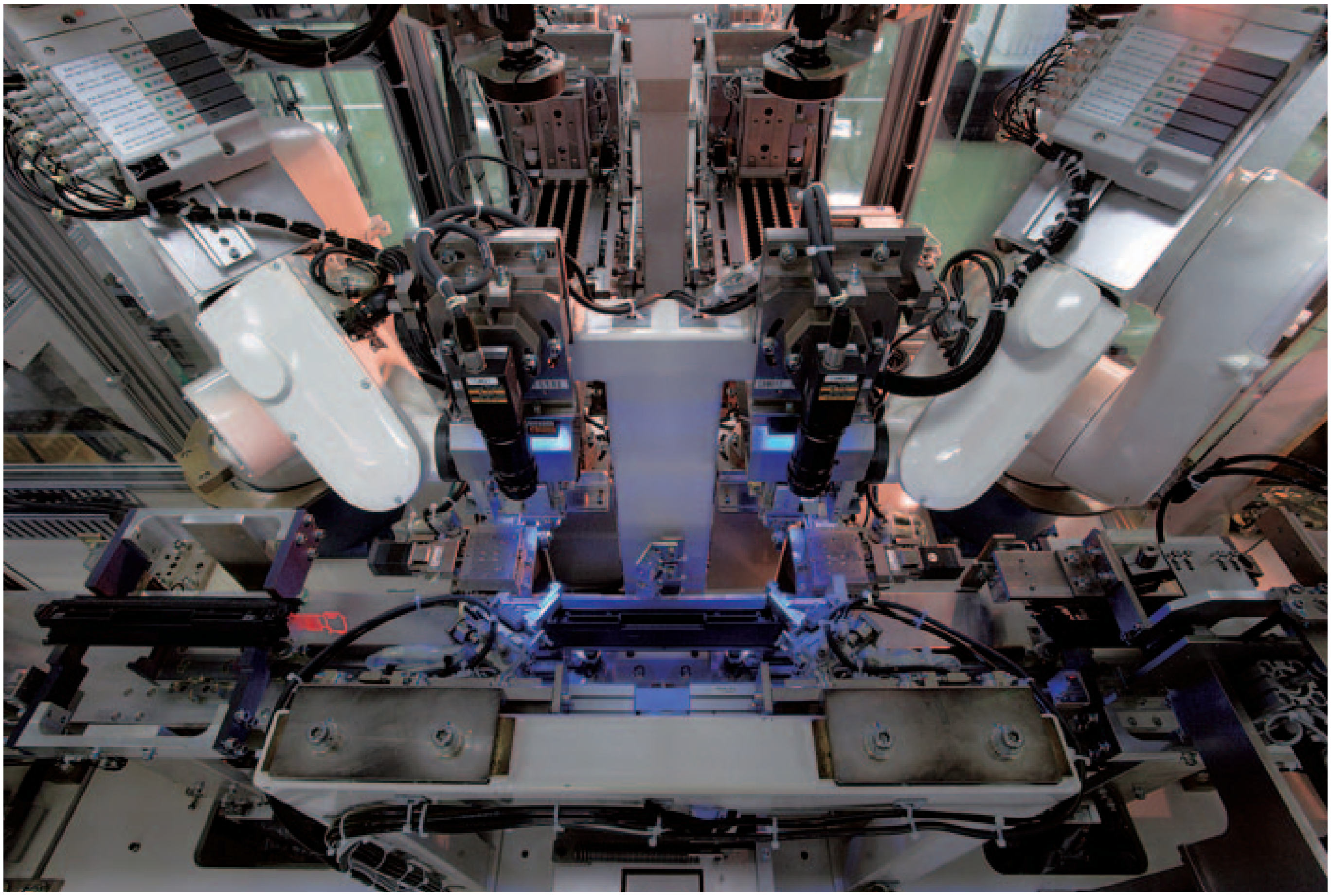
Canon first introduced the cell production system in 1998 and in the ensuing decade has substantially increased production efficiency. Utilizing small teams of workers, or "cells," who assemble one product from start to finish has marked a major step forward in production reforms. Contributing to improved flexibility, Canon is employing cell production at all of its production bases worldwide.

Based on this highly successful cell production system, Canon is moving toward fully integrating comprehensive "pull" production, which involves the timely manufacture of the exact number of products that are sold or "pulled" by the market. This new pull production dramatically increases the speed with which changes can be made in response to fluctuations in order volume. Looking ahead, in order to further shorten lead times and reduce costs, Canon will continue to implement this new pull production while enhancing production reforms in other fields.

Differentiating Products and Cost Cutting through In-House Production

An important strategy for differentiating the Company's products and reducing costs is the in-house production of key devices and components. Canon is also working toward expanding its in-house production of manufac-

Oita Canon is integrating machine and staff assembly operations



New automated toner cartridge production lines were installed at Oita Canon Materials

turing equipment including molds. Canon Mold Co., Ltd. in charge of mold production for the entire Group expanded capacity with a new facility to enhance in-house production of molds in 2007. Canon is promoting comprehensive in-house production from CMOS sensors through printed circuit boards and plastic parts.

Expanding Production Capacity

Canon continues to increase its production capacity to meet growing demand for its products worldwide. Concerning inkjet printers, the Company placed a considerable amount of weight on the expansion of its production facilities based on a long-term perspective. In Vietnam, Canon completed construction of its second inkjet printer plant in 2007 and will commence full-scale operations in 2008. Canon also completed construction of a facility for inkjet cartridge production at Oita Canon Materials Inc. in Japan in 2007. Housing an automated production assembly line, Canon is taking steps to expand production capacity for inkjet cartridges.

Also at Oita Canon Materials, given the growing global demand for toner cartridges, Canon is planning to build a new plant in Hita, Oita in 2008. At Canon Precision Inc. in Aomori, Japan, the Company began construction in 2007 of a plant to manufacture toner cartridges for printers and copying machines. Scheduled to commence operations in 2008, the plant will incorporate automated assembly lines to significantly raise productivity levels.

The Company has significantly raised the production capacity of interchangeable single lens reflex (SLR) lenses at Oita Canon Inc. in Japan. This is in response to the rapidly expanding market for digital SLR cameras. With the addition of lens production, Canon has significantly reduced lead times.

Canon Mold is reinforcing its production facilities for mold-making operations

Canon is significantly boosting sales in emerging markets and expanding its businesses through diversification.

Canon is engaged in the development of molecular diagnostic equipment. The goal is to bring this technology to market in the United States

Customer Contact Points around the World

Regional marketing headquarters oversee activities in each region of the globe: 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 excluding Japan and Korea; Canon Australia Pty. Ltd. in Oceania; and Canon Marketing Japan Inc. in Japan.

The Americas

In fiscal 2007, sales in the Americas increased 4.1% year on year to ¥1,336.1 billion, representing 29.8% of Canon's consolidated net sales.

In this region, Canon enjoyed double-digit sales growth in the areas of large-format printers, print-on-demand (POD), medical equipment and broadcasting equipment. In business machines, sales of the imageRUNNER lineup of color copying machines grew steadily. On the earnings front, high profitability continued in the camera business as Canon held its No. 1 spot for both digital single lens reflex (SLR) cameras and compact digital cameras.

By broad geographic region, firm year-on-year results in North America and strong growth in Latin America drove the Company's performance forward.

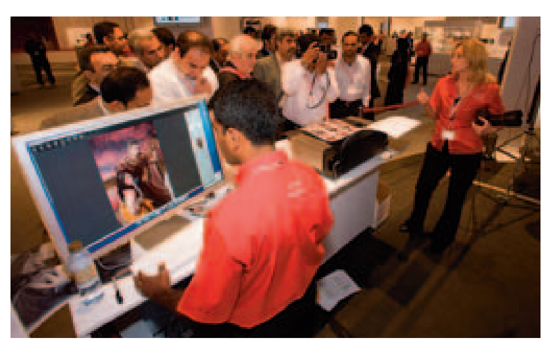
Looking ahead, the Company will strengthen its solutions business and provide optimal proposals on an individual client firm basis. In South America, Canon will place particular emphasis on reinforcing its sales and marketing infrastructure. The Company aims to secure the No. 1 position in both the consumer and business machines markets. At the same time, Canon will cultivate new markets with the establishment of new businesses, such as life science. Canon U.S. Life Sciences, Inc. is engaged in R&D for molecular diagnostic systems. In addition, Canon U.S.A. will expand its business in other fields taking into consideration M&A.

Europe

In Europe, sales climbed 14.1% from the previous fiscal year to ¥1,499.3 billion, comprising 33.5% of consolidated net sales.

In 2007, unit sales in every product category were up. Canon also secured the No. 1 market share for digital SLR cameras, compact digital cameras, and both color and monochrome copying machines. An increase in sales of high-value added products, particularly digital SLR cameras and POD machines, contributed significantly to the Company's earnings.

In the emerging markets of this region, particularly Russia, Canon achieved double-digit percentage sales growth by raising the Company's presence and brand image, increasing investment in marketing, and



Canon Concerto, a private product exhibition, was held in Dubai in 2007, the first time the event has visited the Middle East

Canon Europa celebrated its 50th anniversary of business at a party held in Monaco

more effectively directing sales and marketing channels. The Company also took steps to strengthen its own sales and marketing structure for the Middle East by establishing sales companies with a strong focus on the UAE and Turkey.

Asia and Oceania

Canon reported revenue and profit growth in Japan in fiscal 2007, with sales increasing 1.6% year on year to ¥947.6 billion, representing 21.1% of the Company's consolidated sales.

Along with its M&A activities aimed at grooming IT solutions as a core business, Canon Marketing Japan worked toward establishing next-generation businesses and expanding profits in its business solutions, consumer products, and industrial equipment businesses.

Sales in Oceania and Asian countries were up 11.5%, reaching ¥698.3 billion, which accounts for 15.6% of consolidated sales.

In the growth markets of India and Vietnam, year-on-year sales dramatically increased. Canon also reported steady sales growth in other Asian countries. Celebrating its 10th anniversary in China, 2007 will be remembered as the year in which Canon Asia EXPO 2007 was held in Beijing and the Company first achieved US$1 billion in sales.

Extending its reach across emerging markets including Thailand and Indonesia, the Company will also bolster its sales and marketing activities in tune with the needs and unique characteristics of each country and region.

In Oceania, Canon Australia achieved a remarkable jump in unit sales of large-format printers. The company will boost its solutions business in the finance, legal and government sectors.

Showcasing the appeal of Canon's imaging products and technologies at the Canon Asia EXPO 2007 in Beijing, China

Guided by its corporate philosophy of *kyosei*, Canon actively participates in environmental conservation and social contribution activities around the world.

Camera products, shipped from Oita to Shanghai,
are sent to Beijing via train. Canon is promoting a modal shift in China

Canon's Basic Approach to CSR

Canon's corporate philosophy is *kyosei*, defined as "Living and working together for the common good." The Company puts *kyosei* into practice through its participation in environmental conservation and social contribution activities around the world. As Canon extends its range of business globally, the number of its stakeholders increases and the sphere of its social influence expands. Based on this recognition, we are actively pursuing activities that earn the trust and respect of stakeholders and society.

Environmental Activities

Life Cycle Assessment Approach

Canon conducts its environmental activities from the basic standpoint of life cycle assessment (LCA) to ensure that its products are environmentally friendly at every stage, from procurement and production to use and recycling. At the development stage, the Company's 3D-CAD systems have reduced waste from the creation of virtual prototypes. In recycling, Canon remanufactures monochrome copying machines and color MFDs with a considerable amount of reused components.

Environmentally Friendly Products

Canon designs and produces its products with the environment in mind, including at the usage stage of the product life cycle. For example, the Company's PIXMA MP 610 inkjet multifunction printer (MFP) incorporates a control unit that provides power separately to copy, print and scan functions only when in use, resulting in approximately 86% savings on power consumption compared to earlier models.

In addition, the PowerShot G9 contributes to resource and transportation energy savings. This is attributed to the redesign of its packaging, which has reduced volume and mass by approximately 35% and 23%, respectively, compared with previous products.

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The iR C3380 MFD incorporates Canon's energy-saving, on-demand fixing technology and improved controller, which achieves an approximately 80% reduction in power consumption, compared with previous models

Implementing a Modal Shift

In its distribution activities, Canon has been actively implementing a modal shift—the switch from truck transport to rail or ship transport worldwide. In fiscal 2007, the Company reviewed its logistics routes within China.

A completely closed wastewater processing system at Oita Canon Materials achieved zero wastewater discharge

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Canon Vietnam is implementing the Canon Friendship School Chain project. A total of 16 elementary schools in northern Vietnam will be built or renovated under the project by the end of 2010

For digital cameras, Canon has switched to marine transportation from Fukuoka to Shanghai and rail transportation from Shanghai to Beijing and Guangzhou instead of direct shipment by air to Shanghai, Beijing and Guangzhou from Osaka. This change is estimated to considerably reduce CO_2 emissions.

Furthermore, office machines manufactured in China that were previously shipped by sea to Tokyo, stored in a central facility and transported by truck to sales outlets across Japan, are now directly delivered by sea or rail to sales offices from Fukuoka port. In cutting back distribution channels, this modal shift is contributing to lower CO_2 emissions and costs and shorter delivery times.

Contributing to Society

Guided by its corporate philosophy of *kyosei*, Canon engages in social contributions around the world. The following are a few of the Company's numerous ongoing activities.

Optical Research Funding

In April 2007, Canon collaborated with Utsunomiya University in Japan to set up the Utsunomiya University Center for Optical Research & Education (CORE). Optics is a key technology underpinning many industries including the camera lens industry. Given the current pace of technological change, the needs of optical engineers have increased, but opportunities for professional training in Japan are in short supply. With Canon's contribution of educational support, utilizing Canon employees acting as instructors, CORE will provide systematic education and conduct research in advanced optics technologies over the next five years. Drawing from open subscriptions from within the university, CORE will also promote research projects to develop creative technologies that will contribute to society.

Red Cross Youth Projects in Europe

Canon Europe commenced activities under a partnership

A workshop on International Humanitarian Law organized by the French Red Cross at Pierre & Marie Curie University in Paris

agreement with the Red Cross in Europe in 2006 and has sponsored youth projects organized by thirteen Red Cross National Societies across Europe.

Supporting Education in Vietnam

In July 2007, Canon commenced the Canon Friendship School Chain Project to support the new construction, rebuilding and enlargement of schools in 12 northern provinces in Vietnam. Recognizing that today's youth are responsible for the next generation, Canon is dedicated to creating learning opportunities for children and advancing quality.

WWF-Canada Schools for a Living Planet

As a long-term supporter of the World Wildlife Fund - Canada, Canon is the title sponsor of Schools for a Living Planet, a web-based educational program designed to provide educators with curriculum materials for engaging their students in the vital conservation issues of our time. Canon shares with WWF-Canada the hope that young people will acquire the necessary knowledge to make a difference in the planet's future.

Training and Nurturing Employees

For Canon to progress through the next 100 or even 200 years, it is essential to train and nurture employees at all levels, including upper management. Since the Company's founding, employee education has been based on the guiding principles of the *San-Ji*, or "Three Selfs" spirit, comprised of "self-motivation," or taking the initiative and being proactive in all things; "self-management," or conducting oneself responsibly and being accountable for all one's actions; and "self-awareness," or understanding one's situation and role in it. We believe that employees' commitment to these principles increases the strength and autonomy of each and every employee and ultimately contributes to the Company's development as well as society, which Canon continues to serve.

Canon Global Management Institute

In training provided at the Canon Global Management Institute (CGMI) in Tokyo, trainees learn those theories considered essential to managerial personnel. At the same time, Canon promotes voluntary interactive development among trainees and offers select training programs tailored to individual positions in an effort to nurture a greater sense of responsibility and establish a set of high-quality managerial capabilities.

Canon employees in Europe attending a training session on time management—Canon is enhancing its local educational training programs

Establishment of Regional Technical Skills Training Center

The Company plans to establish a technical skills training center at the site of Oita Canon in April 2009, with the aim to raise the level of technical skills of Group employees, while cultivating and supporting employment in the local community. The facility will be fitted with top-of-the-line manufacturing equipment including plastic-molding machines and automation control equipment. Canon also plans to conduct the appropriate training.

Consistent with the Japanese government's intentions to commence full-fledged implementation of the Job Card program from April 2008, Canon's training facilities located in Oita; Toride, Ibaraki; and Mizonokuchi, Kanagawa will be used for public purposes. In this context, the Company is conducting research into the development of appropriate training programs.

PRODUCT GROUPS
AT A GLANCE

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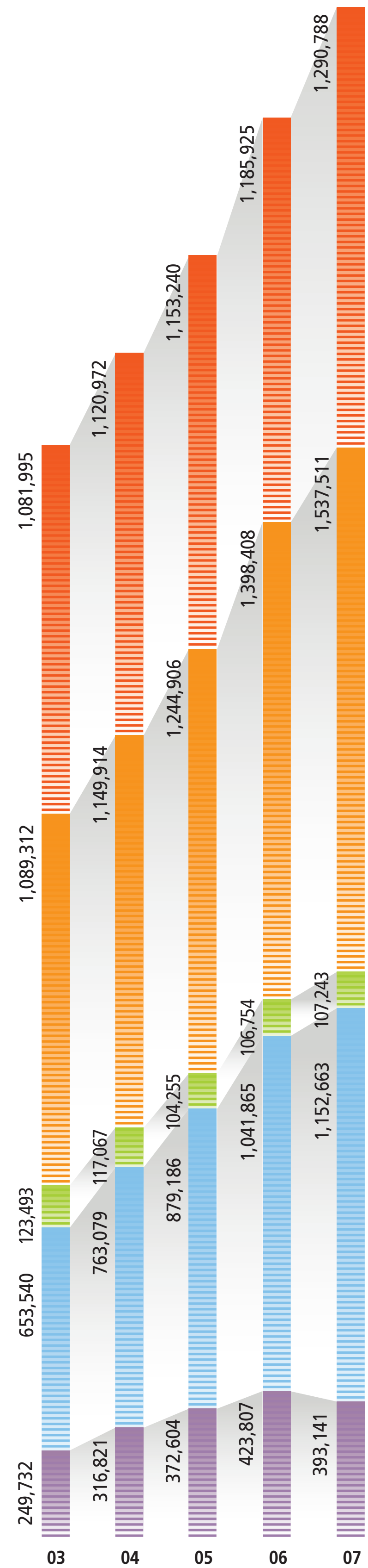
	Main Products
Business Machines ■ **OFFICE IMAGING PRODUCTS** 34	• Office network digital multifunction devices (MFDs) • Color network digital MFDs • Office copying machines • Personal-use copying machines • Full-color copying machines, etc.
Business Machines ■ **COMPUTER PERIPHERALS** 36	• Laser beam printers (LBPs) • Single-function inkjet printers • Inkjet multifunction peripherals • Image scanners, etc.
Business Machines ■ **BUSINESS INFORMATION PRODUCTS**	• Computer information systems • Document scanners • Personal information products, etc.
■ **CAMERAS** 38	• Digital single lens reflex (SLR) cameras • Compact digital cameras • Interchangeable lenses • Digital video camcorders, etc.
■ **OPTICAL AND OTHER PRODUCTS** 40	• Semiconductor-production equipment • Mirror projection mask aligners for LCD panels • Broadcasting equipment • Medical equipment • Components, etc.

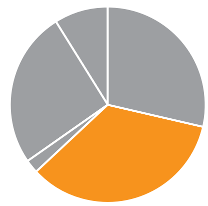
Review of FY2007	Share of Consolidated Sales (FY2007)	Sales Results (Millions of yen)



Sales were ¥1,290.8 billion, up 8.8% year on year, with sales of color MFDs strong in every region. In Europe, the Americas, and Asia and Oceania, Canon's color equipment sales grew more than 20% on a unit basis. Energy-efficient models in the Company's monochrome series also contributed to results. Canon entered the commercial printing industry in earnest through the launch of the imagePRESS C7000VP digital color printing press, which promptly attracted high market praise.

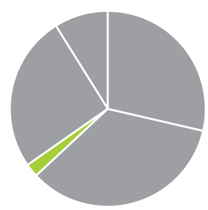
28.8%

Sales increased 9.9% to ¥1,537.5 billion. In LBPs, demand for color and monochrome low-end machines grew. Canon increased its results on a unit and revenue basis by approximately 20% and 10.5%, respectively. At the same time, the Company enjoyed steady growth in sales of consumable supplies. Sales of inkjet printers climbed 9.2% year on year. Despite the continued decline in unit SFP sales, results were supported by the substantial surge in unit MFP sales. In the period under review, sales of consumable supplies also increased steadily.



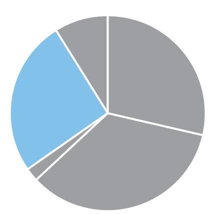
34.3%

Sales increased 0.5% to ¥107.2 billion. Sales of document scanners increased in line with the growing trend toward digitalized documents and market expansion. Calculators maintained high rates of growth throughout Asia, excluding Japan. In 2007, Canon commenced sales of electronic dictionaries in Korea. Coupled with the release of high-value-added electronic dictionary models in Japan, sales in this product category increased steadily.



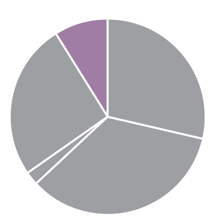
2.4%

Sales increased 10.6% to ¥1,152.7 billion and included a 17% increase in unit sales of digital cameras. Buoyed by the introduction of beginner and mid-level models, sales of digital SLR cameras climbed steadily. In the period under review, Canon successfully increased its market share in compact digital cameras. The Company also experienced sound growth in digital video cameras and other products.



25.7%

Sales were ¥393.1 billion, down 7.2%. Sales of exposure equipment for LCDs decreased due to weak capital investment by LCD panel manufacturers, while semiconductor exposure equipment were essentially on par with the previous year. Canon launched the dry ArF scanning stepper FPA-7000AS5, and the immersion lithography scanning stepper FPA-7000AS7, building a foundation for future sales growth. Incorporating a review of manufacturing and assembly methods, the MPAsp-H700 LCD exposure equipment generated significant praise from the market.



8.8%

OFFICE IMAGING PRODUCTS

Masaki Nakaoka
Chief Executive, Office Imaging Products Operations

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Office network color multifunction device

Reinforcing its color product lineup, Canon aims to secure growth in the production market.

Office imaging, production, SOHO and document solutions represent the four pillars of Canon's Office Imaging Products business. In fiscal 2007, the Company recorded significant sales growth in both value and volume, with the office imaging, production and SOHO businesses in particular showing record-breaking unit sales.

Responding to the shift toward color network digital multifunction devices (MFDs), Canon expanded shipments of color machines in every region. Moreover, total shipments of network digital MFDs, increased considerably to Europe and the Asian region (excluding Japan).

In office imaging, Canon upgraded its product lineup of color machines and increased shipments of mid- to high-speed models. Turning to the SOHO business, the Company enjoyed double-digit growth in unit sales and saw its market share increase. These results are especially important as they translate to an increase in sales of consumable supplies. In document solutions, sales also grew in the double-digit range, and Canon positioned this business as a major pillar for future expansion. The Company also released its high-definition, high-performance imagePRESS C7000VP to the POD market, winning a new customer base.

Along with these excellent results, Canon took a significant step in the expansion of its software business during 2007, reaching the milestone of issuing three million application licenses.

By region, although downward pressure on prices continued in all markets, Canon recorded remarkable unit sales growth in the emerging economies of Asia, the Middle East, Latin America and Eastern Europe. Shipments of color machines were up in Japan as well despite sluggish market conditions.

Looking ahead, Canon is aiming to accelerate the shift to color machines. While making deeper inroads into emerging markets, which continue to expand, the Company is also strengthening its proposal-style solutions business using its Multifunctional Embedded Application Platform (MEAP) technology that enables customization of MFDs. Capitalizing on the dynamism of the POD market, the Company will work to reinforce production systems to boost sales and profits, and further expand its light-production printing segment. Positioning ourselves for market expansion, we will strengthen product lineups in every category while pursuing product development aimed at realizing cross-media imaging.

Fiscal 2007 Review

Sales in the Office Imaging Products business totaled ¥1,290.8 billion in 2007, up 8.8% year on year.

Reflecting the shift to color products, sales of color MFDs were strong in every region as Canon released new models, including the low-end Color imageRUNNER C2880 (iR C2880 in some areas) and the high-end Color imageRUNNER C5185 (iR C5185 in some areas). In Europe, the Americas, and Asia excluding Japan and Oceania, the Company's sales grew more than 20% on a unit basis.

Sales of monochrome network digital MFDs also increased, through such new products as the imageRUNNER 3025 (iR 3025 in some areas), which boasts low power consumption. Although the domestic market was sluggish, double-digit growth was recorded in Asia and Oceania.

In 2007, Canon signaled its full-fledged entry into the commercial printing industry by launching the imagePRESS C7000VP digital color printing device. Despite its release almost halfway into the fiscal year, the C7000VP significantly contributed to sales and won praise in the market for mid-speed production-use products. The C7000VP received the prestigious *Best 10 New Products Award** from the *Nikkan Kogyo Shimbun***. Also the imagePRESS C1 model continued to enjoy popularity, with shipments more than doubling compared with the previous year.

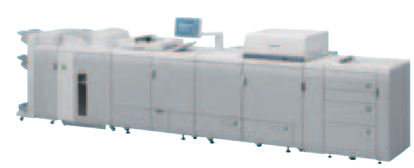
Sales of SOHO market MFDs were strong in fiscal 2007, increasing more than 10% on a unit basis. Canon boosted shipments of low-end monochrome machines for A4 printing that are distinguished for their high efficiency and cost performance.

Canon Marketing Japan acquired Argo 21 Corporation to expand the document solutions business. Even after subtracting the positive effects of this acquisition, the Company enjoyed double-digit percentage sales growth in this business. In combining technological hardware prowess with Canon's inherent solutions strengths, the Company is taking every advantage to create new opportunities.

* An award to new, excellent products with cutting-edge technology
** A major industrial news publication in Japan

Color imageRUNNER C5185 (iR C5185)

imageRUNNER 3025 (iR3025)

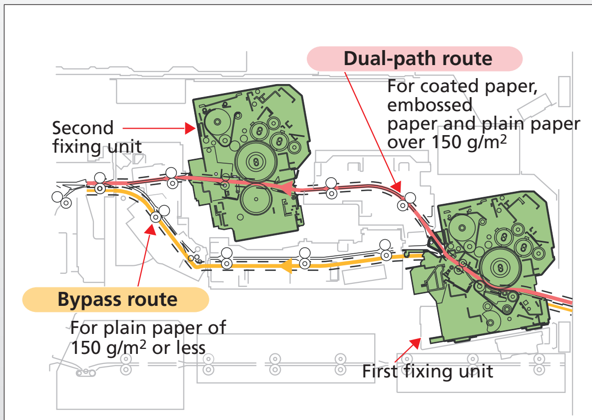


imagePRESS C7000VP

Innovative Product — *imagePRESS C7000VP*

Canon started sales of the imagePRESS C7000VP for short-run printing jobs in the printing and copying industries in the POD market in 2007. Canon's color POD products are built on electrophotographic technologies cultivated for its color multifunction devices. The imagePRESS C7000VP realizes high image-quality that looks and feels like offset printing production.

Canon developed new fixing equipment and a new toner that deliver optimal output irrespective of the paper texture. The C7000VP is equipped with several kinds of automatic registration functions, including Canon's Intelligent Registration Technology (IRT) for attaining front-to-back registration accuracy in double-sided printing. The C7000VP also enables high-speed 70 pages per minute printing to any kind of paper to match professional printing environments.



Canon's imagePRESS handles thick and coated paper through a two-path system employing two fixing units. Paper that does not require dual fixing, such as thin or recycled paper, is processed only in the first fixing unit, bypassing the second fixing unit.

COMPUTER PERIPHERALS

Katsuichi Shimizu
Chief Executive, Inkjet Products Operations

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Inkjet All-in-One

Working toward continuous growth, Canon will consistently offer a product lineup that caters to the needs of all users while boosting sales in emerging markets.

In 2007, the market for inkjet printers continued to shift from single-function printers (SFPs) to multifunction printers (MFPs). As a result, MFP sales increased primarily on a unit basis, while the SFP market contracted in excess of expectations. Against this backdrop, unit sales of Canon's inkjet printers increased slightly from the previous fiscal year. Buoyed by successful efforts to expand its product lineup, however, the Company reported record-breaking results on a value basis, with consumable supplies in particular showing healthy year-on-year growth.

Driving these results was the Company's commitment to photo quality for its inkjet printers, represented for example by Canon's proprietary FINE (Full-photolithography Inkjet Nozzle Engineering) technology for high-resolution, high-speed printing. Because of the Company's technological expertise, its mid- to high-speed products were highly evaluated in the marketplace for their user-friendliness, ease-of-use and sophisticated designs. Furthermore, the Company aggressively promoted MFPs for business use prompting expectations of increased print volumes. Looking to extend our its base, Canon also launched a new MFP series with additional features such as facsimile capabilities. The boost in sales of medium- and high-grade products, led to significant sales growth of consumable supplies.

Looking at results for inkjet printers by region, sales on a unit basis in 2007 remained in line with the previous fiscal year in Japan, North America and Europe, while unit sales set new records in Latin America, Southeast Asia and Russia. With preferences differing from region to region, Canon expanded its printer lineup, introducing core models that match the characteristics of local markets and respond to individual market needs. Sales of medium- and high-grade MFPs stayed on course in Japan and Australia, with robust results in the Americas, Europe and Asia for SFPs and low-end MFPs.

Turning to the Company's production systems, Canon worked to procure parts locally, step up in-house production and reduce costs in Vietnam and Thailand. To meet the high demand for inkjet printer cartridges, Canon bolstered its production capabilities and pushed ahead with automated production. In 2008, a new cartridge production plant will commence operations at Oita Canon Materials.

Also in 2008, Canon will enhance its FINE printhead technology and will also offer user solutions that make photo printing simpler and more enjoyable. This is expected to increase opportunities for printing at home. At the same time, the Company will propose high-speed, high-quality inkjet printer solutions that also take into consideration concerns for the environment to SOHO and office users. While there is little likelihood of strong market growth in 2008, Canon will aggressively promote sales in emerging economies led by the BRICs. Collectively, these initiatives are forecast to further increase sales of consumable supplies.

Fiscal 2007 Review

Sales in the Computer Peripherals business amounted to ¥1,537.5 billion, a year-on-year increase of 9.9%.

In laser beam printers (LBPs), the market for monochrome models remained inactive in North America and Europe, but propelled by the emerging economies of China, India, the Middle East, Russia and Eastern Europe, it continued its steady expansion overall. The market for color models continued to expand in the double-digit growth range. While the main markets for color models are Japan, North America and Europe, the Asian market including China and India has increasingly come into play. With the release in recent years of competitively priced models, the shift to color products throughout Asia has advanced rapidly.

In 2007, demand primarily for color, monochrome and low-end devices increased. Under these conditions, Canon boosted its sales on a unit basis by approximately 20%. The Company's LBP3000, which requires no warm-up time and is ideal for offices, received positive evaluations in the market for its compact and stylish design. In the period under review, Canon recorded a 10.5% increase in overall LBP sales together with steady results in consumable supplies.

The market for inkjet printers continued to expand steadily in emerging economies including the BRICs. Including Japan, North America and Europe, however, the overall market remained flat compared with the previous year.

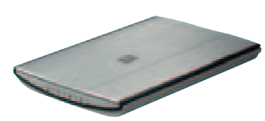
Confronted by persistent and fierce price competition, the SFP market continued to shrink. This was, however, offset by robust MFP unit sales growth, particularly for the PIXUS MP600 and MP610 models. Accounting for these and other factors, overall sales of inkjet printers rose 9.2% year on year. This included solid contributions from inkjet consumable supplies.

Although the market for scanners is contracting, owing to the growth of MFPs, Canon's sales stayed on track compared to the previous year. As a result, the Company's scanner business maintained its No. 1 market share and continued to operate as a sound business.

LBP3000

PIXMA iP4500

PIXMA MP610



CanoScan LiDE90

Innovative Product — *PIXMA Pro9500 Professional Photo Printer*

Demand for inkjet printers that cater to the needs of professionals and dedicated amateurs, who use digital SLR cameras, has increased in recent years, reflecting the trend toward high-resolution printing. To address these needs, Canon commenced sales of the Pro9500 professional photo printer for professionals and high-end amateurs in 2007. Canon designed the printer to use the same pigment ink employed in its large-format inkjet printers—LUCIA. Responding to professional needs, this ink possesses exceptional image durability and contributes to high-definition image quality. Furthermore, the PIXMA Pro9500 can reproduce true-to-life color photographs and accommodate monochrome pictures using a 10-color pigment ink system made up of stable colors including cyan, magenta, yellow, photo cyan, photo magenta, red, green, photo black, matte black and gray inks.

The PIXMA Pro9500 is equipped with Canon's FINE inkjet printing technology. This technology realizes precise and uniform ejection of ultra-fine ink droplets for a high resolution of 4,800 × 2,400 dpi—a level of photo quality vivid enough even for the sharpest eyes of professional and aspiring professional photographers alike.

CAMERAS

Masaya Maeda
Chief Executive,
Image Communication
Products Operations

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Compact digital camera

Canon is expanding its camera business through a broad product lineup in tune with market trends.

Celebrating 70 years since its foundation in the camera business with a string of competitive product launches, Canon held on firmly to its overwhelming No. 1 position in the global markets for single lens reflex (SLR) and compact digital cameras.

In fiscal 2007, the overall market for digital cameras continued to grow, driven by rapid expansion in China, Russia and other emerging markets, as well as in the United States, Japan and other areas. The world market for digital SLR cameras continued on an upward trajectory, while the market for compact digital cameras also expanded, supported by the replacement of older- with newer-model digital cameras and growing demand for a second camera.

To maintain its leading position in the marketplace, Canon has enhanced its lineups of value-added products for both SLR and compact digital cameras with its DIGIC III imaging processor that achieves extraordinary image quality, as well as the Company's advanced optics technology.

Aside from digital cameras, fiscal 2007 was a year of sound growth in every camera category in this segment. In digital video camcorders, where we are making priority efforts to shift to HDs, the Company successfully expanded sales of HD products by delivering industry-leading, high-quality images and compatibility with mini-DV tape, DVDs, and HDD media. Furthermore, as part of the Company's production reforms, automated systems for manufacturing lenses—one of Canon's core competencies—implemented at the Oita Plant have improved production quality and reduced costs.

In fiscal 2008, Canon will improve individual models and further strengthen its varied lineup of digital cameras by responding to changing and growing demand from individuals in contrast to the family level.

Canon will provide a broad lineup, from entry models to equipment for the dedicated enthusiast and professional, that supports developing skills and capabilities. To this end, we will release models for users at every skill level and meet diverse user requirements.

From a production perspective, Canon will continue to implement reforms as it works toward lowering the cost to sales ratio.

Moreover, aiming to ensure the Company's sound growth, Canon has adopted cross-media imaging as the means to attain an advanced synergy between its imaging products. The Company will apply this concept in its pursuit of the ultimate in image quality from still images to movies for input and output devices. An example of the application of this concept is the Cultural Heritage Inheritance Project (*Tsuzuri Project*). In combining the use of EOS cameras with large-format inkjet printers, Canon has contributed to further advances in EOS digital technology. As Canon strives to be the leading imaging company, we will work tirelessly to positively contribute to the evolving digital-photography culture.

Fiscal 2007 Review

Net sales in the Camera segment increased 10.6% year on year to ¥1,152.7 billion boosted by a 17% jump in unit sales of digital cameras.

Sales of digital SLR cameras climbed steadily, led by the compact and lightweight EOS Digital Rebel XTi (EOS 400D). Equipped with a 10.1 million-pixel CMOS sensor, the EOS Digital Rebel XTi (EOS 400D) was highly evaluated for its price performance. Both the EOS 30D for advanced amateurs and the newer EOS 40D also received favorable market assessment for their ease of use and ability to address the most detailed of needs. Along with strong sales of new camera models, sales of interchangeable lenses increased.

In compact digital cameras, the Company introduced 16 models, strengthening its lineup. Offering all the basic functions and outstanding design, the PowerShot SD1000 DIGITAL ELPH (DIGITAL IXUS 70) received high market praise worldwide. The PowerShot G9, which successfully addressed the needs of dedicated amateurs, also enjoyed extraordinary popularity.

Sales and market share for HD camcorders increased in fiscal 2007, supported by the release of the HDV-model HV20 Camcorder. Combining the Company's new in-house-produced full-HD CMOS sensor, an HD video lens and the DIGIC DV II imaging processor, this camcorder produces a high image quality. In bolstering its product lineup through the introduction of an HDD model, Canon further increased its market share in the HD field.

In fiscal 2007, Canon increased its market share for LCD projectors, releasing models that achieve extremely high resolution and faithful color reproduction, such as the SX7 and other SXGA+ model lines equipped with liquid crystal on silicon (LCOS) panels.

PowerShot SD1000 DIGITAL ELPH (DIGITAL IXUS 70)

EOS Digital Rebel XTi (EOS 400D)

HV20

REALis SX7 (XEED SX7)

Innovative Product — *EOS Rebel XSi (EOS 450D) Digital SLR Camera*

Stepping up from Canon's lineup of compact digital cameras, the Company's digital SLR cameras for beginners experienced a sharp jump in demand.

Following the release in fiscal 2007 of the EOS Digital Rebel XTi (EOS 400D) as an SLR-type beginner's model, the EOS Rebel XSi (EOS 450D) further expands Canon's lineup in this category. In March 2008, we released the EOS Rebel XSi (EOS 450D) fitted with a 12.2 million-pixel CMOS sensor as well as the unmatched DIGIC III imaging processor, which handles up to 3.5 shots per second and enables continuous shots of up to 53 frames. This model also boasts a Live View function that allows the photographer to simultaneously view, display, and shoot.

Canon will work to further augment its lineup of digital SLR cameras and to address the needs of a wide spectrum of users from beginners to dedicated amateurs and professionals.

EOS Rebel XSi (EOS 450D)

OPTICAL AND OTHER PRODUCTS

Junji Ichikawa
Chief Executive,
Optical Products Operations

Immersion lithography scanning stepper

Using its own optical technologies and shortening installation times, Canon is expanding its market share.

In 2007, Canon geared up for future demand growth and made steady technological and quality refinements and improvements. It was a meaningful year in that Canon laid the foundation for gaining the future top market share.

In the optical products market, demand for semiconductor exposure equipment was largely in line with that of the previous year; however, sales of mirror projection mask aligners for LCDs were weak due to continued low LCD panel manufacturer capital investment.

The ratio of ArF in semiconductor exposure equipment is increasing and is expected to reach 65% of total sales in 2010. Canon began full-scale business expansion with the shipment of the FPA-7000AS5, a dry ArF scanning stepper, and the launch of the FPA-7000AS7 for the immersion lithography scanning stepper market. Amidst increased capital investment by memory-device manufacturers, Canon's full product lineup is now well positioned to meet various demands in the market. The FPA-7000AS7 features the highest NA (1.35), capable of sub-45nm resolution. Leveraging technological capabilities that enable the in-house development and production of key components, including super high-performance sensors that detect lens positioning errors in sub-nano units, semiconductor exposure equipment showcases the technological strengths of Canon.

In exposure equipment for LCDs, despite ongoing inventory adjustments due to over supply in the LCD panel market, signs of a rebound in capital investment began emerging thanks to a long overdue growth in demand for panels in PC monitors. Under these circumstances, Canon began shipping the MPAsp-H700 in 2007. This LCD exposure equipment for eighth-generation panels has yielded numerous innovations including new production methods for various key components and reduced installation times to one-third thanks to rigorous pre-assembly simulations.

In 2008, our primary objective for semiconductor exposure equipment is to perfect immersion and ArF equipment, making them highly competitive products. In exposure equipment for LCDs, growth in 52-inch large screen LCD TVs and the change in size of PC monitors to accommodate films and moving images have triggered a major rebound in capital investments by LCD panel manufacturers. Canon is taking steps to respond to major demand growth, further improve assembly precision and maintain short delivery times for high-quality products, and thereby expand market share.

Fiscal 2007 Review

Net sales of Optical and Other Products totaled ¥393.1 billion, down 7.2% year on year. On an individual product basis, results in exposure equipment for LCDs were weak due to a downturn in LCD panel manufacturer capital investment. While sales of semiconductor exposure equipment were essentially on par with the previous year, results remained soft.

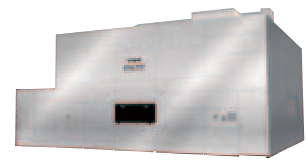
In the semiconductor production equipment market, demand for DRAM and NAND flash memories increased. This was particularly true of Asia, an area where memory-device manufacturers are concentrated. Canon launched the new FPA-5510iZ, an enhanced model more productive than the existing FPA-5500iZ, in order to retain market share amidst heavy competition. Moreover, Canon shipped the dry ArF scanning stepper FPA-7000AS5, and the immersion lithography scanning stepper FPA-7000AS7, thus laying the groundwork for future sales growth.

The market for exposure equipment for LCDs contracted substantially amidst efforts to increase LCD TV size and achieve further productivity improvements in monitor panel production. The MPAsp-H700 LCD exposure equipment for eighth-generation panels have received rave customer reviews not only for their high-quality, high-optical performance and high productivity, but for a significantly shorter installation time.

In digital radiography systems, Canon has shipped a total of 6,000 units since 1998. Sales of the portable CXDI-50G have been favorable, especially outside Japan.

In the large-format printer market, Canon successively launched nine new models to bolster its product lineup. The Company also increased unit printer sales as well as ink sales volumes due to the growing number of printers in the market.

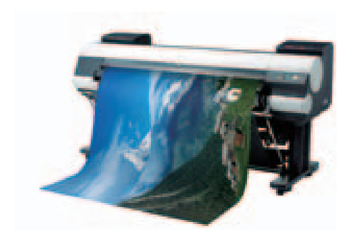
In broadcast and communications, sales of the DIGISUPER 100AF field zoom broadcasting lens fared well on the back of growth in the penetration of hi-vision large-format TVs. This lens contains a unique AF mechanism that enables exact focus of objects moving at high speed as well as an optical image stabilizer developed from know-how acquired from EOS interchangeable lenses.



MPAsp-H700

CXDI-50G

DIGISUPER 100AF

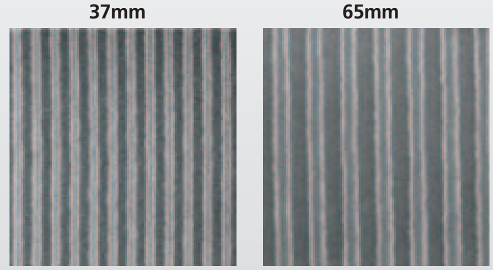


imagePROGRAF iPF9100

Innovative Product — *FPA-7000AS7 Immersion Lithography Scanning Stepper*

Canon launched the FPA-7000AS7 ArF immersion lithography scanning stepper that incorporates a number of advanced technologies, enabling the mass production of state-of-the-art semiconductors below 45nmHP (half pitch). Featuring the world's highest NA (numerical aperture) of 1.35, the scanning stepper employs a guideless two-wafer stage system, which has the advantage of immersion lithography throughout and meets the demand for high speed and high precision. Moreover, Canon developed a proprietary immersion method liquid film system. This system enables a continuous and uninterrupted flow of water to pass under the lens. As a result, Canon has perfected a product that supports the full mass production of state-of-the-art devices below 45nmHP with a maximum resolution of 37nmHP.

37mm 65mm



The NA1.35 lens offers outstanding resolution and quality

MAJOR CONSOLIDATED SUBSIDIARIES

(As of December 31, 2007)

MANUFACTURING

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

RESEARCH & DEVELOPMENT

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

MARKETING & OTHER

Canon Marketing Japan Inc.
Canon System and Support Inc.
Canon System Solutions Inc.
Canon Software Inc.
Argo 21 Corporation
Canon U.S.A., Inc.
Canon Canada, Inc.
Canon Mexicana, S. de R.L. de C.V.
Canon Latin America, Inc.
Canon do Brasil Industria e Comercio Limitada
Canon Chile, S.A.
Canon Panama, S.A.
Canon Argentina, S.A.
Canon Business Solutions-Central, Inc.
Canon Business Solutions-West, Inc.
Canon Business Solutions-East, Inc.
Canon Financial Services, Inc.
Canon Information Technology Services, Inc.
Canon Europa N.V.
Canon Europe Ltd.
Canon (UK) Ltd.
Canon Deutschland GmbH
Canon France S.A.S.
Canon Italia S.p.A.
Canon España S.A.
Canon Nederland N.V.
Canon Danmark A/S
Canon Belgium N.V./S.A.
Canon (Schweiz) AG
Canon Gesellschaft m.b.H.
Canon Svenska AB
Canon Oy
Canon North-East Oy
Canon Norge A.S.
Canon CEE GmbH
Canon Middle East FZ-LIC
Canon South Africa Pty. Ltd.
Canon Australia Pty. Ltd.
Canon New Zealand Ltd.
Canon Finance Australia Ltd.
Canon Finance New Zealand Ltd.
Canon (China) Co., Ltd.
Canon Singapore Pte. Ltd.
Canon Hongkong Co., Ltd.
Canon Marketing (Malaysia) Sdn. Bhd.
Canon Marketing (Philippines), Inc.
Canon Marketing (Thailand) Co., Ltd.
Canon Marketing (Taiwan) Co., Ltd.
Canon India Pte. Ltd.
Canon Korea Consumer Imaging Inc.
Canon Semiconductor Engineering Korea Inc.
Canon Semiconductor Equipment Taiwan Inc.

TABLE OF CONTENTS

GENERAL

The following discussion and analysis provides information that management believes to be relevant to understanding Canon's consolidated financial condition and results of operations. References in this discussion to the "Company" are to Canon Inc. and, unless otherwise indicated, references to the financial condition or operating results of "Canon" refer to Canon Inc. and its consolidated subsidiaries.

OVERVIEW

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

Canon divides its businesses into three product groups: business machines, cameras, and optical and other products. The business machines product group has three sub-groups: office imaging products, computer peripherals and business information products.

Economic environment

Looking back at the global economy in 2007, the U.S. economy proved sluggish in the second half of the year as the fallout from the subprime loan crisis resulted in a decline not only in housing investment, but also in consumer spending. In Europe, the region moved toward moderate recovery as domestic demand expanded in major European countries, boosted by such factors as increased consumer spending owing to continued improvements in the employment environment. Within Asia, the Chinese economy maintained a high growth rate while other economies in the region also enjoyed generally favorable conditions, primarily due to export growth. In Japan, the economy maintained a trend toward recovery, buoyed by an improvement in consumer spending along with increased capital spending fueled by strong corporate earnings.

Market environment

As for the markets in which Canon operates, within the camera segment, demand for digital single-lens reflex ("SLR") cameras and digital compact cameras continued to realize healthy growth during the year. Within the office imaging products market, demand for network digital multifunction devices ("MFDs") remained solid as the office market shifted toward color models in all regions. As for computer peripherals, including printers, demand for laser beam printers continued to grow for both color and monochrome low-end models. Within the inkjet printer market, as the shift in demand from single-function to multifunction machines gained momentum, price competition for multifunction models increased in severity. In the optical equipment segment, while demand for projection aligners, which are used to produce liquid crystal display ("LCD") panels, remained at a low level due to restrained investment by LCD manufacturers, demand for steppers, used in the production of semiconductors, remained at approximately the same level as the previous year. The average value of the yen for the year was ¥117.50 to the U.S. dollar and ¥161.41 to the euro, representing a slight year-on-year decrease against the U.S. dollar, and about a 10% decline against the euro.

Summary of operations

Amid these conditions, Canon's consolidated net sales in 2007 increased by 7.8% from the year-ago period to ¥4,481.3 billion (U.S.$39,310 million), resulting from a solid rise in sales of digital cameras, color network MFDs, and laser beam printers, along with the positive effect of favorable currency exchange rates. Income before income taxes and minority interests in 2007 totaled ¥768.4 billion (U.S.$6,740 million), a year-on-year increase of 6.8%, while net income for the year totaled ¥488.3 billion (U.S.$4,284 million), both marking all-time highs.

Key performance indicators

Following are the key performance indicators ("KPIs") that Canon uses in managing its business. The changes from year to year in these KPIs are set forth in the table shown on page 45.

Revenues

As Canon seeks to become a truly excellent global company, one indicator upon which Canon's management places strong emphasis is revenue. Following are some of the KPIs relating 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 relating to its products. Sales vary based on such factors as product demand, the number and size of transactions within the reporting period, product reputation for new products, and changes in sales prices. Other factors involved are market share and market environment. In addition, management considers an evaluation of net sales by product group important to assessing Canon's performance in sales in various product groups in light of market trends.

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

Operating profit ratio (ratio of operating profit to net sales) and research and development ("R&D") expense to net sales ratio are considered by Canon to be KPIs. Canon is focusing on two areas for improvement. On the one hand, Canon strives to control and reduce its selling, general and administrative expenses. On the other hand, Canon's R&D policy is designed to maintain a high level of spending in core technology in order to sustain Canon's leading position in its current fields of business, and to explore possibilities in other markets. Canon believes such investments will be 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 management believes to be important.

Inventory turnover within days is a KPI because it is a measure of supply-chain management efficiency. Inventories have inherent risks of becoming obsolete, deteriorating or otherwise decreasing in value significantly, which may adversely affect Canon's operating results. To mitigate these risks, management believes that it is important to continue reducing inventories and shortening production lead times in order to achieve early recovery of related product expenses by strengthening supply-chain management.

Canon's management seeks to meet its liquidity and capital requirements primarily with cash flow from operations. Management also seeks debt-free operations. For a manufacturing company such as Canon, the process for realizing profit on any endeavor can be lengthy, involving as it does R&D, manufacturing, and sales activities. Management, therefore, believes that it is important to have sufficient financial strength so that it does not have to rely on external funding. Canon has continued to reduce its reliance on external funding for capital investments in favor of generating the necessary funds from its own operations.

Stockholders' equity to total assets ratio (ratio of total stockholders' equity to total assets) is another KPI for Canon. Canon believes that stockholders' equity to total asset ratio measures its long-term viability. Canon believes that a high or increasing stockholders' equity ratio usually indicates that Canon has a good, or improving ability to fund debt obligations and other unexpected expenses, which means in the long-term that Canon is better able to maintain a high level of stable investments for its future operations and development. As Canon puts a strong emphasis on its research and development activities, management believes that it is important to maintain a stable financial base and, accordingly, a high level of stockholders' equity to total assets ratio.

KEY PERFORMANCE INDICATORS

	2007	2006	2005	2004	2003
Net sales (Millions of yen)	**¥4,481,346**	¥4,156,759	¥3,754,191	¥3,467,853	¥3,198,072
Gross profit to net sales ratio	**50.1%**	49.6%	48.5%	49.4%	50.3%
R&D expense to net sales ratio	**8.2%**	7.4%	7.6%	7.9%	8.1%
Operating profit to net sales ratio	**16.9%**	17.0%	15.5%	15.7%	14.2%
Inventory turnover within days	**44 days**	45 days	47 days	49 days	49 days
Debt to total assets ratio	**0.6%**	0.7%	0.8%	1.1%	3.1%
Stockholders' equity to total assets ratio	**64.8%**	66.0%	64.4%	61.6%	58.6%

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue recognition

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

Revenue from sales of consumer products including office imaging products, computer peripherals, business information products and cameras is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

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

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

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

For all other arrangements with multiple elements, Canon allocates revenue to each element based on its relative fair value if such element meets the criteria for treatment as a separate unit of accounting as prescribed in the Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." Otherwise, revenue is deferred until the undelivered elements are fulfilled and accounted for as a single unit of accounting.

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

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

Allowance for doubtful receivables

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

Valuation of inventories

Inventories are stated at the lower of cost or market value. Cost is determined principally by the average method for domestic inventories and 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.

Property, plant and equipment and accounting change

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.

Effective April 1, 2007, the Company and its domestic subsidiaries elected to change the declining-balance method of depreciating machinery and equipment from the fixed-percentage-on-declining base application to the 250% declining-balance application. Estimated residual values were also reduced in conjunction with this change. The Company and its domestic subsidiaries believe that the 250% declining-balance application is preferable because it provides a better matching of the allocation of cost of machinery and equipment with associated revenues in light of increasingly short product life cycles.

Environmental liabilities

Canon is subject to liability for the investigation and clean-up of environmental contamination at each of the properties that Canon owns or operates, as well as at certain properties Canon formerly owned or operated. Canon employs extensive internal environmental protection programs that focus on preventive measures. Canon conducts environmental assessments for a number of its locations and operating facilities. If Canon was to be held responsible for damages in any future litigation or proceedings, such costs may not be covered by insurance and may be material. The liabilities for environmental remediation and other environmental costs are accrued when it is considered probable and costs can be reasonably estimated.

Income taxes

As more fully disclosed in the Notes to Consolidated Financial Statements, Canon adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109," on January 1, 2007. Canon considers many factors when evaluating and estimating income tax uncertainties. These factors include an evaluation of the technical merits of the tax positions as well as the amounts and probabilities of the outcomes that could be realized upon settlement. The actual resolutions of those uncertainties will inevitably differ from those estimates, and such differences may be material to the financial statements.

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

In preparing its financial statements for fiscal 2007, Canon estimated a weighted-average discount rate of 2.5% for Japanese plans and 4.5% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.9% for Japanese plans and 6.0% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income governmental and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. A decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately 9%. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, are deferred until subsequent periods, as permitted by the Statement of Financial Accounting Standards ("SFAS") No. 87, "Employers' Accounting for Pensions."

Decreases in expected return on plan assets may increase net periodic benefit cost by decreasing expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For fiscal 2008, if a change of 50 basis points in the expected long-term rate of return on plan assets is to occur, that may cause a change of approximately ¥3,022 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 income (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 the value of plan assets in future fiscal years and, ultimately, future pension income (expense).

On December 31, 2006, Canon adopted the recognition and disclosure provisions of SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS 158"). SFAS 158 required Canon to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in the December 31, 2006 consolidated balance sheet, with a corresponding adjustment to accumulated other comprehensive income (loss), net of tax.

Effective January 1, 2007, Canon and certain of its domestic subsidiaries have amended their funded defined benefit pension plans, and the projected benefit obligation has decreased by ¥101,620 million (U.S.$891 million), primarily due to the modification of the pattern of future benefit payments. This decrease is amortized as a reduction of net periodic benefit cost over the employee's average remaining service period. The amount is approximately ¥5,834 million (U.S.$51 million) per year. In conjunction therewith, Canon and certain of its domestic subsidiaries have implemented an unfunded retirement and severance plan and a defined contribution pension plan for certain future pension benefits attributable to employee's future services.

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen 2007	change	2006	change	2005	Thousands of U.S. dollars 2007
Net sales	**¥4,481,346**	**+7.8%**	¥4,156,759	+10.7%	¥3,754,191	**$39,310,053**
Operating profit	**756,673**	**+7.0**	707,033	+21.3	583,043	**6,637,482**
Income before income taxes and minority interests	**768,388**	**+6.8**	719,143	+17.5	612,004	**6,740,246**
Net income	**488,332**	**+7.2**	455,325	+18.5	384,096	**4,283,614**

Sales

Canon's consolidated net sales in fiscal 2007 totaled ¥4,481,346 million (U.S.$39,310 million). This represents a 7.8% increase from the previous fiscal year, reflecting solid rises in sales of digital cameras and color network digital MFDs, and laser beam printers, along with the positive effects of the depreciation of the yen.

Overseas operations are significant to Canon's operating results and generated approximately 77% of total net sales in fiscal 2007. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen in relation to such other currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localizing some manufacturing and procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on results of operations.

The average value of the yen in fiscal 2007 was ¥117.50 to the U.S. dollar, and ¥161.41 to the euro, representing a slight decrease against the U.S. dollar, and about 10% decline against the euro, compared with the previous year. The effects of foreign exchange rate fluctuations favorably impacted net sales by approximately ¥125,500 million. This favorable impact was comprised of approximately ¥9,600 million for U.S. dollar denominated sales, ¥104,700 million for euro denominated sales and ¥11,200 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. Such raw materials are subject to fluctuations in world market prices and exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses and rent expenses. The ratio of cost of sales to net sales for fiscal 2007, 2006 and 2005 was 49.9%, 50.4% and 51.5%, respectively.

Gross profit

Canon's gross profit in fiscal 2007 increased by 9.1% to ¥2,246,981 million (U.S.$19,710 million) from fiscal 2006. The gross profit ratio improved 0.5 points year on year to reach 50.1%. The improved gross profit ratio was mainly the result of such factors as the launch of new products and the in-house manufacturing of key components and key devices, in addition to cost-reduction efforts realized through ongoing production-reform and procurement-reform activities, which absorbed the negative effects of escalating raw materials cost and severe price competition in the consumer product market.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Although the growth in selling, general and administrative expenses—which increased 7.4% year on year—remained less than revenue growth, R&D expenditures grew by 19.4% from the year-ago period to ¥368,261 million (U.S.$3,230 million) due to active R&D investment, resulting in an increase in the operating expense to net sales ratio of 0.6 points year on year to 33.2%.

Operating profit

Operating profit in fiscal 2007 increased by 7.0% to ¥756,673 million (U.S.$6,637 million) from fiscal 2006. Operating profit in fiscal 2007 was 16.9% of net sales.

The Company and its domestic subsidiaries implemented a change in the accounting method used to calculate depreciation of fixed assets at the start of the second quarter of the year, which resulted in an increase of depreciation expense by ¥63,773 million (U.S.$559 million) compared with the previously used method.

Other income (deductions)

Other income (deductions) for fiscal 2007 stayed at almost the same level as the previous year. Although interest and dividend income increased by ¥5,666 million (U.S.$50 million), the foreign currency exchange loss offset it by ¥6,139 million (U.S.$54 million).

Income before income taxes and minority interests

Income before income taxes and minority interests in fiscal 2007 was ¥768,388 million (U.S.$6,740 million), a 6.8% increase from fiscal 2006, and constituted 17.1% of net sales.

Income taxes

Provision for income taxes in fiscal 2007 increased by ¥16,025 million (U.S.$141 million) from fiscal 2006, primarily as a result of the increase in income before income taxes and minority interests. The effective tax rate during fiscal 2007 declined by 0.1% compared with fiscal 2006.

Net income

As a result of the factors offering above, net income in fiscal 2007 increased by 7.2% to ¥488,332 million (U.S.$4,284 million), which represents a 10.9% return on net sales.

Product information

Canon divides its businesses into three product groups: business machines, cameras and optical and other products.

- **The business machines product group** includes office imaging products, computer peripherals and business information products.
  Office imaging products include mainly office network digital MFDs, color network digital MFDs, office copying machines, personal-use copying machines, and full-color copying machines.
  Computer peripherals include mainly laser beam printers, inkjet multifunction peripherals, single function inkjet printers, and image scanners.
  Business information products include mainly computer information systems, document scanners, and personal information products.
- **The cameras product group** includes mainly digital single lens reflex ("SLR") cameras, digital compact cameras, interchangeable lenses, and digital video camcorders.
- **The optical and other products product group** includes mainly semiconductor production equipment, mirror projection mask aligners for LCD panels, broadcasting equipment, medical equipment, large format printers, and related components.

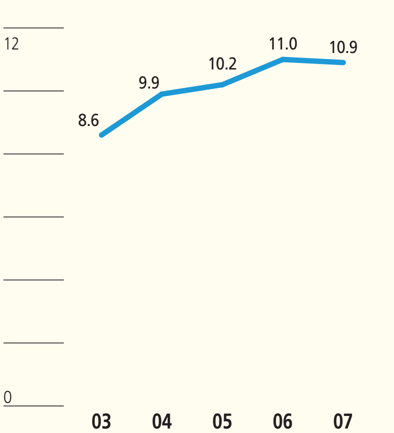
Sales by product

Canon's sales by product group are summarized as follows:

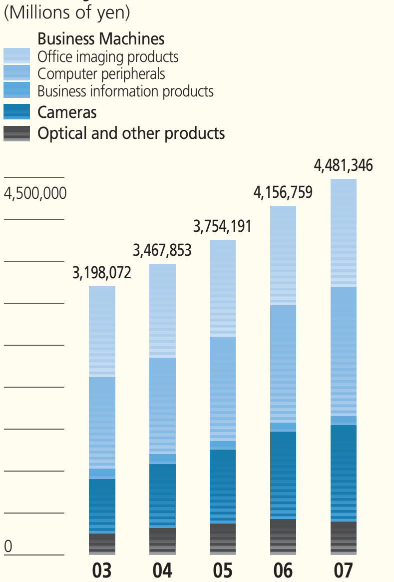
SALES BY PRODUCT

	Millions of yen 2007	change	2006	change	2005	Thousands of U.S. dollars 2007
Business machines:						
Office imaging products	**¥1,290,788**	**+8.8%**	¥1,185,925	+2.8%	¥1,153,240	**$11,322,702**
Computer peripherals	**1,537,511**	**+9.9**	1,398,408	+12.3	1,244,906	**13,486,939**
Business information products	**107,243**	**+0.5**	106,754	+2.4	104,255	**940,727**
	2,935,542	**+9.1**	2,691,087	+7.5	2,502,401	**25,750,368**
Cameras	**1,152,663**	**+10.6**	1,041,865	+18.5	879,186	**10,111,079**
Optical and other products	**393,141**	**–7.2**	423,807	+13.7	372,604	**3,448,606**
Total	**¥4,481,346**	**+7.8%**	¥4,156,759	+10.7%	¥3,754,191	**$39,310,053**

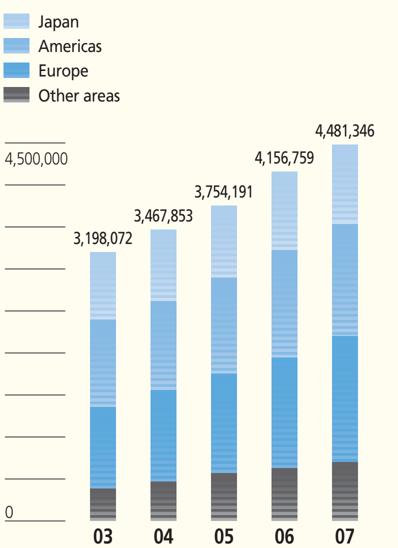
Return on Sales
(%)



Sales by Product
(Millions of yen)



Sales by Region
(Millions of yen)



Sales of business machines, constituting 65.5% of consolidated net sales, increased 9.1%, to ¥2,935,542 million (U.S.$25,750 million) in fiscal 2007.

Sales of office imaging products increased 8.8% in fiscal 2007, to ¥1,290,788 million (U.S.$11,323 million). In the business machine segment, as demand for network digital MFDs shifted toward color models in both the domestic Japanese and overseas markets, the competitively priced iR C2880 series and the high-end iR C5185 series continued to enjoy strong sales. Among monochrome network digital MFDs, the iR5055 series and the new energy-saving iR3025 series contributed to expanded sales. Additionally, Canon marked its entry into the commercial print market with the launch of the new imagePRESS C7000VP. Color office imaging products accounted for 35% and 31% and monochrome office imaging products accounted for 45% and 49% of office imaging products sales in fiscal 2007 and 2006, respectively. Sales of facsimiles and information system business accounted for 20% of sales of office imaging products in both fiscal 2007 and 2006.

Sales of computer peripherals increased 9.9% in fiscal 2007 to ¥1,537,511 million (U.S.$13,487 million). Laser beam printers enjoyed a year-on-year increase of over 20% in unit sales, with strong demand for both color and monochrome low-end models, and consumables also growing favorably, resulting in an increase of 10.5% in sales in value terms. As for inkjet printers, despite a continuing decline in unit sales for single-function models and severe price competition in the market, sales in value terms increased by 9.2% in 2007, boosted by such factors as increased unit sales of multifunction models, including the PIXMA MP600/610, and healthy sales growth for consumables.

Sales of business information products increased 0.5%, to ¥107,243 million (U.S.$941 million) in fiscal 2007.

Sales of cameras continued to achieve growth of 10.6% in fiscal 2007, totaling ¥1,152,663 million (U.S.$10,111 million). The growth was fueled by demand for digital SLR cameras, with particularly strong sales for the compact, lightweight-body EOS DIGITAL REBEL XTi and the advanced-amateur-model EOS 30D/40D which, in turn, led to expanded sales of interchangeable lenses for SLR cameras. As for compact digital cameras, Canon strengthened its lineup with the launch of 16 new models—5 stylish ELPH-series models and 11 PowerShot-series models—catering to a diverse range of shooting styles. As a result, unit sales of digital cameras for 2007 increased by approximately 17% from the year-ago period. In the field of digital video camcorders, the launch of consumer-market HDV models equipped with Canon HD CMOS sensors contributed to expanded sales, filling out Canon's digital camcorder lineup along with MiniDV, DVD and hard disk models. Sales of cameras constituted 25.7% of consolidated net sales in fiscal 2007.

Sales of optical and other products decreased 7.2% in fiscal 2007, to ¥393,141 million (U.S.$3,449 million). In the optical and other products segment, sales of aligners, used to produce LCD panels, decreased amid reduced market demand due to restrained investment by LCD manufacturers, and sales of steppers, used in the production of semiconductors, also declined slightly. Sales of optical and other products constituted 8.8% of consolidated net sales in fiscal 2007.

Sales by region

A geographical analysis indicates that net sales in fiscal 2007 increased in every region.

In Japan, sales of office imaging products increased by 6.8% in fiscal 2007 due to the growth of color network digital MFDs and cameras also achieved sales growth of 7.4% due to strong demand for digital SLR cameras. Sales of optical and other products decreased by 6.8% due to a reduced demand for steppers. As a result, net sales in this region increased by 1.6% in fiscal 2007 from fiscal 2006.

In the Americas, net sales increased by 3.1% on a local currency basis in fiscal 2007, mainly due to increased sales of digital cameras and color network digital MFDs. Sales of digital cameras experienced continued strong demand and benefited from the effect of newly-launched products such as the EOS 40D, advanced-amateur-model, and the EOS DIGITAL REBEL XTi. On a yen basis, net sales in the Americas increased by 4.1% in fiscal 2007.

In Europe, net sales increased by 5.3% on a local currency basis in fiscal 2007, mainly due to increased sales of laser beam printers, color network digital MFDs and digital cameras. On a yen basis, after accounting for the depreciation of the yen against the euro, net sales in Europe grew 14.1% in fiscal 2007.

Sales in other areas increased by 11.5% on a yen basis in fiscal 2007, reflecting overall sales growth, particularly in digital cameras and laser beam printers.

A summary of net sales by region is provided below:

SALES BY REGION

	Millions of yen 2007	change	2006	change	2005	Thousands of U.S. dollars 2007
Japan	¥ 947,587	+1.6%	¥ 932,290	+8.9%	¥ 856,205	$ 8,312,167
Americas	1,336,168	+4.1	1,283,646	+12.0	1,145,950	11,720,772
Europe	1,499,286	+14.1	1,314,305	+11.3	1,181,258	13,151,632
Other areas	698,305	+11.5	626,518	+9.8	570,778	6,125,482
Total	¥4,481,346	+7.8%	¥4,156,759	+10.7%	¥3,754,191	$39,310,053

Note: This summary of net sales by region of destination is determined by the location of the customer.

SEGMENT INFORMATION BY PRODUCT

Millions of yen		Business Machines	Cameras	Optical and Other Products	Corporate and Eliminations	Consolidated
2007	Net sales:					
	Unaffiliated customers	**¥2,935,542**	**¥1,152,663**	**¥393,141**	**¥ —**	**¥4,481,346**
	Intersegment	**—**	**—**	**238,659**	**(238,659)**	**—**
	Total	**2,935,542**	**1,152,663**	**631,800**	**(238,659)**	**4,481,346**
	Operating cost and expenses	**2,285,281**	**845,237**	**610,720**	**(16,565)**	**3,724,673**
	Operating profit	**¥ 650,261**	**¥ 307,426**	**¥ 21,080**	**¥ (222,094)**	**¥ 756,673**
	Assets	**¥1,762,167**	**¥ 561,504**	**¥544,734**	**¥1,644,220**	**¥4,512,625**
	Depreciation and amortization	**159,309**	**37,180**	**69,843**	**75,362**	**341,694**
	Capital expenditure	**166,143**	**32,870**	**78,449**	**151,087**	**428,549**
2006	Net sales:					
	Unaffiliated customers	¥2,691,087	¥1,041,865	¥423,807	¥ —	¥4,156,759
	Intersegment	—	—	190,687	(190,687)	—
	Total	2,691,087	1,041,865	614,494	(190,687)	4,156,759
	Operating cost and expenses	2,091,858	773,127	573,019	11,722	3,449,726
	Operating profit	¥ 599,229	¥ 268,738	¥ 41,475	¥ (202,409)	¥ 707,033
	Assets	¥1,617,198	¥ 542,866	¥501,008	¥1,860,843	¥4,521,915
	Depreciation and amortization	127,873	28,756	37,018	68,647	262,294
	Capital expenditure	154,259	31,517	36,272	157,609	379,657
2005	Net sales:					
	Unaffiliated customers	¥2,502,401	¥ 879,186	¥372,604	¥ —	¥3,754,191
	Intersegment	—	—	158,114	(158,114)	—
	Total	2,502,401	879,186	530,718	(158,114)	3,754,191
	Operating cost and expenses	1,960,373	705,480	491,898	13,397	3,171,148
	Operating profit	¥ 542,028	¥ 173,706	¥ 38,820	¥ (171,511)	¥ 583,043
	Assets	¥1,427,277	¥ 480,957	¥517,527	¥1,617,792	¥4,043,553
	Depreciation and amortization	123,037	27,662	28,011	47,231	225,941
	Capital expenditure	201,887	57,678	15,955	108,264	383,784

Thousands of U.S.dollars		Business Machines	Cameras	Optical and Other Products	Corporate and Eliminations	Consolidated
2007	Net sales:					
	Unaffiliated customers	**$25,750,368**	**$10,111,079**	**$3,448,606**	**$ —**	**$39,310,053**
	Intersegment	**—**	**—**	**2,093,499**	**(2,093,499)**	**—**
	Total	**25,750,368**	**10,111,079**	**5,542,105**	**(2,093,499)**	**39,310,053**
	Operating cost and expenses	**20,046,324**	**7,414,360**	**5,357,193**	**(145,306)**	**32,672,571**
	Operating profit	**$ 5,704,044**	**$ 2,696,719**	**$ 184,912**	**$ (1,948,193)**	**$ 6,637,482**
	Assets	**$15,457,605**	**$ 4,925,474**	**$4,778,368**	**$14,422,983**	**$39,584,430**
	Depreciation and amortization	**1,397,447**	**326,140**	**612,658**	**661,071**	**2,997,316**
	Capital expenditure	**1,457,395**	**288,333**	**688,149**	**1,325,325**	**3,759,202**

Notes:
1. General corporate expenses of ¥221,979 million (U.S.$1,947 million), ¥202,328 million and ¥171,522 million in the years ended December 31, 2007, 2006 and 2005, respectively, are included in "Corporate and Eliminations."
2. Corporate assets of ¥1,644,220 million (U.S.$14,423 million), ¥1,860,933 million and ¥1,239,255 million as of December 31, 2007, 2006 and 2005, respectively, which mainly consist of cash and cash equivalents, time deposits, marketable securities, investments and corporate properties, are included in "Corporate and Eliminations."
3. The segments are defined under Japanese GAAP. In grouping of segment information by product, Japanese GAAP requires that consideration be given to similarities of product types and characteristics, manufacturing methods, sales markets, and other factors that are similar.
4. As noted in Note 1-(l) of the Notes to Consolidated Financial Statements, Effective April 1, 2007, the Company and its domestic subsidiaries elected to change the declining-balance method of depreciating machinery and equipment.

   The change in depreciation methods caused an increase in depreciation expense by ¥29,148 million (U.S.$256 million) in the Business Machines segment, ¥6,451 million (U.S.$56 million) in the Cameras segment, ¥15,540 million (U.S.$136 million) in the Optical and other products segment and ¥12,634 million (U.S.$111 million) in Corporate and Eliminations.

SEGMENT INFORMATION BY GEOGRAPHIC AREA

Millions of yen		Japan	Americas	Europe	Others	Corporate and Eliminations	Consolidated
2007	Net sales:						
	Unaffiliated customers	**¥1,048,310**	**¥1,329,479**	**¥1,499,821**	**¥ 603,736**	**¥ —**	**¥4,481,346**
	Intersegment	**2,494,251**	**4,608**	**3,496**	**824,844**	**(3,327,199)**	**—**
	Total	**3,542,561**	**1,334,087**	**1,503,317**	**1,428,580**	**(3,327,199)**	**4,481,346**
	Operating cost and expenses	**2,722,672**	**1,281,805**	**1,441,972**	**1,378,306**	**(3,100,082)**	**3,724,673**
	Operating profit	**¥ 819,889**	**¥ 52,282**	**¥ 61,345**	**¥ 50,274**	**¥ (227,117)**	**¥ 756,673**
	Assets	**¥2,715,294**	**¥ 506,295**	**¥ 732,579**	**¥ 367,234**	**¥ 191,223**	**¥4,512,625**
2006	Net sales:						
	Unaffiliated customers	¥1,037,657	¥1,277,867	¥1,313,919	¥ 527,316	¥ —	¥4,156,759
	Intersegment	2,311,482	4,764	3,586	792,018	(3,111,850)	—
	Total	3,349,139	1,282,631	1,317,505	1,319,334	(3,111,850)	4,156,759
	Operating cost and expenses	2,558,685	1,236,138	1,272,463	1,275,817	(2,893,377)	3,449,726
	Operating profit	¥ 790,454	¥ 46,493	¥ 45,042	¥ 43,517	¥ (218,473)	¥ 707,033
	Assets	¥2,644,116	¥ 432,001	¥ 682,381	¥ 339,314	¥ 424,103	¥4,521,915
2005	Net sales:						
	Unaffiliated customers	¥ 979,748	¥1,139,784	¥1,178,672	¥ 455,987	¥ —	¥3,754,191
	Intersegment	2,046,173	7,424	2,206	646,530	(2,702,333)	—
	Total	3,025,921	1,147,208	1,180,878	1,102,517	(2,702,333)	3,754,191
	Operating cost and expenses	2,362,019	1,110,415	1,147,658	1,071,155	(2,520,099)	3,171,148
	Operating profit	¥ 663,902	¥ 36,793	¥ 33,220	¥ 31,362	¥ (182,234)	¥ 583,043
	Assets	¥2,419,012	¥ 406,101	¥ 569,750	¥ 312,472	¥ 336,218	¥4,043,553

Thousands of U.S.dollars		Japan	Americas	Europe	Others	Corporate and Eliminations	Consolidated
2007	Net sales:						
	Unaffiliated customers	**$ 9,195,702**	**$11,662,096**	**$13,156,325**	**$ 5,295,930**	**$ —**	**$39,310,053**
	Intersegment	**21,879,394**	**40,422**	**30,666**	**7,235,474**	**(29,185,956)**	**—**
	Total	**31,075,096**	**11,702,518**	**13,186,991**	**12,531,404**	**(29,185,956)**	**39,310,053**
	Operating cost and expenses	**23,883,087**	**11,243,904**	**12,648,877**	**12,090,404**	**(27,193,701)**	**32,672,571**
	Operating profit	**$ 7,192,009**	**$ 458,614**	**$ 538,114**	**$ 441,000**	**$ (1,992,255)**	**$ 6,637,482**
	Assets	**$23,818,368**	**$ 4,441,184**	**$ 6,426,132**	**$ 3,221,351**	**$ 1,677,395**	**$39,584,430**

Notes:
1. General corporate expenses of ¥221,979 million (U.S.$1,947 million), ¥202,328 million and ¥171,522 million in the years ended December 31, 2007, 2006 and 2005, respectively, are included in "Corporate and Eliminations."
2. Corporate assets of ¥1,644,220 million (U.S.$14,423 million), ¥1,860,933 million and ¥1,239,255 million as of December 31, 2007, 2006 and 2005, respectively, which mainly consist of cash and cash equivalents, time deposits, marketable securities, investments and corporate properties, are included in "Corporate and Eliminations."
3. Segment information by geographic area is determined by the location of the Company or its relevant subsidiary making the sale. The segments are defined under Japanese GAAP. In grouping of segment information by geographic area, Japanese GAAP requires that consideration be given to geographic proximity, as well as similarities of economic activities, interrelationships of business activities and other similar factors.

Operating profit by product

Operating profit for business machines in fiscal 2007 increased by ¥51,032 million (U.S.$448 million) to ¥650,261 million (U.S.$5,704 million). This increase resulted primarily from sales growth and cost reduction efforts.

Operating profit for cameras in fiscal 2007 increased by ¥38,688 million (U.S.$339 million) to ¥307,426 million (U.S.$2,697 million). The suppression of price declines through the launch of new products and continued cost reduction efforts realized through ongoing production reform and procurement boosted the operating profit of this segment.

Operating profit for optical and other products in fiscal 2007 decreased by ¥20,395 million (U.S.$179 million) to ¥21,080 million (U.S.$185 million) mainly due to a decline in the sales volume of aligners and steppers.

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

The return on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Return on foreign operation sales is calculated by dividing net income of foreign subsidiaries, after factoring in consolidation adjustments between foreign subsidiaries, by net sales of foreign subsidiaries. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. The returns on foreign operation sales in fiscal 2007, 2006 and 2005 were 4.0%, 3.7% and 3.0%, respectively. This compares with returns of 10.9%, 11.0% and 10.2% on consolidated operations for the respective years.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents in fiscal 2007 decreased by ¥211,163 million (U.S.$1,852 million) to ¥944,463 million (U.S.$8,285 million), compared with ¥1,155,626 million in fiscal 2006 and ¥1,004,953 million in fiscal 2005. Canon's cash and cash equivalents are typically denominated both in Japanese yen and in U.S. dollar, with the remainder denominated in foreign currencies except for the U.S. dollar.

Net cash provided by operating activities in fiscal 2007 increased by ¥144,028 million (U.S.$1,263 million) from the previous year to ¥839,269 million (U.S.$7,362 million), reflecting the growth in sales and increased cash proceeds from sales, combined with an increase in net income. Cash flow from operating activities consisted of the following key components: the major component of Canon's cash inflow is cash received from customers, while the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, and income taxes.

For fiscal 2007, cash inflow from cash received from customers increased, due to the increase in net sales. This increase in cash inflow was within the range of the increase in net sales, as there were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials also increased, as a result of an increase in net sales. However, this increase was less than the increase in net sales, due to the effects of cost reductions. Cost reductions reflect a decline in unit prices of parts and raw materials, as well as a streamlining of the process of using these parts and materials through promoting efficiency in operations. Cash outflow for payroll increased, due to an increase in the number of employees. The employees in the Asian region increased, due to the expansion of production in the region. Cash outflow for payments for selling, general and administrative expenses increased, but the increase was within the range of the increase in net sales, due to cost-cutting efforts. Cash outflow for payments of income taxes increased, due to the increase in taxable income.

Net cash used in investing activities in fiscal 2007 was ¥432,485 million (U.S.$3,794 million), compared with ¥460,805 million in fiscal 2006 and ¥401,141 million in fiscal 2005, consisting primarily of capital expenditures. Purchases of fixed assets in fiscal 2007 totaled ¥474,285 million (U.S.$4,160 million), which was used mainly to expand production capabilities in Japan and overseas and to strengthen the Company's production-technology related infrastructure. As a result, free cash flow, or cash flow from operating activities minus cash flow from investing activities, totaled ¥406,784 million (U.S.$3,568 million) for fiscal 2007 as compared to ¥234,436 million for fiscal 2006.

Net cash used in financing activities totaled ¥604,383 million (U.S.$5,302 million) in fiscal 2007, mainly resulting from the ¥450,000 million (U.S.$3,947 million) purchase of treasury stock with the aim of improving capital efficiency and ensuring a flexible capital strategy and the dividend payout. The Company paid dividends in fiscal 2007 of ¥110.00 (U.S.$0.96) per share, which was an increase of ¥26.67 (U.S.$0.23) per share over the prior year (after adjusting for the effect of 3 for 2 stock split in 2006).

Canon seeks to meet its liquidity and capital requirements principally with cash flow from operations. Consistent with this objective, Canon continued to reduce its reliance on external funding for capital investments in favor of relying upon internally generated cash flows. This approach is supplemented with group-wide treasury and cash management activities undertaken at the parent company level. Canon believes that its working capital is sufficient for its present requirements.

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

Short-term loans (including current portion of long-term debt) amounted to ¥18,317 million (U.S.$161 million) at December 31, 2007 compared to ¥15,362 million at December 31, 2006. Long-term debt (excluding current portion) amounted to ¥8,680 million (U.S.$76 million) at December 31, 2007 compared to ¥15,789 million at December 31, 2006.

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

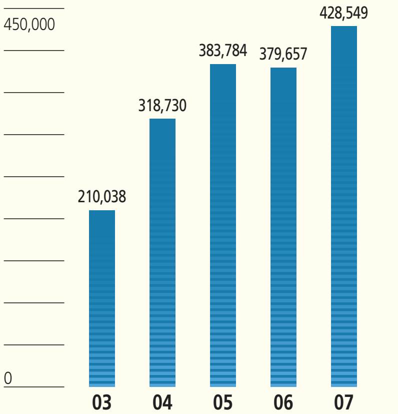
In order to facilitate access to global capital markets, Canon obtains credit ratings from two rating agencies; Moody's Investors Services, Inc. ("Moody's") and Standard and Poor's Rating Services ("S&P"). In addition, Canon maintains a rating from Rating and Investment Information, Inc. ("R&I"), a rating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

As of February 18, 2008, 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.

Capital expenditures (purchases of property, plant and equipment) in fiscal 2007 amounted to ¥428,549 million (U.S.$3,759 million) compared with ¥379,657 million in fiscal 2006 and ¥383,784 million in fiscal 2005. In fiscal 2007, capital expenditures were mainly used to expand production capabilities in both domestic and overseas regions, and to bolster the Company's production-technology related infrastructure. In addition, Canon has been continually investing in tools and dies for business machines, in which the amount invested is generally the same each year. For fiscal 2008, Canon projects its capital expenditures will be approximately ¥440,000 million (U.S.$3,860 million). The capital expenditures include investments in new production plants and new facilities of Canon.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥21,720 million (U.S.$191 million) in fiscal 2007, ¥44,981 million in fiscal 2006, ¥40,059 million in fiscal 2005. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥10,262 million (U.S.$90 million) in fiscal 2007, ¥6,233 million in fiscal 2006, and ¥4,878 million in fiscal 2005.

Capital Expenditures
(Millions of yen)



Working capital in fiscal 2007 decreased by ¥266,960 million (U.S.$2,342 million), to ¥1,352,082 million (U.S.$11,860 million), compared with ¥1,619,042 million in fiscal 2006 and ¥1,379,941 million in fiscal 2005. This decrease was primarily a result of a decrease in cash and cash equivalents. 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 capital expenditures and investments. The working capital ratio (ratio of current assets to current liabilities) for fiscal 2007 was 2.08 compared to 2.39 for fiscal 2006 and 2.28 for fiscal 2005.

Return on assets (Net income divided by the average of total assets) was 10.8% in fiscal 2007, compared to 10.6% in fiscal 2006 and 10.1% in fiscal 2005.

Return on stockholders' equity (Net income divided by the average of total stockholders' equity) was 16.5% in fiscal 2007 compared with 16.3% in fiscal 2006 and 16.0% in fiscal 2005.

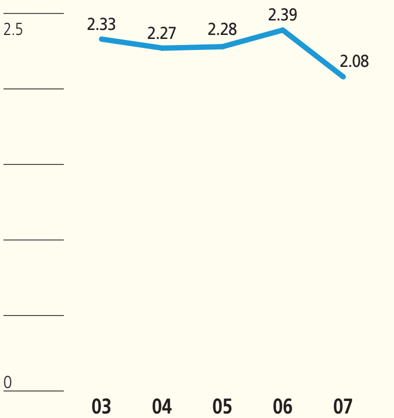
Debt to total assets ratio was 0.6%, 0.7% and 0.8% as of December 31, 2007, 2006 and 2005, respectively. Canon had short-term loans and long-term debt of ¥26,997 million (U.S.$237 million) as of December 31, 2007, ¥31,151 million as of December 31, 2006 and ¥32,141 million as of December 31, 2005.

OFF-BALANCE SHEET ARRANGEMENTS

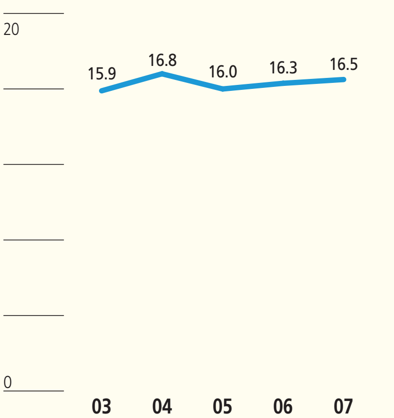
As part of its ongoing business, Canon does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating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

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years in the case of employees with housing loans, and of 1 year to 10 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥27,946 million (U.S.$245 million) at December 31, 2007. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees were insignificant.

Working Capital Ratio



Return on Stockholders' Equity
(%)



CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2007.

		Payments Due By Period			
Millions of yen	**Total**	Less than 1 year	1–3 years	3–5 years	More than 5 years
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**¥ 10,988**	¥ 4,651	¥ 5,055	¥ 1,268	¥ 14
Other long-term debt	**13,121**	10,778	1,443	691	209
Operating lease obligations	**57,401**	16,365	20,019	9,736	11,281
Purchase commitments for:					
Property, plant and equipment	**117,119**	117,119	—	—	—
Parts and raw materials	**91,882**	91,882	—	—	—
Total	**¥290,511**	¥240,795	¥26,517	¥11,695	¥11,504

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 14, Income Taxes in the Notes to Consolidated Financial Statements for further details.

		Payments due by period			
Thousands of U.S.dollars	**Total**	Less than 1 year	1–3 years	3–5 years	More than 5 years
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**$ 96,386**	$ 40,798	$ 44,342	$ 11,123	$ 123
Other long-term debt	**115,096**	94,544	12,658	6,061	1,833
Operating lease obligations	**503,518**	143,553	175,605	85,403	98,957
Purchase commitments for:					
Property, plant and equipment	**1,027,360**	1,027,360	—	—	—
Parts and raw materials	**805,982**	805,982	—	—	—
Total	**$2,548,342**	$2,112,237	$232,605	$102,587	$100,913

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue is recognized and is included in selling, general and administrative expenses. Estimates for accrued product warranty cost are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2007, accrued product warranty costs amounted to ¥20,138 million (U.S.$177 million).

At December 31, 2007, commitments outstanding for the purchase of property, plant and equipment were approximately ¥117,119 million (U.S.$1,027 million), and commitments outstanding for the purchase of parts and raw materials were approximately ¥91,882 million (U.S.$806 million), both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During fiscal 2008, Canon expects to contribute ¥13,699 million (U.S.$120 million) to its Japanese defined benefit pension plans and ¥4,409 million (U.S.$39 million) to its foreign defined benefit pension plans.

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

RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

The fiscal year 2007 is the second year of Phase III (2006-2010) of the Excellent Global Corporation Plan, which has an objective to realize "Sound Growth" toward "Joining the World's Top 100 Companies."

Canon has established the following as key strategies:

- Realize an overwhelming No.1 position worldwide in all current core businesses,
- Expand operations through diversification and
- Identify new business domains and accumulate necessary technological capabilities.

Canon is striving to achieve these strategies as follows:

- Realize an overwhelming No.1 position worldwide in all current core businesses: Product R&D divisions will work together with the corporate R&D headquarters to bolster product competitiveness through development of extremely superior next-generation products.
- Expand operations through diversification: Canon is studying existing technologies to expand business domains. Furthermore, Canon will continue to develop various types of displays, such as Surface-conduction Electron-emitter Display ("SED") and Organic Light-Emitting Diode displays ("OLED"), in order to realize "cross-media imaging"—a sophisticated combination of imaging input and output equipment for data, still images and video that allows users to intuitively process images and information in any context in daily life or industry.
- Identify new business domains and accumulate necessary technological capabilities: Canon established a "Strategic Committee for New Domains." As a result of discussions in that committee, Canon targeted the "medical sector" and "intelligent robot industry" as new business domains, and "safety technology" as a common base technology, and recommended strengthening research and development of related technologies. In addition, Canon is developing and strengthening relationships with universities and other research institutes, such as Stanford University, Kyoto University, Tokyo Institute of Technology and the National Institute of Advanced Industrial Science and Technology, to carry on fundamental research and develop cutting-edge technologies.

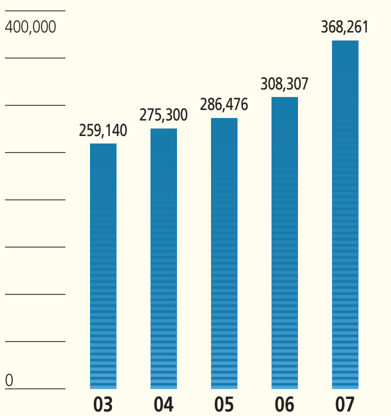
Canon has utilized 3D-CAD systems for some time in boosting R&D efficiency to curtail product development times and costs. Moreover, Canon enhanced and evolved its simulation, measurement, and analysis technologies by introducing leading-edge facilities including one of Japan's highest-performance cluster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

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

Canon's consolidated R&D expenditures were ¥368,261 million (U.S.$3,230 million) in fiscal 2007, ¥308,307 million in fiscal 2006 and ¥286,476 million in fiscal 2005. The ratios of R&D expenditure to the consolidated total net sales for fiscal 2007, 2006 and 2005 were 8.2%, 7.4% and 7.6%, respectively.

Canon believes that new products protected by seminal patents will not easily allow competitors to catch up with it, and will give it an advantage in establishing standards in the market and industry. According to the United States patent annual list, which IFI CLAIMS® Patent Services released, Canon obtained the third greatest number of private sector patents in 2007. This achievement marks Canon's sixteenth consecutive year as one of the top three patent-receiving private-sector organizations.

R&D Expenditure
(Millions of yen)



RECENT DEVELOPMENTS

Canon Marketing Japan Inc. acquired shares of Argo 21 Corporation (listed on the Tokyo stock exchange), which possesses an advanced IT solution business, through a tender offer and it became a consolidated subsidiary as of June 21, 2007. Subsequently, Canon Marketing Japan Inc. acquired all of the remaining issued and outstanding shares of Argo 21 Corporation as of November 1, 2007 through a share exchange. With Argo 21 as a wholly-owned subsidiary, Canon Marketing Japan Inc. aims to strengthen its IT solutions business. In conjunction with this transaction, Argo 21 Corporation has been delisted from the Tokyo stock exchange on October 26, 2007.

Canon acquired shares of Tokki Corporation (listed on the JASDAQ stock exchange), which possesses advanced display technology, through a tender offer and a third party allotment, and made it into a consolidated subsidiary as of December 28, 2007. With Tokki Corporation as a subsidiary, Canon aims to accelerate the development of its display business.

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

As the next step, Canon plans to acquire additional Hitachi Displays' shares and make Hitachi Displays a Canon subsidiary.

MARKET RISK EXPOSURE

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

Equity price risk

Canon holds marketable securities included in current assets as short-term investments, 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 were as follows at December 31, 2007.

Available-for-sale securities	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair Value	Cost	Fair Value
Due within one year	¥ 51	¥ 51	$ 447	$ 447
Due after one year through five years	3,430	3,638	30,088	31,912
Due after five years	3,822	4,726	33,526	41,456
Equity securities	12,666	22,316	111,105	195,755
	¥19,969	¥30,731	$175,166	$269,570

Held-to-maturity securities	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair Value	Cost	Fair Value
Due within one year	¥10,115	¥10,115	$ 88,728	$ 88,728

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, because most of the counterparties are internationally recognized financial institutions 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, 2007. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2008.

Millions of yen	U.S.$	euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	¥361,582	¥294,355	¥41,303	¥697,240
Estimated fair value	(6,253)	(5,132)	(62)	(11,447)
Forwards to buy foreign currencies:				
Contract amounts	¥ 29,826	¥ 2,451	¥14,620	¥ 46,897
Estimated fair value	(53)	9	(38)	(82)

Thousands of U.S. dollars	U.S.$	euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	$3,171,772	$2,582,061	$362,307	$6,116,140
Estimated fair value	(54,851)	(45,018)	(543)	(100,412)
Forwards to buy foreign currencies:				
Contract amounts	$ 261,632	$ 21,500	$128,245	$ 411,377
Estimated fair value	(465)	79	(334)	(720)

Canon's long-term debt consists generally of fixed rate. Accordingly, Canon considers interest rate risk is insignificant. For debt obligations, the table below presents principal cash flows by expected maturity dates and related weighted average interest rates, as of December 31, 2007.

LONG-TERM DEBT (including due within one year)

Millions of yen

	Weighted average interest rates	Total	Expected maturity date 2008	2009	2010	2011	2012	Thereafter	Estimated Fair Value
Japanese yen notes	2.27%	**¥10,000**	¥10,000	¥ —	¥ —	¥ —	¥ —	¥ —	¥10,065
Japanese yen convertible debentures	1.30%	**128**	128	—	—	—	—	—	668
Other long-term debt	1.80%	**13,981**	5,301	4,052	2,446	1,504	455	223	13,981
Total		**¥24,109**	¥15,429	¥4,052	¥2,446	¥1,504	¥455	¥223	¥24,714

Thousands of U.S. dollars

	Weighted average interest rates	Total	Expected maturity date 2008	2009	2010	2011	2012	Thereafter	Estimated Fair Value
Japanese yen notes	2.27%	**$ 87,719**	$ 87,719	$ —	$ —	$ —	$ —	$ —	$ 88,289
Japanese yen convertible debentures	1.30%	**1,123**	1,123	—	—	—	—	—	5,860
Other long-term debt	1.80%	**122,640**	46,500	35,544	21,456	13,193	3,991	1,956	122,640
Total		**$211,482**	$135,342	$35,544	$21,456	$13,193	$3,991	$1,956	$216,789

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings through other income (deductions) in the same period as the hedged items affect earnings. Substantially all amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next 12 months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2007, 2006 and 2005. The amount of net gains or losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was net losses of ¥6,883 million (U.S.$60 million), ¥5,917 million and ¥3,725 million for the years ended December 31, 2007, 2006 and 2005, 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 the contracts are recorded in earnings immediately.

LOOKING FORWARD

Though there is a slight sense of uncertainty regarding the future and global economies are now confronted with factors heightening the risk of economic downturn such as financial market confusion due to the subprime loan issue and the impacts of rising crude oil prices, Canon expects modest economic growth to continue on the whole led by the high economic growth of the BRIC countries. On the other hand, however, it is expected that competition will intensify and business conditions for Canon will become increasingly severe.

In addressing those business and economic conditions, Canon, views the current fiscal year, the third year of Phase III (2006 to 2010) of our "Excellent Global Corporation Plan," as a key period for firmly positioning itself for achieving its 2010 objectives, and will actively work to further strengthen and enhance its management base.

Toward that goal, Canon will focus on strengthening product development capabilities, the source of competitiveness in all of its operations, introduce superior products to those of its competitors, and achieve the real global No.1 market positions in all of its core businesses.

Additionally, Canon will work to lower its cost rate even further by automating production and moving forward with efforts to produce more key parts in-house through measures like advancing the stable adoption of automated assembly equipment, and by undertaking production and procurement innovation activities. Additionally, regarding product quality, which is always the top concern of a manufacturer, Canon will strategically undertake product quality innovation activities to augment its ability to deliver safety, security, and satisfaction to our customers.

To enhance its future-oriented R&D, Canon will strengthen companywide strategic functions related to R&D under an organizational structure starting form during the current fiscal year, and focus on areas like technology development for future product and research on future technologies.

Canon will also accelerate the development of various kinds of displays to promptly establish the display business because the development of new core businesses is essential for realizing sound growth of its business.

Additionally, because compliance is a key requirement for Canon to continue to prosper as a truly excellent global company, Canon will take measures that go beyond those Canon has taken in the past to ensure that all executives and employees thoroughly understand and implement Canon's compliance practices.

Business machines segment

Office imaging products

In the office imaging products segment, it has become more important to provide added value in the form of networking, integration, color printing, and multifunction models. Also, in addition to the stable market for mid-segment office products, Canon expects that the market for higher-end models and low-end multifunction models will expand. The market for color digital devices continued to grow rapidly, and sales of monochrome digital MFDs were stable, reflecting the market trend shifting from single-function to multifunction. Recently, there has been a new, printer-based multifunction printer ("MFP") market created by printer vendors as they seek to enter the copier and MFD market.

To maintain and enhance a competitive edge and to meet more sophisticated customer demands, Canon is strengthening its marketing capabilities by reinforcing its hardware and software product lineups and by improving functionality. In 2007, Canon strengthened the product lineups of its color digital devices as well as its monochrome machines and maintained its market share by executing business strategies in line with current market trends.

Computer peripheral products

In the Inkjet printer market, Canon expects a continuation of declines in market prices, slowdown in market growth, and a shift from single-function printers ("SFP") to MFPs. To manage these trends, Canon launched new lineups of SFPs and MFPs from flagship to entry models in order to expand its printer sales.

Canon's laser beam printer business holds a strong position in the market. In the monochrome laser beam printer market, Canon expects that the transition to a low price segment will expand sales in the micro-business/home office market and in the emerging markets. In the color laser beam printer market, Canon expects continued strong growth in demand. In general, competition will become more intense as competitors implement aggressive price strategies in order to establish themselves as market leaders. Canon seeks to remain competitive by developing technologies that can be deployed in a timely fashion to produce innovative products in all segments. Canon is also working to lower costs by automating production of consumables and to secure procurement of essential parts through internal sourcing.

Although Canon expects that the size of the scanner market will continue to contract, the "Cano Scan 8800F" which is based on CCD technology and the "Canon Scan LiDE 90" incorporating Contact Image Sensor technology were both introduced in fiscal 2007 in order to increase Canon's share of this market.

Business information products

As for document scanners, adoptions of internal information management systems by corporations, and other factors are driving a worldwide movement to digitize documents and the market for low-priced, compact scanners continued to expand. Under these circumstances, as for the "DR Scanner Series," Canon introduced the compact, affordable "image FORMULA DR-2510C" in Japan and the "ScanFront 220P," which is capable of distributing scanned images over a network, in Japan and overseas, and worked to expand sales of these products. As a result, sales have steadily increased in fiscal 2007.

With regard to servers and personal computers, demand from corporate clients in the Japanese market held steady in fiscal 2007, but a decline in sales was caused by Canon's change in marketing strategy from selling single products to a solutions business involving combinations of various products. This trend is expected to continue in fiscal 2008.

Cameras segment

The entire digital camera market continues to expand. While the growth rate has slowed in Japan and the United States, emerging markets, especially China and Eastern Europe, have experienced strong growth. In addition, the emergence of digital imaging systems has contributed to this growth as well, such as PC-free direct printing systems, by expanding the digital imaging functionality through network connectivity, along with the improvement of the user-friendly image processing interfaces and software.

The digital camera industry is seeing growth on various fronts. As with most other digital consumer electronics, the digital camera market is now confronted with a fierce price war and intensified technological competition in terms of picture quality and functions. Profit margins have been shrinking for the overall industry, but Canon has been able to maintain higher margins through reforms of its production and procurement systems.

Canon expects the market for compact digital cameras to expand in the intermediate term. However, profit margins for the overall industry are moving lower as prices fall and competition increases. Therefore, Canon seeks to continue cutting production costs while expanding sales volumes.

There are signs of rapid growth in the market for compact photo printers, which present a new business opportunity. By creating a strong product line, over the mid-term Canon believes that it will be able to take a significant role in this market and turn the compact photo printer business into a new earnings source for Canon.

Canon believes that it played a major role in the continued expansion of the digital SLR market in fiscal 2007. This market is expected to continue growing for the time being. Canon expects the interchangeable lens market to grow as a result of the rapid market penetration of digital SLR cameras. Canon aims to expand its sales and market share by introducing the most suitable products for the digital SLR camera users, including products with Image Stabilizer capability.

For video camcorders, the market has recently switched entirely over to digital. Against this background, two trends have been conspicuous in the market. First is the diversity of recording media for video cameras, including DVD, HDD, SD cards and other new forms of media. Second is the trend towards higher picture quality using high-resolution recording methods such as HDV and AVCHD. Canon believes that these two trends will lead to higher picture quality of video camcorders with longer battery life, and will likely contribute to further growth for the overall digital video market.

Canon will seek continued sales growth with a stronger product line while investing in research and development in order to better respond to new market trends.

Canon expects that the market for business-use liquid crystal projectors will continue to grow by about 10% per year on a unit basis, while market prices will continue to decline, resulting in almost no sales growth. Especially in the low-end segment, sales are expected to decline, despite an increase in units sold. On the other side, unit prices of high resolution and high luminosity models are relatively stable and unit sales and sales in value terms are both expected to grow.

In these market conditions, Canon believes that its high-resolution and high luminosity projectors have been very well received by professionals such as system integrators. Canon plans to continue to develop distinctive, value-added products by further improving picture quality, resolution, luminosity and system expandability with Canon's proprietary AISYS technology and LCOS.

Optical and other products segment

In the semiconductor-production equipment industry, equipment manufacturers must provide high quality products corresponding to rapid technology progress. Canon will continue to focus on developing new products which adopt leading-edge technologies, such as immersion exposure technology and ultra precision processing and measurement technology.

In the LCD production mask aligner market, Canon will seek to strengthen its technical capabilities to meet the recent trend toward larger glass-substrates due to the increasing demand for larger LCD televisions.

In addition, Canon will continue to make distinctive products enabling high resolution and high productivity.

In the TV lens market, demand for HDTV, which has grown in the United States and Japan, is now growing in Europe as well. In particular, there has been increased demand for lenses used for broadcasting sporting events and for producing dramas and documentaries. Canon also expects to see new worldwide replacement demand thanks to greater progress in digitalization. At the same time, there have been signs of expanded HDTV applications by the media. While Canon already has a major market share worldwide for this class of lenses, it intends to continue to strengthen its position in this market.

The large format printer market unit sales and sales in value terms have experienced stable growth of 10% every year. Canon's sales growth in this market is much higher than average growth in the market and our market share has expanded every year. Unit price in the market has been stable in recent years. Canon has been able to incur lower costs of production and improve inventory turnover by expanding its market share and achieving economics of scale that improve its profitability.

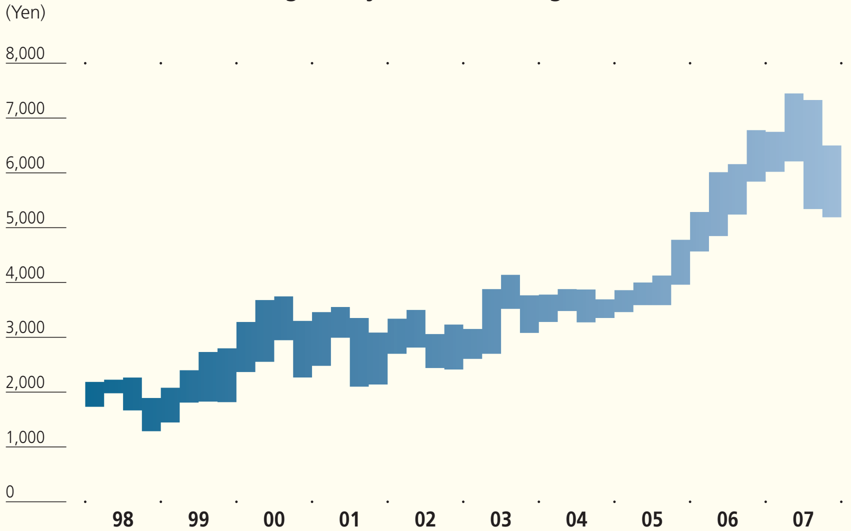
Forward looking statements

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

TEN-YEAR FINANCIAL SUMMARY

	Millions of yen (except per share amounts) 2007	2006	2005	2004
Net sales:				
Domestic	¥ 947,587	¥ 932,290	¥ 856,205	¥ 849,734
Overseas	3,533,759	3,224,469	2,897,986	2,618,119
Total	4,481,346	4,156,759	3,754,191	3,467,853
Percentage of previous year	107.8%	110.7%	108.3%	108.4%
Net income	488,332	455,325	384,096	343,344
Percentage of sales	10.9%	11.0%	10.2%	9.9%
Advertising	132,429	116,809	106,250	111,770
Research and development	368,261	308,307	286,476	275,300
Depreciation of property, plant and equipment	309,815	235,804	205,727	174,397
Capital expenditures	428,549	379,657	383,784	318,730
Long-term debt, excluding current installments	¥ 8,680	¥ 15,789	¥ 27,082	¥ 28,651
Stockholders' equity	2,922,336	2,986,606	2,604,682	2,209,896
Total assets	4,512,625	4,521,915	4,043,553	3,587,021
Per share date:				
Income before cumulative effect of change in accounting principle:				
Basic	¥ 377.59	¥ 341.95	¥ 288.63	¥ 258.53
Diluted	377.53	341.84	288.36	257.85
Net income:				
Basic	377.59	341.95	288.63	258.53
Diluted	377.53	341.84	288.36	257.85
Cash dividends declared	110.00	83.33	66.67	43.33
Stock price:				
High	7,450	6,780	4,780	3,880
Low	5,190	4,567	3,460	3,273
Average number of common shares in thousands	1,293,296	1,331,542	1,330,761	1,328,048
Number of employees	131,352	118,499	115,583	108,257

Common Stock Price Range (Tokyo Stock Exchange)



2003	2002	2001	2000	1999	1998	Thousands of U.S. dollars (except per share amounts) **2007**
¥ 801,400	¥ 732,551	¥ 827,288	¥ 779,366	¥ 718,513	¥ 725,063	**$ 8,312,167**
2,396,672	2,207,577	2,080,285	1,917,054	1,812,383	2,011,021	**30,997,886**
3,198,072	2,940,128	2,907,573	2,696,420	2,530,896	2,736,084	**39,310,053**
108.8%	101.1%	107.8%	106.5%	92.5%	102.5%	**107.8%**
275,730	190,737	167,561	134,088	70,234	109,569	**4,283,614**
8.6%	6.5%	5.8%	5.0%	2.8%	4.0%	**10.9%**
100,278	71,725	66,837	67,840	67,544	76,911	**1,161,658**
259,140	233,669	218,616	194,552	177,922	176,967	**3,230,360**
168,636	158,469	147,286	144,043	155,682	159,888	**2,717,676**
210,038	198,702	207,674	170,986	200,386	221,401	**3,759,202**
¥ 59,260	¥ 81,349	¥ 95,526	¥ 142,925	¥ 165,277	¥ 180,320	**$ 76,140**
1,865,545	1,591,950	1,458,476	1,298,914	1,202,003	1,155,520	**25,634,526**
3,182,148	2,942,706	2,844,756	2,832,125	2,587,532	2,728,329	**39,584,430**
¥ 209.21	¥ 145.04	¥ 124.71	¥ 102.44	¥ 53.77	¥ 84.07	**$ 3.31**
207.17	143.20	123.03	101.01	53.00	82.62	**3.31**
209.21	145.04	127.53	102.44	53.77	84.07	**3.31**
207.17	143.20	125.80	101.01	53.00	82.62	**3.31**
33.33	20.00	16.67	14.00	11.33	11.33	**0.96**
4,140	3,500	3,553	3,747	2,800	2,267	**65.35**
2,607	2,413	2,100	2,267	1,447	1,287	**45.53**
1,317,974	1,315,074	1,313,940	1,308,909	1,306,049	1,303,374	
102,567	97,802	93,620	86,673	81,009	79,799	

Note: U.S. dollar amounts are translated from yen at the rate of U.S.$1 = ¥114, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 28, 2007.

CONSOLIDATED BALANCE SHEETS

CANON INC. AND SUBSIDIARIES

December 31, 2007 and 2006

ASSETS	Millions of yen 2007	Millions of yen 2006	Thousands of U.S. dollars (Note 2) 2007
Current assets:			
Cash and cash equivalents	¥ 944,463	¥1,155,626	$ 8,284,763
Time deposits	10,333	41,953	90,640
Marketable securities (Notes 4 and 11)	10,166	10,445	89,175
Trade receivables, net (Note 5)	794,240	761,947	6,967,018
Inventories (Note 6)	563,474	539,057	4,942,754
Prepaid expenses and other current assets (Notes 8 and 14)	286,111	273,321	2,509,746
Total current assets	2,608,787	2,782,349	22,884,096
Noncurrent receivables (Note 20)	15,239	14,335	133,675
Investments (Note 4)	90,086	110,418	790,228
Property, plant and equipment, net (Notes 7, 8 and 11)	1,364,702	1,266,425	11,971,070
Other assets (Notes 8, 9, 10, 13 and 14)	433,811	348,388	3,805,361
Total assets	¥4,512,625	¥4,521,915	$ 39,584,430

LIABILITIES AND STOCKHOLDERS' EQUITY	Millions of yen 2007	Millions of yen 2006	Thousands of U.S. dollars (Note 2) 2007
Current liabilities:			
Short-term loans and current portion of long-term debt (Note 11)	¥ 18,317	¥ 15,362	$ 160,675
Trade payables (Note 12)	514,226	493,058	4,510,754
Accrued income taxes (Note 14)	150,726	133,745	1,322,158
Accrued expenses (Note 20)	357,525	303,353	3,136,184
Other current liabilities (Notes 7 and 14)	215,911	217,789	1,893,957
Total current liabilities	1,256,705	1,163,307	11,023,728
Long-term debt, excluding current installments (Note 11)	8,680	15,789	76,140
Accrued pension and severance cost (Note 13)	44,710	83,876	392,193
Other noncurrent liabilities (Note 14)	57,324	55,536	502,843
Total liabilities	1,367,419	1,318,508	11,994,904
Minority interests	222,870	216,801	1,955,000
Commitments and contingent liabilities (Note 20)			
Stockholders' equity:			
Common stock			
Authorized 3,000,000,000 shares; issued 1,333,636,210 shares in 2007 and 1,333,445,830 shares in 2006 (Note 15)	174,698	174,603	1,532,439
Additional paid-in capital (Note 15)	402,991	403,510	3,535,009
Legal reserve (Note 16)	46,017	43,600	403,658
Retained earnings (Note 16)	2,720,146	2,368,047	23,860,930
Accumulated other comprehensive income (loss) (Note 17)	34,670	2,718	304,123
Treasury stock, at cost 72,588,428 shares in 2007 and 1,794,390 shares in 2006	(456,186)	(5,872)	(4,001,633)
Total stockholders' equity	2,922,336	2,986,606	25,634,526
Total liabilities and stockholders' equity	¥4,512,625	¥4,521,915	$ 39,584,430

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2007	2006	2005	**2007**
Net sales	**¥4,481,346**	¥4,156,759	¥3,754,191	**$39,310,053**
Cost of sales (Notes 7, 10, 13 and 20)	**2,234,365**	2,096,279	1,935,148	**19,599,693**
Gross profit	**2,246,981**	2,060,480	1,819,043	**19,710,360**
Operating expenses (Notes 1, 7, 10, 13 and 20):				
Selling, general and administrative expenses	**1,122,047**	1,045,140	949,524	**9,842,518**
Research and development expenses	**368,261**	308,307	286,476	**3,230,360**
	1,490,308	1,353,447	1,236,000	**13,072,878**
Operating profit	**756,673**	707,033	583,043	**6,637,482**
Other income (deductions):				
Interest and dividend income	**32,819**	27,153	14,252	**287,886**
Interest expense	**(1,471)**	(2,190)	(1,741)	**(12,904)**
Other, net (Notes 1, 4 and 19)	**(19,633)**	(12,853)	16,450	**(172,218)**
	11,715	12,110	28,961	**102,764**
Income before income taxes and minority interests	**768,388**	719,143	612,004	**6,740,246**
Income taxes (Note 14)	**264,258**	248,233	212,785	**2,318,053**
Income before minority interests	**504,130**	470,910	399,219	**4,422,193**
Minority interests	**15,798**	15,585	15,123	**138,579**
Net income	**¥ 488,332**	¥ 455,325	¥ 384,096	**$ 4,283,614**
	Yen			U.S. dollars (Note 2)
Net income per share (Note 18):				
Basic	**¥ 377.59**	¥ 341.95	¥ 288.63	**$ 3.31**
Diluted	**377.53**	341.84	288.36	**3.31**
Cash dividends per share	**110.00**	83.33	66.67	**0.96**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
CANON INC. AND SUBSIDIARIES

	Millions of yen						
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total stockholders' equity
Balance at December 31, 2004	¥173,864	¥401,773	¥41,200	¥1,699,634	¥(101,312)	¥ (5,263)	¥2,209,896
Conversion of convertible debt and other	574	574					1,148
Capital transaction by consolidated subsidiaries and affiliated companies		899					899
Cash dividends				(64,310)			(64,310)
Transfer to legal reserve			1,131	(1,131)			—
Comprehensive income:							
Net income				384,096			384,096
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					53,979		53,979
Net unrealized gains and losses on securities					(1,397)		(1,397)
Net gains and losses on derivative instruments					(481)		(481)
Minimum pension liability adjustments					20,999		20,999
Total comprehensive income							457,196
Repurchase of treasury stock, net						(147)	(147)
Balance at December 31, 2005	174,438	403,246	42,331	2,018,289	(28,212)	(5,410)	2,604,682
Conversion of convertible debt and other	165	264					429
Cash dividends				(104,298)			(104,298)
Transfer to legal reserve			1,269	(1,269)			—
Comprehensive income:							
Net income				455,325			455,325
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					48,630		48,630
Net unrealized gains and losses on securities					1,992		1,992
Net gains and losses on derivative instruments					(489)		(489)
Minimum pension liability adjustments					(3,575)		(3,575)
Total comprehensive income							501,883
Adjustment to initially apply SFAS 158, net of tax (Note 13)					(15,628)		(15,628)
Repurchase of treasury stock, net						(462)	(462)
Balance at December 31, 2006	174,603	403,510	43,600	2,368,047	2,718	(5,872)	2,986,606
Cumulative effect of a change in accounting principle-adoption of EITF06-2, net of tax (Note 1)				**(2,204)**			**(2,204)**
Conversion of convertible debt and other	**95**	**(522)**					**(427)**
Cash dividends				**(131,612)**			**(131,612)**
Transfer to legal reserve			**2,417**	**(2,417)**			**—**
Comprehensive income:							
Net income				**488,332**			**488,332**
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					**(62)**		**(62)**
Net unrealized gains and losses on securities					**(1,778)**		**(1,778)**
Net gains and losses on derivative instruments					**814**		**814**
Pension liability adjustments					**32,978**		**32,978**
Total comprehensive income							**520,284**
Repurchase of treasury stock, net		**3**				**(450,314)**	**(450,311)**
Balance at December 31, 2007	**¥174,698**	**¥402,991**	**¥46,017**	**¥2,720,146**	**¥ 34,670**	**¥(456,186)**	**¥2,922,336**
	Thousands of U.S. dollars (Note 2)						
Balance at December 31, 2006	$1,531,606	$3,539,561	$382,456	$20,772,342	$ 23,842	$ (51,510)	$26,198,297
Cumulative effect of a change in accounting principle-adoption of EITF06-2, net of tax (Note 1)				**(19,333)**			**(19,333)**
Conversion of convertible debt and other	**833**	**(4,579)**					**(3,746)**
Cash dividends				**(1,154,491)**			**(1,154,491)**
Transfer to legal reserve			**21,202**	**(21,202)**			**—**
Comprehensive income:							
Net income				**4,283,614**			**4,283,614**
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					**(544)**		**(544)**
Net unrealized gains and losses on securities					**(15,596)**		**(15,596)**
Net gains and losses on derivative instruments					**7,140**		**7,140**
Pension liability adjustments					**289,281**		**289,281**
Total comprehensive income							**4,563,895**
Repurchase of treasury stock, net		**27**				**(3,950,123)**	**(3,950,096)**
Balance at December 31, 2007	**$1,532,439**	**$3,535,009**	**$403,658**	**$23,860,930**	**$ 304,123**	**$(4,001,633)**	**$25,634,526**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2007	2006	2005	**2007**
Cash flows from operating activities:				
Net income	**¥ 488,332**	¥ 455,325	¥ 384,096	**$ 4,283,614**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	**341,694**	262,294	225,941	**2,997,316**
Loss on disposal of property, plant and equipment	**9,985**	16,182	13,784	**87,588**
Deferred income taxes	**(35,021)**	(6,945)	(766)	**(307,202)**
Increase in trade receivables	**(10,722)**	(40,969)	(48,391)	**(94,053)**
(Increase) decrease in inventories	**(26,643)**	(5,542)	27,558	**(233,711)**
Increase (decrease) in trade payables	**21,136**	(2,313)	16,018	**185,404**
Increase in accrued income taxes	**14,988**	22,657	1,998	**131,474**
Increase in accrued expenses	**43,035**	36,165	31,241	**377,500**
Decrease in accrued pension and severance cost	**(15,387)**	(20,309)	(16,221)	**(134,974)**
Other, net	**7,872**	(21,304)	(29,580)	**69,053**
Net cash provided by operating activities	**839,269**	695,241	605,678	**7,362,009**
Cash flows from investing activities:				
Purchases of fixed assets	**(474,285)**	(424,862)	(395,055)	**(4,160,395)**
Proceeds from sale of fixed assets	**9,635**	12,507	14,827	**84,518**
Purchases of available-for-sale securities	**(2,281)**	(7,768)	(5,680)	**(20,009)**
Proceeds from sale and maturity of available-for-sale securities	**8,614**	4,047	12,337	**75,561**
Proceeds from maturity of held-to-maturity securities	**10,000**	—	—	**87,719**
(Increase) decrease in time deposits	**31,681**	(35,863)	(6,090)	**277,904**
Acquisitions of subsidiaries, net of cash acquired	**(15,675)**	(2,485)	(17,657)	**(137,500)**
Purchases of other investments	**(2,432)**	(8,911)	(19,531)	**(21,333)**
Other, net	**2,258**	2,530	15,708	**19,807**
Net cash used in investing activities	**(432,485)**	(460,805)	(401,141)	**(3,793,728)**
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	**2,635**	1,053	1,716	**23,114**
Repayments of long-term debt	**(13,046)**	(5,861)	(15,187)	**(114,439)**
Decrease in short-term loans	**(358)**	(828)	(12,011)	**(3,140)**
Dividends paid	**(131,612)**	(104,298)	(64,310)	**(1,154,491)**
Repurchases of treasury stock, net	**(450,311)**	(462)	(147)	**(3,950,096)**
Other, net	**(11,691)**	2,909	(4,000)	**(102,553)**
Net cash used in financing activities	**(604,383)**	(107,487)	(93,939)	**(5,301,605)**
Effect of exchange rate changes on cash and cash equivalents	**(13,564)**	23,724	6,581	**(118,983)**
Net increase (decrease) in cash and cash equivalents	**(211,163)**	150,673	117,179	**(1,852,307)**
Cash and cash equivalents at beginning of year	**1,155,626**	1,004,953	887,774	**10,137,070**
Cash and cash equivalents at end of year	**¥ 944,463**	¥1,155,626	¥1,004,953	**$ 8,284,763**
Supplemental disclosure for cash flow information (Note 22):				
Cash paid during the year for:				
Interest	**¥ 1,476**	¥ 2,146	¥ 1,919	**$ 12,947**
Income taxes	**273,888**	244,236	211,540	**2,402,526**

See accompanying notes to consolidated financial statements.

1. Basis of Presentation and Significant Accounting Policies

(a) Description of Business

Canon Inc. (the "Company") and subsidiaries (collectively "Canon") is one of the world's leading manufacturers in such fields as office imaging products, computer peripherals, business information products, cameras, and optical related products. Office imaging products consist mainly of network multifunction devices and copying machines. Computer peripherals consist mainly of laser beam and inkjet printers. Business information products consist mainly of computer information systems, document scanners and calculators. Cameras consist mainly of digital single lens reflex ("SLR") cameras, digital compact cameras, interchangeable lenses and digital video camcorders. Optical and other products include semiconductor production equipment, mirror projection mask aligners for liquid crystal displays ("LCDs") panels, broadcasting equipment, medical equipment and large format printers. Canon's consolidated net sales for the years ended December 31, 2007, 2006 and 2005 were distributed as follows: office imaging products 29%, 28% and 31%, computer peripherals 34%, 34% and 33%, business information products 2%, 3% and 3%, cameras 26%, 25% and 23%, and optical and other products 9%, 10% and 10%, respectively.

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 geographical area. Approximately 77%, 75% and 74% of consolidated net sales for the years ended December 31, 2007, 2006 and 2005 were generated outside Japan, with 30%, 31% and 30% in the Americas, 33%, 31% and 32% in Europe, and 14%, 13% and 12% in other areas, respectively.

Canon sells laser beam printers on an OEM basis to Hewlett-Packard Company; such sales constituted approximately 22%, 22% and 21% of consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively.

Canon's manufacturing operations are conducted primarily at 24 plants in Japan and 17 overseas plants which are located in countries or regions such as the United States, Germany, France, Taiwan, China, Malaysia, Thailand and Vietnam.

(b) Basis of Presentation

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

Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with U.S. generally accepted accounting principles. 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 under Financial Accounting Standards Board ("FASB") Interpretation No. 46 (revised December 2003) ("FIN 46R"), "Consolidation of Variable Interest Entities." All significant intercompany balances and transactions have been eliminated.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount 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, environmental liabilities, valuation of deferred tax assets, uncertain tax positions and employee retirement and severance benefit plans. Actual results could differ materially from those estimates.

(e) Cash Equivalents

All highly liquid investments acquired with an original maturity of three months or less are considered to be cash equivalents.

(f) Time Deposits

Time deposits with original maturities of more than three months are included in the consolidated balance sheets under the caption of time deposits.

(g) 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). Foreign currency exchange losses, net were ¥31,943 million ($280,202 thousand), ¥25,804 million and ¥3,710 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(h) Marketable Securities and 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. Unrealized holding gains and losses, net of the related tax effect, are reported as a separate component of other comprehensive income (loss) until realized. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts.

Available-for-sale and held-to-maturity securities are regularly reviewed for other-than-temporary declines in carrying value 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. When such a decline exists, Canon recognizes an impairment loss to the extent by which the cost basis of the investment exceeds the fair value of the investment. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate.

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

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

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

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

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

(k) Impairment of Long-Lived Assets
Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to 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.

(l) Property, Plant and Equipment and Accounting Change
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.

Effective April 1, 2007, the Company and its domestic subsidiaries elected to change the declining-balance method of depreciating machinery and equipment from the fixed-percentage-on-declining base application to the 250% declining-balance application. Estimated residual values were also reduced in conjunction with this change. The Company and its domestic subsidiaries believe that the 250% declining-balance application is preferable because it provides a better matching of the allocation of cost of machinery and equipment with associated revenues in light of increasingly short product life cycles.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3," this change in depreciation methods represents a change in accounting estimate effected by a change in accounting principle. Accordingly, the affects of the change are accounted for prospectively beginning with the period of change and prior period results have not been restated. The change in depreciation methods caused an increase in depreciation expense by ¥63,773 million ($559,412 thousand) for the year ended December 31, 2007. Net income, basic net income per share and diluted net income per share decreased by ¥32,321 million ($283,518 thousand), ¥24.99 ($0.22) and ¥24.99 ($0.22), respectively, for the year ended December 31, 2007.

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

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

(m) 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. Intangible assets with finite useful lives, consisting primarily of software and license fees, are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Certain costs incurred in connection with developing or obtaining internal use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(n) 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.

(o) Income Taxes

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

Canon recognizes the financial statement effects of tax positions when they are 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 percent 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.

(p) Issuance of Stock by Subsidiaries and Equity Investees

The change in the Company's proportionate share of a subsidiary's or equity investee's equity resulting from the issuance of stock by the subsidiary or equity investee is accounted for as an equity transaction.

(q) Net Income per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during each year. Diluted net income per share includes the effect from potential issuance of common stock based on the assumption that all convertible debentures were converted into common stock.

(r) Revenue Recognition

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

Revenue from sales of consumer products including office imaging products, computer peripherals, business information products and cameras is recognized upon shipment or delivery, depending upon when title and risk of loss transfer to the customer.

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

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

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

For all other arrangements with multiple elements, Canon allocates revenue to each element based on its relative fair value if such element meets the criteria for treatment as a separate unit of accounting as prescribed in the Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." Otherwise, revenue is deferred until the undelivered elements are fulfilled and accounted for as a single unit of accounting.

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

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

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

(s) Research and Development Costs
Research and development costs are expensed as incurred.

(t) Advertising Costs
Advertising costs are expensed as incurred. Advertising expenses were ¥132,429 million ($1,161,658 thousand), ¥116,809 million and ¥106,250 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(u) Shipping and Handling Costs
Shipping and handling costs totaled ¥63,708 million ($558,842 thousand), ¥62,626 million and ¥50,052 million for the years ended December 31, 2007, 2006 and 2005, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(v) 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. On the date the derivative contract is entered into, Canon designates the derivative as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge), or 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 fair values or 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 fair-value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in earnings. 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 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. Canon records these derivative financial instruments in the consolidated balance sheets at fair value. The changes in fair values are immediately recorded in earnings.

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

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

(x) New Accounting Standards
In June 2006, the FASB ratified the EITF consensus on EITF Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43" ("EITF 06-2"). EITF 06-2 provides guidance for an accrual of compensated absences that require a minimum service period but have no increase in the benefit even with additional years of service. EITF 06-2 is effective for fiscal years beginning after December 15, 2006, and was adopted by Canon in the first quarter beginning January 1, 2007 through a cumulative-effect adjustment which increased accrued expenses by ¥4,402 million ($38,614 thousand) and decreased retained earnings by ¥2,204 million ($19,333 thousand).

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN48"). FIN48 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN48 is effective for fiscal years beginning after December 15, 2006, and was adopted by Canon in the first quarter beginning January 1, 2007. See Note 14 for further discussion of the effect of adopting FIN 48 on Canon's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS157"). SFAS157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by Canon in the first quarter beginning January 1, 2008. In February 2008, the FASB issued Staff Positions No. FAS157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" and No. FAS157-2, "Effective Date of FASB Statement No. 157," which partially delay the effective date of SFAS 157 for one year for certain nonfinancial assets and liabilities and remove certain leasing transactions from its scope. The adoption of SFAS157 will not have a material impact on Canon's consolidated results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" ("SFAS

159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by Canon in the first quarter beginning January 1, 2008. The adoption of SFAS 159 will not have a material impact on Canon's consolidated results of operations and financial condition.

In June 2007, the FASB ratified the EITF consensus on EITF Issued No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and is required to be adopted by Canon in the first quarter beginning January 1, 2008. The adoption of EITF 07-3 will not have a material impact on Canon's consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations " ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and is required to be adopted by Canon in the first quarter beginning January 1, 2009. Canon is currently evaluating the potential effect, if any, that the adoption of SFAS 141R will have on Canon's consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statement, an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008 and is required to be adopted by Canon in the first quarter beginning January 1, 2009. Canon is currently evaluating the effect that the adoption of SFAS 160 will have on its consolidated results of operations and financial condition.

(y) Reclassification

Time deposits with original maturities of more than three months, which were previously included in prepaid expenses and other current assets, have been reclassified to time deposits in the consolidated balance sheets to conform to the current year presentation.

2. Basis of Financial Statement Translation

The consolidated financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥114=U.S.$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on December 28, 2007. This translation should not be construed as a representation that the amounts shown could be converted into United States dollars at such rate.

3. Foreign Operations

Amounts included in the consolidated financial statements relating to subsidiaries operating in foreign countries are summarized as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	**2007**
December 31:				
Total assets	**¥2,077,268**	¥1,995,927	¥1,751,011	**$18,221,649**
Net assets	**1,024,150**	907,845	767,711	**8,983,772**
Years ended December 31:				
Net sales	**¥3,433,036**	¥3,119,102	¥2,774,443	**$30,114,351**
Net income	**136,560**	114,916	81,916	**1,197,895**

4. Marketable Securities and Investments

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities and held-to-maturity securities by major security type at December 31, 2007 and 2006 were as follows:

December 31 Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2007: Current:				
Available-for-sale:				
Bank debt securities	**¥ 51**	**¥ —**	**¥ —**	**¥ 51**
Held-to-maturity:				
Corporate debt securities	**10,115**	**—**	**—**	**10,115**
	¥10,166	**¥ —**	**¥ —**	**¥10,166**
Noncurrent:				
Available-for-sale:				
Government bonds	**¥ 496**	**¥ —**	**¥ 25**	**¥ 471**
Corporate debt securities	**3,183**	**31**	**49**	**3,165**
Fund trusts	**3,573**	**1,158**	**3**	**4,728**
Equity securities	**12,666**	**10,233**	**583**	**22,316**
	¥19,918	**¥11,422**	**¥660**	**¥30,680**

Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2006: Current:				
Available-for-sale:				
Government bonds	¥ 224	¥ —	¥ —	¥ 224
Bank debt securities	71	—	1	70
	295	—	1	294
Held-to-maturity:				
Corporate debt securities	10,151	—	—	10,151
	¥10,446	¥ —	¥ 1	¥10,445
Noncurrent:				
Available-for-sale:				
Government bonds	¥ 335	¥ —	¥ 15	¥ 320
Corporate debt securities	4,090	35	1	4,124
Fund trusts	4,072	1,536	1	5,607
Equity securities	12,648	17,479	275	29,852
	21,145	19,050	292	39,903
Held-to-maturity:				
Corporate debt securities	10,311	—	—	10,311
	¥31,456	¥19,050	¥292	¥50,214

Thousands of U.S. dollars	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2007: Current:				
Available-for-sale:				
Bank debt securities	$ 447	$ —	$ —	$ 447
Held-to-maturity:				
Corporate debt securities	88,728	—	—	88,728
	$ 89,175	$ —	$ —	$ 89,175
Noncurrent:				
Available-for-sale:				
Government bonds	$ 4,351	$ —	$ 220	$ 4,131
Corporate debt securities	27,921	272	430	27,763
Fund trusts	31,342	10,158	26	41,474
Equity securities	111,105	89,763	5,113	195,755
	$174,719	$100,193	$5,789	$269,123

Maturities of debt securities and fund trusts classified as available-for-sale and held-to-maturity were as follows at December 31, 2007:

Available-for-sale securities

	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	¥ 51	¥ 51	$ 447	$ 447
Due after one year through five years	3,430	3,638	30,088	31,912
Due after five years	3,822	4,726	33,526	41,456
	¥7,303	¥8,415	$64,061	$73,815

Held-to-maturity securities

	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	¥10,115	¥10,115	$88,728	$88,728

The gross realized gains for the year ended December 31, 2007, 2006 and 2005 were ¥1,512 million ($13,263 thousand), ¥674 million and ¥11,049 million, respectively. The gross realized losses for the years ended December 31, 2007, 2006 and 2005 were not significant.

At December 31, 2007, substantially all of the available-for-sale and held-to-maturity securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥14,017 million ($122,956 thousand) and ¥18,462 million at December 31, 2007 and 2006, respectively. Investments with an aggregate cost of ¥12,929 million ($113,412 thousand) were not evaluated for impairment because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥42,817 million ($375,588 thousand) and ¥40,143 million at December 31, 2007 and 2006, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), are earnings of ¥5,634 million ($49,421 thousand), ¥4,237 million and ¥1,646 million for the years ended December 31, 2007, 2006 and 2005, respectively.

5. Trade Receivables

Trade receivables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Notes	¥ 23,632	¥ 24,241	$ 207,298
Accounts	785,155	751,555	6,887,325
	808,787	775,796	7,094,623
Less allowance for doubtful receivables	(14,547)	(13,849)	(127,605)
	¥794,240	¥761,947	$6,967,018

6. Inventories

Inventories are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Finished goods	¥366,845	¥359,471	$3,217,939
Work in process	175,704	160,231	1,541,263
Raw materials	20,925	19,355	183,552
	¥563,474	¥539,057	$4,942,754

7. Property, Plant and Equipment

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

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Land	¥ 249,959	¥ 231,026	$ 2,192,623
Buildings	1,198,519	1,077,585	10,513,324
Machinery and equipment	1,406,849	1,261,176	12,340,781
Construction in progress	103,749	79,582	910,079
	2,959,076	2,649,369	25,956,807
Less accumulated depreciation	(1,594,374)	(1,382,944)	(13,985,737)
	¥ 1,364,702	¥ 1,266,425	$ 11,971,070

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was ¥309,815 million ($2,717,676 thousand), ¥235,804 million and ¥205,727 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥120,823 million ($1,059,851 thousand) and ¥122,081 million at December 31, 2007 and 2006, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets.

8. Finance Receivables and Operating Leases

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

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Total minimum lease payments receivable	**¥229,229**	¥216,697	**$2,010,781**
Unguaranteed residual values	**17,036**	14,377	**149,439**
Executory costs	**(2,960)**	(2,923)	**(25,965)**
Unearned income	**(27,756)**	(24,930)	**(243,474)**
	215,549	203,221	**1,890,781**
Less allowance for doubtful receivables	**(8,590)**	(7,871)	**(75,351)**
	206,959	195,350	**1,815,430**
Less current portion	**(72,776)**	(72,808)	**(638,386)**
	¥134,183	¥122,542	**$1,177,044**

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2007 and 2006 was ¥63,190 million ($554,298 thousand) and ¥62,357 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2007 and 2006 was ¥48,818 million ($428,228 thousand) and ¥46,092 million, respectively.

The following is a schedule by year of the future minimum lease payments to be received under financing leases and non-cancelable operating leases at December 31, 2007.

Year ending December 31:	Millions of yen		Thousands of U.S. dollars	
	Financing leases	Operating leases	Financing leases	Operating leases
2008	¥ 88,947	¥ 8,175	$ 780,237	$ 71,711
2009	66,846	4,192	586,368	36,772
2010	43,217	2,427	379,096	21,289
2011	20,918	1,250	183,491	10,965
2012	7,373	416	64,675	3,649
Thereafter	1,928	4	16,914	35
	¥229,229	¥16,464	$2,010,781	$144,421

9. Acquisitions

In 2007, the Company and one of its subsidiaries acquired two companies for a total cost of ¥26,387 million ($231,465 thousand). One company, which was acquired with cash, is engaged in developing, manufacturing, selling and providing services for equipment used in the manufacture of organic EL display panels and thin-film solar cells. The other company, which was acquired with cash and share exchange by the subsidiary of the Company, is engaged in providing architecture, management and maintenance services for information systems. In connection with those transactions, Canon recognized goodwill of ¥10,086 million ($88,474 thousand) and intangible assets of ¥2,915 million ($25,570 thousand), which were classified as other assets in the accompanying consolidated balance sheets. Intangible assets consist primarily of customer contracts and related customer relationships, and are subject to a weighted average amortization period of approximately 14 years.

In 2005, the Company acquired two companies for a total cost of ¥20,205 million, which was paid in cash. Those companies are engaged in the development, manufacturing and sales of semiconductor manufacturing equipment, factory automation equipment and vacuum equipment for production of electronic parts, including semiconductors, flat panel displays, magnetic heads and hard disc drives. In connection with those transactions, Canon recognized goodwill of ¥4,885 million and intangible assets of ¥16,382 million, which were classified as other assets in the accompanying consolidated balance sheets. Intangible assets consist primarily of developed technology, and are subject to a weighted average amortization period of approximately 9 years.

Canon acquired businesses other than those described above for the years ended December 31, 2007, 2006 and 2005 that were not material to its consolidated financial statements.

Canon has included the results of operations of these transactions prospectively from the respective dates of transactions. Canon has not presented pro forma results of operations of the acquired businesses because the results are not material to its consolidated results of operations on either an individual or an aggregate basis.

10. Goodwill and Other Intangible Assets

Intangible assets developed or acquired during the year ended December 31, 2007 totaled ¥44,592 million ($391,158 thousand), which are subject to amortization and primarily consist of software of ¥36,513 million ($320,289 thousand), which is mainly for internal use, and license fees of ¥1,486 million ($13,035 thousand), in addition to those recorded from acquired businesses. The weighted average amortization period for software and license fees is approximately 4 years and 8 years, respectively.

The components of acquired intangible assets subject to amortization included in other assets at December 31, 2007 and 2006 were as follows:

December 31	2007		2006	
Millions of yen	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Software	**¥174,645**	**¥ 96,445**	¥140,756	¥76,120
License fees	**22,825**	**11,697**	23,681	11,257
Other	**31,488**	**9,241**	24,899	4,919
	¥228,958	**¥117,383**	¥189,336	¥92,296

	2007	
Thousands of U.S. dollars	Gross carrying amount	Accumulated amortization
Software	**$1,531,974**	**$ 846,009**
License fees	**200,219**	**102,605**
Other	**276,211**	**81,061**
	$2,008,404	**$1,029,675**

Aggregate amortization expense for the years ended December 31, 2007, 2006 and 2005 was ¥31,879 million ($279,640 thousand), ¥26,490 million and ¥20,214 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥34,751 million ($304,833 thousand) in 2008, ¥25,151 million ($220,623 thousand) in 2009, ¥16,861 million ($147,904 thousand) in 2010, ¥9,089 million ($79,728 thousand) in 2011, and ¥5,071 million ($44,482 thousand) in 2012.

Intangible assets not subject to amortization other than goodwill at December 31, 2007 and 2006 were not significant.

The changes in the carrying amount of goodwill for the years ended December 31, 2007 and 2006 were as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Balance at beginning of year	¥40,801	¥40,161	$357,904
Goodwill acquired during the year	13,573	2,297	119,061
Recognition of acquired company's tax benefits	—	(1,038)	—
Translation adjustments and other	2,409	(619)	21,131
Balance at end of year	¥56,783	¥40,801	$498,096

During the year ended December 31, 2006, Canon recognized ¥1,038 million of deferred tax benefits relating to preexisting net operating tax losses of a company acquired in 2005. In connection therewith, Canon reduced the related goodwill by the same amount.

11. Short-Term Loans and Long-Term Debt

Short-term loans consisting of bank borrowings at December 31, 2007 and 2006 were ¥2,888 million ($25,333 thousand) and ¥99 million, respectively. The weighted average interest rates on short-term loans outstanding at December 31, 2007 and 2006 were 3.16% and 4.91%, respectively.

Long-term debt consisted of the following:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Loans, principally from banks, maturing in installments through 2017; bearing weighted average interest of 1.80% and 1.34% at December 31, 2007 and 2006, respectively, partially secured by mortgage of property, plant and equipment	¥ 2,993	¥ 149	$ 26,254
2.95% Japanese yen notes, due 2007	—	10,000	—
2.27% Japanese yen notes, due 2008	10,000	10,000	87,719
1.30% Japanese yen convertible debentures, due 2008	128	318	1,123
Capital lease obligations	10,988	10,585	96,386
	24,109	31,052	211,482
Less current portion	(15,429)	(15,263)	(135,342)
	¥ 8,680	¥ 15,789	$ 76,140

The aggregate annual maturities of long-term debt outstanding at December 31, 2007 were as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2008	¥15,429	$135,342
2009	4,052	35,544
2010	2,446	21,456
2011	1,504	13,193
2012	455	3,991
Thereafter	223	1,956
	¥24,109	$211,482

Certain property, plant and equipment with a net book carrying value of ¥2,872 million ($25,193 thousand) at December 31, 2007 were mortgaged to secure loans from banks.

Canon entered into an agreement whereby certain assets were deposited into an irrevocable trust to meet the debt service requirements of the 2.27% Japanese yen notes of ¥10,000 million ($87,719 thousand). The assets contributed by Canon were debt securities with carrying amounts of ¥10,115 million ($88,728 thousand) at December 31, 2007. Cash flows from such investments will be used solely to satisfy the principal and interest obligations for the debts. Accordingly, the debt securities are included in the consolidated balance sheets under the captions of marketable securities.

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.

The 1.30% Japanese yen convertible debentures due 2008 are convertible into approximately 128,000 shares of common stock at a conversion price of ¥998.00 ($8.75) per share at December 31, 2007.

12. Trade Payables

Trade payables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Notes	**¥ 17,088**	¥ 15,902	**$ 149,894**
Accounts	**497,138**	477,156	**4,360,860**
	¥514,226	¥493,058	**$4,510,754**

13. 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. Certain foreign subsidiaries also have defined contribution pension plans covering substantially all of their employees.

Effective January 1, 2007, the Company and certain of its domestic subsidiaries have amended their funded defined benefit pension plans, and the projected benefit obligation has decreased by ¥101,620 million ($891,404 thousand) primarily due to the modification of the pattern of future benefit payments. In conjunction therewith, the Company and certain of its domestic subsidiaries also have implemented an unfunded retirement and severance plan and a defined contribution pension plan for certain future pension benefits attributable to employees' future services.

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, 2007, 2006 and 2005 were ¥10,262 million ($90,018 thousand), ¥6,233 million and ¥4,878 million respectively.

Canon uses a measurement date of December 31 for the majority of its plans.

On December 31, 2006, Canon adopted the recognition and disclosure provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132 (R)" ("SFAS158"). SFAS 158 required Canon to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligations) of its pension plans in the December 31, 2006 consolidated balance sheet, with a corresponding adjustment to accumulated other comprehensive income (loss), net of tax. The adjustment to accumulated other comprehensive income (loss) at adoption represented the unrecognized actuarial loss, unrecognized prior service credit, and unrecognized net transition obligation, all of which were previously netted against the plans' funded status in the consolidated balance sheet pursuant to the provisions of SFAS 87. These amounts are subsequently recognized as net periodic benefit cost pursuant to Canon's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods are recognized as a component of other comprehensive income (loss). Those amounts are subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized in accumulated other comprehensive income (loss) at adoption of SFAS 158. The adoption of SFAS 158 had no effect on the consolidated statement of income for the year ended December 31, 2006, or for any prior period presented, and it will not affect Canon's operating results in future periods.

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:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007	2007	2006	2007
Change in benefit obligations:						
Benefit obligations at beginning of year	¥ 578,086	¥539,212	$5,070,930	¥110,505	¥ 81,281	$ 969,342
Service cost	20,161	23,916	176,851	4,016	3,483	35,228
Interest cost	11,888	13,411	104,281	4,947	3,898	43,395
Plan participants' contributions	—	—	—	1,613	1,412	14,149
Amendments	(101,620)	(954)	(891,404)	—	—	—
Actuarial gain (loss)	(4,623)	13,200	(40,553)	(3,293)	10,386	(28,886)
Benefits paid	(12,888)	(11,413)	(113,053)	(3,177)	(1,651)	(27,868)
Acquisition	2,474	714	21,702	—	—	—
Foreign currency exchange rate changes	—	—	—	(778)	11,696	(6,825)
Benefit obligations at end of year	493,478	578,086	4,328,754	113,833	110,505	998,535
Change in plan assets:						
Fair value of plan assets at beginning of year	520,476	475,344	4,565,579	87,173	70,174	764,676
Actual return on plan assets	(15,796)	14,803	(138,562)	2,283	4,055	20,026
Employer contributions	17,510	41,422	153,596	4,210	3,559	36,930
Plan participants' contributions	—	—	—	1,613	1,412	14,149
Benefits paid	(12,498)	(11,413)	(109,632)	(2,242)	(1,651)	(19,667)
Acquisition	1,758	320	15,422	—	—	—
Foreign currency exchange rate changes	—	—	—	(129)	9,624	(1,132)
Fair value of plan assets at end of year	511,450	520,476	4,486,403	92,908	87,173	814,982
Funded status at end of year	¥ 17,972	¥ (57,610)	$ 157,649	¥ (20,925)	¥ (23,332)	$(183,553)

Amounts recognized in the consolidated balance sheets at December 31, 2007 and 2006 are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007	2007	2006	2007
Other assets	¥ 41,567	¥ 3,018	$ 364,623	¥ 347	¥ 6	$ 3,043
Accrued expenses	—	—	—	(157)	(90)	(1,377)
Accrued pension and severance cost	(23,595)	(60,628)	(206,974)	(21,115)	(23,248)	(185,219)
	¥ 17,972	¥(57,610)	$ 157,649	¥(20,925)	¥(23,332)	$(183,553)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2007 and 2006 are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007	2007	2006	2007
Actuarial loss	¥ 146,937	¥119,484	$ 1,288,921	¥16,905	¥19,821	$148,290
Prior service credit	(182,073)	(93,932)	(1,597,131)	(953)	(1,003)	(8,360)
Net transition obligation	2,888	3,610	25,333	—	—	—
	¥ (32,248)	¥ 29,162	$ (282,877)	¥15,952	¥18,818	$139,930

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

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007	2007	2006	2007
Accumulated benefit obligation	¥471,146	¥542,610	$4,132,860	¥104,275	¥98,589	$914,693

The projected benefit obligations and the fair value of plan assets for the pension plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligations and the fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007	2007	2006	2007
Plans with projected benefit obligations in excess of plan assets:						
Projected benefit obligations	¥179,455	¥546,221	$1,574,167	¥113,790	¥110,501	$998,158
Fair value of plan assets	155,860	485,593	1,367,193	92,518	87,163	811,562
Plans with accumulated benefit obligations in excess of plan assets:						
Accumulated benefit obligations	¥ 46,789	¥510,223	$ 410,430	¥104,119	¥ 98,589	$913,325
Fair value of plan assets	29,599	481,452	259,640	92,401	87,163	810,535

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, 2007, 2006 and 2005 consisted of the following components:

Years ended December 31	Japanese plans				Foreign plans			
	Millions of yen			Thousands of U.S. dollars	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007	2007	2006	2005	2007
Service cost	¥ 20,161	¥ 23,916	¥ 22,799	$ 176,851	¥ 4,016	¥ 3,483	¥ 3,002	$ 35,228
Interest cost	11,888	13,411	12,769	104,281	4,947	3,898	3,403	43,395
Expected return on plan assets	(21,148)	(21,705)	(15,964)	(185,509)	(5,427)	(4,494)	(3,687)	(47,605)
Amortization of net transition obligation	722	345	345	6,333	—	—	—	—
Amortization of prior service credit	(13,479)	(7,436)	(6,855)	(118,237)	(86)	(113)	(1,152)	(754)
Amortization of actuarial loss	4,868	3,377	8,222	42,702	887	402	2,320	7,780
	¥ 3,012	¥ 11,908	¥ 21,316	$ 26,421	¥ 4,337	¥ 3,176	¥ 3,886	$ 38,044

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the year ended December 31, 2007 were summarized as follows:

	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
Current year actuarial (gain) loss	¥ 32,321	$ 283,518	¥(149)	$(1,307)
Amortization of actuarial loss	(4,868)	(42,702)	(887)	(7,780)
Prior service credit due to amendments	(101,620)	(891,404)	—	—
Amortization of prior service credit	13,479	118,237	86	754
Amortization of net transition obligation	(722)	(6,333)	—	—
	¥ (61,410)	$(538,684)	¥(950)	$(8,333)

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

	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
Net transition obligation	¥ 722	$ 6,333	¥ —	$ —
Prior service credit	(13,361)	(117,202)	(86)	(754)
Actuarial loss	6,685	58,640	849	7,447

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

December 31	Japanese plans		Foreign plans	
	2007	2006	2007	2006
Discount rate	2.5%	2.5%	5.1%	4.5%
Assumed rate of increase in future compensation levels	2.9%	2.9%	3.1%	2.9%

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

Years ended December 31	Japanese plans			Foreign plans		
	2007	2006	2005	**2007**	2006	2005
Discount rate	**2.5%**	2.5%	2.5%	**4.5%**	4.8%	4.8%
Assumed rate of increase in future compensation levels	**2.9%**	2.9%	3.1%	**2.9%**	2.6%	2.7%
Expected long-term rate of return on plan assets	**3.9%**	4.5%	4.5%	**6.0%**	6.4%	6.6%

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

Plan assets
The weighted-average asset allocations of Canon's benefit plans at December 31, 2007 and 2006 and target asset allocation by asset category are as follows:

December 31	Japanese plans			Foreign plans		
	2007	2006	Target allocation	**2007**	2006	Target allocation
Asset category:						
Equity securities	**33.6%**	43.0%	35.4%	**52.4%**	57.9%	52.3%
Debt securities	**45.2**	37.5	45.2	**33.8**	25.9	33.4
Cash	**1.1**	0.5	0.2	**—**	—	—
Life insurance company general accounts	**19.5**	18.6	18.7	**—**	—	—
Other	**0.6**	0.4	0.5	**13.8**	16.2	14.3
	100.0%	100.0%	100.0%	**100.0%**	100.0%	100.0%

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.

The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥1,257million ($11,026 thousand) and ¥1,797 million at December 31, 2007 and 2006, respectively.

Contributions
Canon expects to contribute ¥13,699 million ($120,167 thousand) to its Japanese defined benefit pension plans and ¥4,409 million ($38,675 thousand) to its foreign defined benefit pension plans for the year ending December 31, 2008.

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

Year ending December 31:	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
2008	¥ 10,949	$ 96,044	¥ 2,163	$ 18,974
2009	11,981	105,096	2,258	19,807
2010	13,209	115,868	2,376	20,842
2011	14,901	130,711	2,570	22,544
2012	16,119	141,395	2,678	23,491
2013—2017	100,323	880,026	16,852	147,825

14. Income Taxes

Domestic and foreign components of income before income taxes and minority interests, and the current and deferred income tax expense (benefit) attributable to such income are summarized as follows:

Years ended December 31		Millions of yen		
		Japanese	Foreign	Total
2007:	Income before income taxes and minority interests	**¥575,017**	**¥193,371**	**¥768,388**
	Income taxes:			
	Current	**¥238,921**	**¥ 60,358**	**¥299,279**
	Deferred	**(31,930)**	**(3,091)**	**(35,021)**
		¥206,991	**¥ 57,267**	**¥264,258**
2006:	Income before income taxes and minority interests	¥556,759	¥162,384	¥719,143
	Income taxes:			
	Current	¥201,022	¥ 54,156	¥255,178
	Deferred	(73)	(6,872)	(6,945)
		¥200,949	¥ 47,284	¥248,233
2005:	Income before income taxes and minority interests	¥492,709	¥119,295	¥612,004
	Income taxes:			
	Current	¥172,595	¥ 40,956	¥213,551
	Deferred	3,441	(4,207)	(766)
		¥176,036	¥ 36,749	¥212,785

		Thousands of U.S. dollars		
		Japanese	Foreign	Total
2007:	Income before income taxes and minority interests	**$5,044,009**	**$1,696,237**	**$6,740,246**
	Income taxes:			
	Current	**$2,095,799**	**$ 529,456**	**$2,625,255**
	Deferred	**(280,088)**	**(27,114)**	**(307,202)**
		$1,815,711	**$ 502,342**	**$2,318,053**

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 40% for the years ended December 31, 2007, 2006 and 2005.

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

Years ended December 31	**2007**	2006	2005
Japanese statutory income tax rate	**40.0%**	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.3**	0.3	0.3
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(2.8)**	(2.1)	(1.9)
Tax credit for research and development expenses	**(4.5)**	(4.1)	(3.9)
Other	**1.4**	0.4	0.3
Effective income tax rate	**34.4%**	34.5%	34.8%

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

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Prepaid expenses and other current assets	**¥ 79,846**	¥ 66,839	**$ 700,403**
Other assets	**68,178**	67,568	**598,053**
Other current liabilities	**(4,506)**	(4,133)	**(39,526)**
Other noncurrent liabilities	**(28,157)**	(39,299)	**(246,991)**
	¥115,361	¥ 90,975	**$1,011,939**

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 are presented below:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
Deferred tax assets:			
Inventories	**¥ 17,359**	¥ 20,077	**$ 152,272**
Accrued business tax	**11,555**	10,654	**101,360**
Accrued pension and severance cost	**16,336**	37,385	**143,298**
Research and development—costs capitalized for tax purposes	**42,434**	31,068	**372,228**
Property, plant and equipment	**53,487**	26,577	**469,184**
Accrued expenses	**27,903**	21,277	**244,763**
Net operating losses carried forward	**4,080**	1,767	**35,790**
Other	**34,448**	28,061	**302,175**
	207,602	176,866	**1,821,070**
Less valuation allowance	**(9,327)**	(6,500)	**(81,816)**
Total deferred tax assets	**198,275**	170,366	**1,739,254**
Deferred tax liabilities:			
Undistributed earnings of foreign subsidiaries	**(13,566)**	(9,138)	**(119,000)**
Net unrealized gains on securities	**(4,440)**	(7,521)	**(38,947)**
Tax deductible reserve	**(8,574)**	(11,955)	**(75,210)**
Financing lease revenue	**(26,892)**	(35,990)	**(235,894)**
Prepaid pension and severance cost	**(10,604)**	(3,752)	**(93,018)**
Other	**(18,838)**	(11,035)	**(165,246)**
Total deferred tax liabilities	**(82,914)**	(79,391)	**(727,315)**
Net deferred tax assets	**¥115,361**	¥ 90,975	**$1,011,939**

The net changes in the total valuation allowance were increases of ¥2,827 million ($24,798 thousand) and ¥3,155 million for the years ended December 31, 2007 and 2006, respectively, and a decrease of ¥150 million for the year ended December 31, 2005.

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, 2007.

At December 31, 2007, Canon had net operating losses which can be carried forward for income tax purposes of ¥11,795 million ($103,465 thousand) to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from 1 year to 10 years as follows:

	Millions of yen	Thousands of U.S. dollars
Within one year	¥ —	$ —
After one year through five years	1,717	15,061
After five years through ten years	6,009	52,711
Indefinite period	4,069	35,693
Total	¥11,795	$103,465

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 ¥49,661 million ($435,623 thousand) for a portion of undistributed earnings of foreign subsidiaries that arose during the year ended December 31, 2007 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, 2007, such undistributed earnings of these subsidiaries were ¥686,837 million ($6,024,886 thousand).

Canon adopted FIN48 effective January 1, 2007. As a result of implementation of FIN48, Canon identified unrecognized tax benefits of ¥16,087 million ($141,114 thousand) as of January 1, 2007, and did not require a cumulative-effect adjustment to retained earnings.

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

	Millions of yen	Thousands of U.S. dollars
Balance at January 1, 2007	¥16,087	$141,114
Additions for tax positions of the current year	994	8,719
Additions for tax positions of prior years	1,902	16,684
Reductions for tax positions of prior years	(1,340)	(11,754)
Lapse of the applicable statute of limitations	(1,311)	(11,500)
Settlements	(322)	(2,825)
Other	(219)	(1,920)
Balance at December 31, 2007	¥15,791	$138,518

Total amount of unrecognized tax benefits that would reduce the effective tax rate, if recognized, is ¥8,278 million ($72,614 thousand).

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 periods. Based on each of the items of which Canon is aware at December 31, 2007, 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 in the consolidated statements of income. Both interest and penalties accrued as of December 31, 2007 and interest and penalties included in income taxes for the year ended December 31, 2007 are not material.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2006. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2000. In other major foreign tax jurisdictions, including the United States and Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2003 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for certain years after 2002 in Japan and in major foreign tax jurisdictions.

15. Common Stock

Based on the resolution of Board of Directors on May 11, 2006, the Company made a three-for-two stock split on July 1, 2006, for stockholders recorded in the stockholders' register as of June 30, 2006. All share and per share information has been adjusted to reflect the implementation of the stock split.

For the years ended December 31, 2007, 2006 and 2005, the Company issued 190,380 shares, 331,661 shares and 1,148,292 shares of common stock, respectively, in connection with the conversion of convertible debt. In accordance with the Corporation Law of Japan, conversion into common stock of convertible debt is accounted for by crediting one-half or more of the conversion price to the common stock account and the remainder to the additional paid-in capital account.

16. Legal Reserve and Retained Earnings

The Corporation Law of Japan provides that an amount equal to 10% of distributions from retained earnings paid by the Company and its Japanese subsidiaries be appropriated as a legal reserve. No further appropriations are required when the total amount of the additional paid-in capital and the legal reserve equals 25% of their respective stated capital. The Corporation Law of Japan also provides that additional paid-in capital and legal reserve are available for appropriations by the resolution of the stockholders. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of the respective countries.

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2007, 2006 and 2005 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2007 do not reflect current year-end dividends in the amount of ¥75,663 million ($663,711 thousand) which will be payable in March 2008 upon approval by the stockholders.

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 ¥1,383,747 million ($12,138,132 thousand) at December 31, 2007.

Retained earnings at December 31, 2007 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥20,792 million ($182,386 thousand).

17. Other Comprehensive Income (Loss)

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

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	**2007**
Foreign currency translation adjustments:				
Balance at beginning of year	**¥ 22,858**	¥(25,772)	¥ (79,751)	**$ 200,509**
Adjustments for the year	**(62)**	48,630	53,979	**(544)**
Balance at end of year	**22,796**	22,858	(25,772)	**199,965**
Net unrealized gains and losses on securities:				
Balance at beginning of year	**8,065**	6,073	7,470	**70,745**
Adjustments for the year	**(1,778)**	1,992	(1,397)	**(15,596)**
Balance at end of year	**6,287**	8,065	6,073	**55,149**
Net gains and losses on derivative instruments:				
Balance at beginning of year	**(1,663)**	(1,174)	(693)	**(14,587)**
Adjustments for the year	**814**	(489)	(481)	**7,140**
Balance at end of year	**(849)**	(1,663)	(1,174)	**(7,447)**
Minimum pension liability adjustments:				
Balance at beginning of year	**—**	(7,339)	(28,338)	**—**
Adjustments for the year	**—**	(3,575)	20,999	**—**
Adjustment to initially apply SFAS 158	**—**	10,914	—	**—**
Balance at end of year	**—**	—	(7,339)	**—**
Pension liability adjustments:				
Balance at beginning of year	**(26,542)**	—	—	**(232,825)**
Adjustments for the year	**32,978**	—	—	**289,281**
Adjustment to initially apply SFAS 158	**—**	(26,542)	—	**—**
Balance at end of year	**6,436**	(26,542)	—	**56,456**
Total accumulated other comprehensive income (loss):				
Balance at beginning of year	**2,718**	(28,212)	(101,312)	**23,842**
Adjustments for the year	**31,952**	46,558	73,100	**280,281**
Adjustment to initially apply SFAS 158	**—**	(15,628)	—	**—**
Balance at end of year	**¥ 34,670**	¥ 2,718	¥ (28,212)	**$ 304,123**

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments are as follows:

Years ended December 31	Millions of yen		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2007:			
Foreign currency translation adjustments	**¥ (370)**	**¥ 308**	**¥ (62)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(7,237)**	**3,037**	**(4,200)**
Reclassification adjustments for gains and losses realized in net income	**(293)**	**2,715**	**2,422**
Net change during the year	**(7,530)**	**5,752**	**(1,778)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**590**	**(236)**	**354**
Reclassification adjustments for gains and losses realized in net income	**772**	**(312)**	**460**
Net change during the year	**1,362**	**(548)**	**814**
Pension liability adjustments:			
Amount arising during the year	**62,768**	**(26,502)**	**36,266**
Reclassification adjustments for gains and losses realized in net income	**(5,766)**	**2,478**	**(3,288)**
Net change during the year	**57,002**	**(24,024)**	**32,978**
Other comprehensive income (loss)	**¥50,464**	**¥(18,512)**	**¥31,952**
2006:			
Foreign currency translation adjustments	¥49,518	¥ (888)	¥48,630
Net unrealized gains and losses on securities:			
Amount arising during the year	3,708	(1,502)	2,206
Reclassification adjustments for gains and losses realized in net income	(388)	174	(214)
Net change during the year	3,320	(1,328)	1,992
Net gains and losses on derivative instruments:			
Amount arising during the year	(7,126)	2,858	(4,268)
Reclassification adjustments for gains and losses realized in net income	6,309	(2,530)	3,779
Net change during the year	(817)	328	(489)
Minimum pension liability adjustments	(4,391)	816	(3,575)
Other comprehensive income (loss)	¥47,630	¥ (1,072)	¥46,558
2005:			
Foreign currency translation adjustments	¥55,345	¥ (1,366)	¥53,979
Net unrealized gains and losses on securities:			
Amount arising during the year	9,005	(3,892)	5,113
Reclassification adjustments for gains and losses realized in net income	(10,793)	4,283	(6,510)
Net change during the year	(1,788)	391	(1,397)
Net gains and losses on derivative instruments:			
Amount arising during the year	(9,137)	3,658	(5,479)
Reclassification adjustments for gains and losses realized in net income	8,333	(3,335)	4,998
Net change during the year	(804)	323	(481)
Minimum pension liability adjustments	40,364	(19,365)	20,999
Other comprehensive income (loss)	¥93,117	¥(20,017)	¥73,100

	Thousands of U.S. dollars		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2007:			
Foreign currency translation adjustments	**$ (3,246)**	**$ 2,702**	**$ (544)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(63,482)**	**26,640**	**(36,842)**
Reclassification adjustments for gains and losses realized in net income	**(2,570)**	**23,816**	**21,246**
Net change during the year	**(66,052)**	**50,456**	**(15,596)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**5,175**	**(2,070)**	**3,105**
Reclassification adjustments for gains and losses realized in net income	**6,772**	**(2,737)**	**4,035**
Net change during the year	**11,947**	**(4,807)**	**7,140**
Pension liability adjustments:			
Amount arising during the year	**550,597**	**(232,474)**	**318,123**
Reclassification adjustments for gains and losses realized in net income	**(50,579)**	**21,737**	**(28,842)**
Net change during the year	**500,018**	**(210,737)**	**289,281**
Other comprehensive income (loss)	**$442,667**	**$(162,386)**	**$280,281**

18. Net Income per Share

The basic and diluted net income per share as well as the number of shares has been calculated to reflect the three-for-two stock split that was completed on July 1, 2006.

A reconciliation of the numerators and denominators of basic and diluted net income per share computations is as follows:

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	**2007**
Net income	**¥488,332**	¥455,325	¥384,096	**$4,283,614**
Effect of dilutive securities:				
1.20% Japanese yen convertible debentures, due 2005	**—**	—	5	**—**
1.30% Japanese yen convertible debentures, due 2008	**4**	8	18	**35**
Diluted net income	**¥488,336**	¥455,333	¥384,119	**$4,283,649**

	Number of shares		
Average common shares outstanding	**1,293,295,680**	1,331,542,074	1,330,760,715
Effect of dilutive securities:			
1.20% Japanese yen convertible debentures, due 2005	**—**	—	185,755
1.30% Japanese yen convertible debentures, due 2008	**221,751**	474,796	1,118,931
Diluted common shares outstanding	**1,293,517,431**	1,332,016,870	1,332,065,401

	Yen			U.S. dollars
Net income per share:				
Basic	**¥377.59**	¥341.95	¥288.63	**$3.31**
Diluted	**377.53**	341.84	288.36	**3.31**

19. 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, because most of the counterparties are internationally recognized financial institutions and contracts are diversified across a number of major financial institutions.

Foreign currency exchange rate risk management

Canon's international operations expose Canon to the risk of changes in foreign currency exchange rates. Canon uses foreign exchange contracts to manage certain foreign currency exchange exposures principally from the exchange of U.S. dollars and euros into Japanese yen. These contracts are primarily used to hedge the foreign currency exposure of forecasted intercompany sales and intercompany trade receivables 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.

Cash flow hedge

Changes in the fair value of derivative financial instruments designated as cash flow hedges, including foreign exchange contracts associated with forecasted intercompany sales, are reported in accumulated other comprehensive income (loss). These amounts are subsequently reclassified into earnings through other income (deductions) in the same period as the hedged items affect earnings. Substantially all amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next 12 months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2007, 2006 and 2005. The amount of net gains or losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was net losses of ¥6,883 million ($60,377 thousand), ¥5,917 million and ¥3,725 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Derivatives not designated as hedges

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

Contract amounts of foreign exchange contracts at December 31, 2007 and 2006 are set forth below:

December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	**2007**
To sell foreign currencies	**¥697,240**	¥717,136	**$6,116,140**
To buy foreign currencies	**46,897**	51,189	**411,377**

20. Commitments and Contingent Liabilities

Commitments

At December 31, 2007, commitments outstanding for the purchase of property, plant and equipment approximated ¥117,119 million ($1,027,360 thousand), and commitments outstanding for the purchase of parts and raw materials approximated ¥91,882 million ($805,982 thousand).

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,440 million ($126,667 thousand) and ¥13,648 million at December 31, 2007 and 2006, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under the operating lease arrangements amounted to ¥36,900 million ($323,684 thousand), ¥36,157 million and ¥38,297 million for the years ended December 31, 2007, 2006 and 2005, 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, 2007 are as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending December 31:		
2008	¥16,365	$143,553
2009	12,382	108,614
2010	7,637	66,991
2011	5,681	49,833
2012	4,055	35,570
Thereafter	11,281	98,957
Total future minimum lease payments	¥57,401	$503,518

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 ¥27,946 million ($245,140 thousand) at December 31, 2007. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2007 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, 2007 and 2006 are summarized as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Balance at beginning of year	**¥ 18,144**	¥ 16,746	**$ 159,158**
Addition	**31,053**	18,686	**272,395**
Utilization	**(26,199)**	(18,377)	**(229,816)**
Other	**(2,860)**	1,089	**(25,088)**
Balance at end of year	**¥ 20,138**	¥ 18,144	**$ 176,649**

Legal proceedings

In October 2003, a lawsuit was filed by a former employee against the Company at the Tokyo District Court in Japan. The lawsuit alleges that the former employee is entitled to ¥45,872 million ($402,386 thousand) as compensation for an invention related to certain technology used by the Company, and the former employee has sued for a partial payment of ¥1,000 million ($8,772 thousand) and interest thereon. On January 30, 2007, the Tokyo District Court in Japan ordered the Company to pay the former employee approximately ¥33.5 million ($294 thousand) and interest thereon. On the same day, the Company appealed the decision. This lawsuit is currently under trial in the Intellectual Property High Court.

In Germany, Verwertungsgesellschaft Wort ("VG Wort"), a collecting agency representing certain copyright holders, has filed a series of lawsuits seeking to impose copyright levies upon digital products such as PCs and printers, that allegedly enable the reproduction of copyrighted materials, against the companies importing and distributing these digital products. In May 2004, VG Wort filed a civil lawsuit against Hewlett-Packard

GmbH seeking levies on multi-function printers. This is an industry test case under which Hewlett-Packard GmbH represents other companies sharing common interests, and Canon has undertaken to be bound by the final decision of this court case. The court of first instance and the court of appeals held that the multi-function printers were subject to a levy. In particular, the court of appeals ordered Hewlett-Packard GmbH to pay the amount equivalent to the levies imposed on photocopiers (EUR 38.35 to EUR 613.56 per unit, depending on printing speed and color printing capability). On January 30, 2008, the Federal Supreme Court delivered its short judgment in favor of VG Wort, maintaining the judgment of the court of appeals, whereby the court decided that, for MFPs sold during the period from 1997 through 2001, the same full tariff as applicable to photocopier should be applied. It is expected that the Federal Supreme Court will issue a written full judgment explaining the rationale underlying its decision sometime in the next several months. If Hewlett-Packard GmbH decides to file a claim with the Federal Constitutional Court challenging the judgment of the Federal Supreme Court, it will have 30 days to file a claim from receipt of the Federal Supreme Court's written full judgment. With regard to single-function printers, VG Wort filed a separate lawsuit in January 2006 against Canon, seeking payment of copyright levies, and the court of first instance in Düsseldorf ruled in favor of the claim by VG Wort in November 2006. Canon lodged an appeal against such decision in December 2006. In a similar court case, which does not include Canon, seeking copyright levies on single-function printers of Epson Deutschland GmbH, Xerox GmbH and Kyocera Mita Deutschland GmbH, the court of appeals in Düsseldorf rejected such alleged levies on January 23, 2007. Consistent with the last decision, Canon won its appeal at the court of appeal. In its judgment of November 13, 2007, the court of appeal rejected VG Wort's claim against Canon. VG Wort appealed further against decisions of the court of appeal for both Epson et al. and Canon cases before the Federal Supreme Court. In December 2007, for a similar Hewlett-Packard GmbH case relating to single-function printers, the Federal Supreme Court delivered its judgment in favor of Hewlett-Packard GmbH and dismissed VG Wort's claim. Written full judgment by the Federal Supreme Court was issued on January 24, 2008. Canon was informed that VG Wort already filed a constitutional complaint with the Federal Constitutional Court against said judgment of the Federal Supreme Court. Canon, other companies and the industry associations have expressed opposition to such extension of the levy scope. Based on industry opposition to the extension of levies to digital products, Canon's assessments of the merits of various proceeding and Canon's estimates of the units impacted and levies, Canon has accrued amounts that it believes are adequate to address the matters described above. However, the final conclusion of these court cases including the amount of levies to be imposed and the associated financial impact on Canon remains uncertain.

In April 2005, a lawsuit was filed by Nano-Proprietary Inc. ("NPI") against the Company and Canon U.S.A., Inc. in the United States District Court of Texas alleging that SED Inc., a joint venture company established by the Company and Toshiba Corporation, was not regarded as a "subsidiary" under the Patent License Agreement between the Company and NPI and that the extension of the license to SED Inc. constituted a breach of the agreement. NPI also alleged that Canon committed fraud in executing such agreement, and requested rescission of the agreement and compensatory damages. In November 2006, the Court denied Canon's motion for a summary judgment that SED Inc. was a subsidiary of the Company. In January 2007, the Company purchased all the shares of SED Inc. owned by Toshiba Corporation, making SED Inc. a 100% owned subsidiary of the Company. However, on February 22, 2007, the Court issued a summary judgment stating that SED Inc. (before the above stock purchase) was not a subsidiary of the Company, that the Company had materially breached the patent license agreement and that NPI was allowed to terminate that agreement. Thereafter, a trial was held from April 30 to May 3, 2007, in Austin, Texas. NPI's fraud claims against Canon were withdrawn by NPI and the jury returned a verdict that NPI had sustained no damages. All claims against Canon U.S.A., Inc. were also withdrawn by NPI. On May 15, 2007, Canon filed a notice of appeal to the United States Court of Appeals for the Fifth Circuit, appealing the District Court's prior ruling that Canon had breached the patent license agreement with NPI that allowed NPI to terminate that agreement. On June 4, 2007, NPI also filed a notice of appeal, appealing the District Court's determination that NPI had sustained no damages. These appeals are still pending.

Canon is involved in various claims and legal actions, including those noted above, arising in the ordinary course of business. In accordance with SFAS No. 5, "Accounting for Contingencies," Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, Canon believes that any damage amounts claimed in the specific matters discussed above are not a meaningful indicator of Canon's potential liability. In the opinion of management, the ultimate disposition of the above mentioned matters will not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows. However, litigation is inherently unpredictable. While Canon believes that it has valid defenses with respect to legal matters pending against it, it is possible that Canon's consolidated financial position, results of operations, or cash flows could be materially affected in any particular period by the unfavorable resolution of one or more of these matters.

21. 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, 2007 and 2006 are set forth below. The following summary excludes cash and cash equivalents, time deposits, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables, accrued expenses for which fair values approximate their carrying amounts. The summary also excludes marketable securities and investments which are disclosed in Note 4.

December 31	Millions of yen				Thousand of U.S. dollars	
	2007		2006		2007	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	**¥(24,109)**	**¥(24,714)**	¥(31,052)	¥(32,795)	**$(211,482)**	**$(216,789)**
Foreign exchange contracts:						
Assets	**806**	**806**	307	307	**7,070**	**7,070**
Liabilities	**(12,335)**	**(12,335)**	(17,534)	(17,534)	**(108,202)**	**(108,202)**

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

Long-term debt

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

Foreign exchange contracts

The fair values of foreign exchange contracts, all of which are used for purposes other than trading, are estimated by obtaining quotes from brokers.

Limitations

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

Concentrations of credit risk

At December 31, 2007 and 2006, one customer accounted for approximately 16% and 14% 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.

22. Supplemental Cash Flow Information

For the years ended December 31, 2007, 2006 and 2005, aggregate common stock and additional paid-in capital arising from conversion of convertible debt amounted to ¥190 million ($1,667 thousand), ¥331 million and ¥1,147 million, respectively.

23. Subsequent Event

On February 27, 2008, the Company entered into a stock purchase agreement with Hitachi, Ltd. ("Hitachi") to acquire shares of Hitachi Displays, Ltd. ("Hitachi Displays"), a wholly-owned subsidiary of Hitachi, with an aim to construct a comprehensive liquid crystal display ("LCD") panel business alliance, following the resolution of the acquisition by the Board of Directors on the same day. Under the terms of this agreement, the Company will acquire a 24.9% stake in Hitachi Displays by March 31, 2008, for approximately ¥43,200 million ($378,947 thousand), pending regulatory approval.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Canon is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934 as 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, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework* (the COSO criteria).

Based on its assessment, management concluded that, as of December 31, 2007, Canon's internal control over financial reporting was effective based on the COSO criteria.

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

Fujio Mitarai
Chairman and CEO

Masahiro Osawa
Managing Director
Group Executive of Finance and Accounting Headquarters

March 14, 2008

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The Board of Directors and Stockholders of
Canon Inc.

We have audited the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company's consolidated financial statements do not disclose segment information required by Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information." In our opinion, disclosure of segment information is required by U.S. generally accepted accounting principles.

In our opinion, except for the omission of segment information as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2007 the Company changed its method of accounting for depreciation.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2008 expressed an unqualified opinion thereon.

We have also recomputed the translation of the consolidated financial statements as of and for the year ended December 31, 2007 into United States dollars. In our opinion, the consolidated financial statements expressed in Japanese yen have been translated into United States dollars on the basis described in Note 2.

Ernst & Young ShinNihon

March 14, 2008

ERNST & YOUNG

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The Board of Directors and Stockholders of
Canon Inc.

We have audited Canon Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Canon Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We 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. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, all expressed in Japanese yen, and our report thereon dated March 14, 2008 stated that, except for the omission of segment information required by Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

Ernst & Young ShinNihon

March 14, 2008

TRANSFER AND REGISTRAR'S OFFICE

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STOCKHOLDER INFORMATION

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

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

Stockholders' Annual General Meeting:
March 28, 2008, in Tokyo

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

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