CANON ANNUAL REPORT 2014

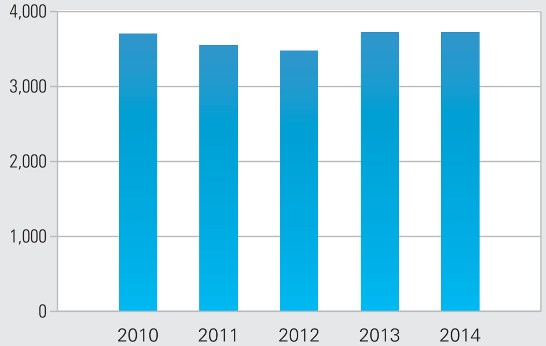
Fiscal Year Ended December 31, 2014

FINANCIAL HIGHLIGHTS

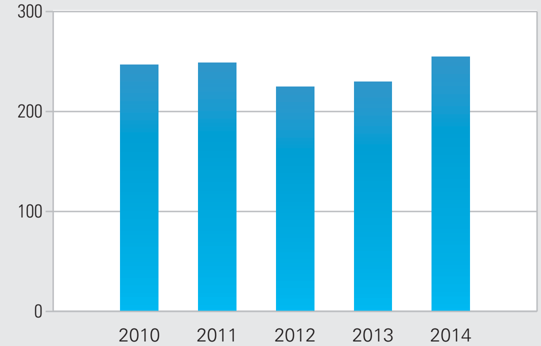
	Millions of yen (except per share amounts)			*Thousands of U.S. dollars (except per share amounts)*
	2014	2013	Change (%)	2014
Net sales	¥3,727,252	¥3,731,380	-0.1	$30,803,736
Operating profit	363,489	337,277	7.8	3,004,041
Income before income taxes	383,239	347,604	10.3	3,167,264
Net income attributable to Canon Inc.	254,797	230,483	10.5	2,105,760
Net income attributable to Canon Inc. stockholders per share:				
—Basic	¥ 229.03	¥ 200.78	14.1	$ 1.89
—Diluted	229.03	200.78	14.1	1.89
Total assets	¥4,460,618	¥4,242,710	5.1	$36,864,612
Canon Inc. stockholders' equity	¥2,978,184	¥2,910,262	2.3	$24,613,091

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 JPY121=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2014, solely for the convenience of the reader.

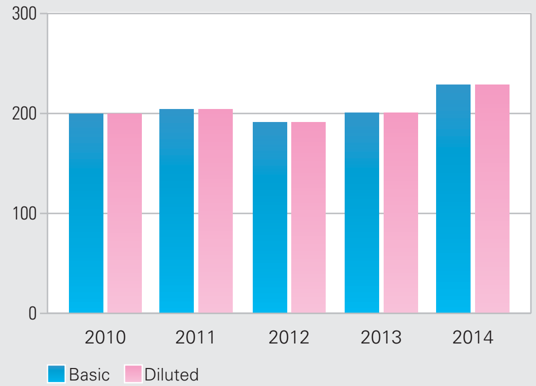
Net Sales
(Billions of yen)



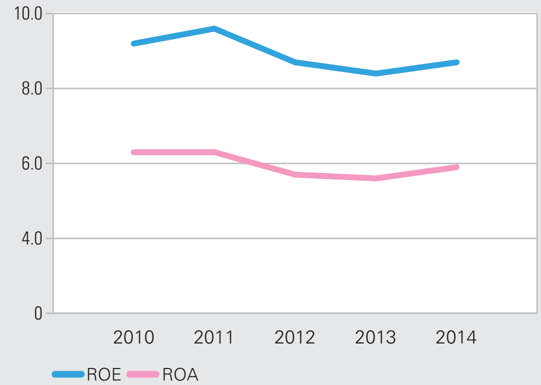
Net Income Attributable to Canon Inc.
(Billions of yen)



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



ROE/ROA
(%)



CORPORATE PROFILE

Canon develops, manufactures and markets a growing lineup of copying machines, printers, cameras and industrial and other equipment. Through these products, the Company meets growing customer needs that are becoming increasingly diversified and sophisticated. Today, the Canon brand is recognized and trusted throughout the world.

In 1996, Canon launched its Excellent Global Corporation Plan with the aim of becoming a company worthy of admiration and respect the world over. Currently, the Company is working to achieve the overwhelming No. 1 position in its existing core businesses and expand related and peripheral businesses by strengthening its advanced solutions business, centered on innovative products, and through other measures. At the same time, Canon is nurturing its operations in the fields of medical equipment and industrial equipment, to establish new core businesses. The Company is working to fulfill its responsibilities to investors and society, emphasizing sound corporate governance and stepping up the implementation of activities that contribute to environmental and social sustainability.

CORPORATE PHILOSOPHY: *KYOSEI*

Canon's corporate philosophy is *kyosei*.

It conveys our dedication to seeing all people, regardless of culture, customs, language or race, harmoniously living and working together in happiness into the future. Unfortunately, current factors related to economies, resources and the environment make realizing *kyosei* difficult.

Canon strives to eliminate these factors through corporate activities rooted in *kyosei*. Truly global companies must foster good relations with customers and communities, as well as with governments, regions and the environment as part of their fulfillment of social responsibilities.

For this reason, Canon's goal is to contribute to global prosperity and the well-being of mankind as we continue our efforts to bring the world closer to achieving *kyosei*.

CORPORATE GOAL

Canon sees itself growing and prospering over the next 100, and even 200, years. Toward this end, the Company has been promoting its Excellent Global Corporation Plan, launching Phase IV of the initiative in 2011. Building on the financial strengths that the Company has continuously reinforced through the implementation of the plan, Canon aims to join the ranks of the world's top 100 companies in terms of major management indicators.

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Cover Photo:
Tim Rayman, nature photographer Canon's interchangeable lens digital cameras and interchangeable lenses have served and will be serving professional photographers around the world who use the latest technologies to capture the best moments.

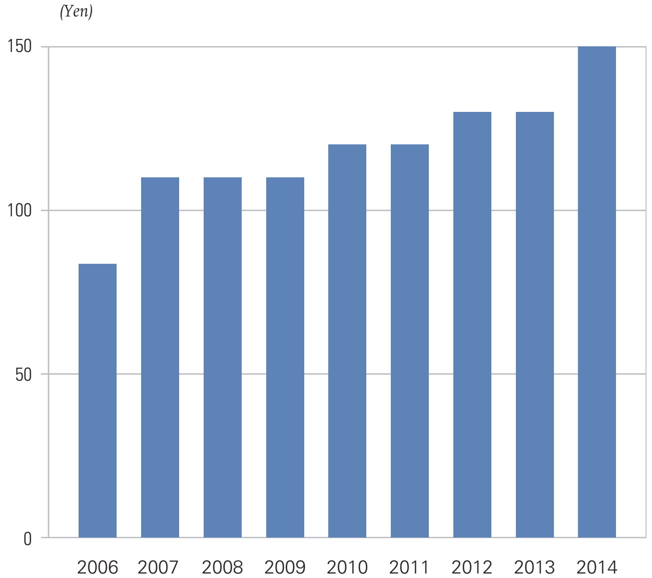
Fujio Mitarai
Chairman & CEO
Canon Inc.

Canon will bring Phase IV of its Excellent Global Corporation Plan to a close by building a solid foundation for a return to a path of growth.

Performance in 2014

Despite expectations of an overall turnaround in the global economy in 2014, particularly in the United States and Japan, the operating environment we faced remained very challenging due to unforeseen developments, such as the conflict between Russia and Ukraine. On the other hand, we saw the yen depreciate further against both the U.S. dollar and the euro. In light of these circumstances, in accordance with our basic policy of emphasizing profit over sales, we made a concerted Group-wide effort with various initiatives, including the creation of powerful hit products within current businesses, the thorough reinforcement of our global sales capabilities, and pursuit of a new dimension in cost reductions.

Cash Dividend
(Yen)



* The amount of annual cash dividend per share in 2006 has been adjusted to reflect the three-for-two stock split made on July 1, 2006.

As a result, despite the various challenges we faced in 2014, including a decline in unit sales of digital cameras, we realized an increase in unit sales of office color multifunction devices (MFDs), posting consolidated net sales of ¥3,727.3 billion, around the same level as the previous year. Furthermore, the gross profit ratio improved 1.7 points to 49.9%, approaching the record level we reached in 2007. At the time, the yen was even weaker than it is now, which points to the fact that Canon's manufacturing power, which had suffered immediately after the Lehman crisis, is now back on track and stronger than ever. Additionally, thanks to ongoing rigorous expense cutting, operating profit increased 7.8% to ¥363.5 billion while net income climbed 10.5% to ¥254.8 billion. These figures are the highest since the collapse of Lehman Brothers and mark our second consecutive year-on-year increases for both operating profit and net income.

Free cash flow, as well, increased ¥57.2 billion year on year to ¥314.6 billion, exceeding net income for the second successive year. Taking advantage of this ample cash flow, we carried out three share buybacks in 2014, purchasing some ¥150 billion worth of Company stock. With a stockholders' equity ratio of 66.8% at the end of 2014, we were able to maintain our sound, essentially debt-free financial structure. Additionally, underscoring our stable and proactive shareholder return policy, we declared an annual cash dividend of ¥150.00 per share, a ¥20.00 increase from 2013.

Excellent Global Corporation Plan

Canon launched the Excellent Global Corporation Plan in 1996 and, over the nearly 20 years since it was introduced, we have reinforced our business foundation through the Plan's various phases.

During Phase I (1996–2000), we focused on shifting from nonconsolidated business management to consolidated business management while stressing the importance of total optimization over partial optimization, and of profit over sales. By emphasizing the importance of cash-flow management and comprehensively eliminating waste, we were able to reduce our debt by more than half while also significantly increasing productivity through the introduction of the cell production system and other measures.

In Phase II (2001–2005), we focused on reinforcing Canon's product competitiveness. We fully digitalized our copying machine and camera offerings, laying the groundwork for the successes that we enjoy today while also enabling us to become an essentially debt-free company.

During Phase III (2006–2010), we sought to expand Canon's business scope, broadening our businesses in the printing and medical equipment fields while actively carrying out M&A activities.

And in 2011, under the slogan "Aiming for the Summit: Speed & Sound Growth," we embarked on Phase IV, spanning the five-year period through 2015. Focusing on the six key strategies explained below, Phase IV calls for proactive, quick reforms ahead of the dramatically changing times, along with the achievement of sound business growth through the further expansion of our corporate scale while maintaining high profitability.

2015 is the final year of Phase IV. During the year, we will make a concerted effort to improve our financial performance and build a robust foundation toward further growth in the future.

The Excellent Global Corporation Plan

Phase I 1996–2000	Phase II 2001–2005	Phase III 2006–2010		Phase IV 2011–2015
Strengthened our financial structure by thoroughly eliminating wastefulness, with production reforms playing a major role, based on changing our mindset with a focus on total optimization and profitability.	Recognized the need for digitalization and raised product competitiveness by enhancing our development infrastructure and reinforcing key components.	Strove to achieve "Sound Growth," seeking high growth levels by establishing new businesses while raising the profitability of existing businesses. With the global economy plunging into the global recession, shifted direction towards "improving the quality of management."	**Set up an even stronger financial structure and increased momentum towards a dramatic leap forward from now.**	Tackle again the challenge of achieving "Sound Growth" through timely change in advance of changes in the times. **Slogan:** "Aiming for the Summit: Speed & Sound Growth"

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

In 2014, within the office MFD segment, we significantly boosted unit sales of color machines through the addition of color A4-model MFDs and color imagePRESS-series models to our product lineups. Moreover, Océ, which produces such products as high-speed continuous feed commercial printers, recorded healthy sales growth. In the growing market for office solutions, we continued strengthening our hardware offerings while improving our ability to provide an extensive range of high-quality "one-stop" services.

In the digital camera segment, unit sales of both interchangeable lens cameras and compact cameras declined year on year. Nevertheless, we maintained the No. 1 position in the global market with a 44% share for interchangeable lens cameras and a 22% share for compact cameras*. Within this segment, we worked to improve profitability, boosting sales of interchangeable lens digital cameras with the new EOS 7D Mark II and other models targeting advanced-amateur users, while reinforcing our compact camera lineup through the introduction of high-value-added models that deliver exceptional image quality and high zoom magnification.

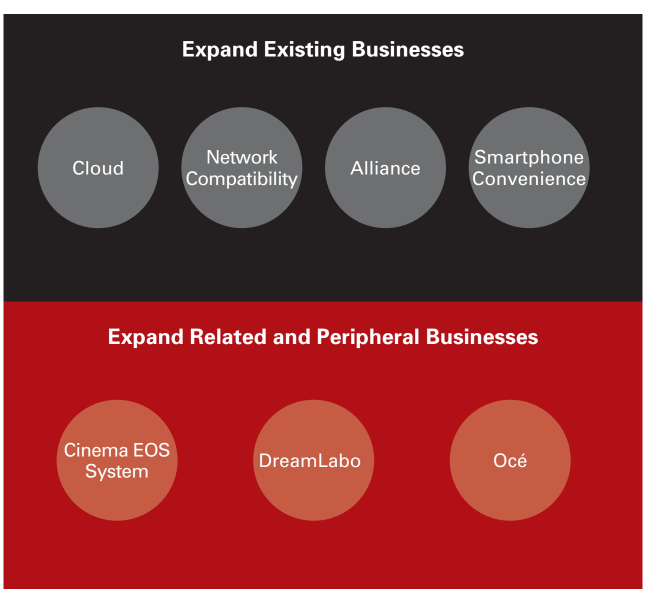
As for inkjet printers, having made our full-fledged entry into the business inkjet printer market, we are focusing on expanding our share within this segment. We are also working to increase sales of large-format printers, for which we posted record-high unit sales in 2014.

In the industrial equipment segment, we were able to boost our market share, buoyed by strong demand for our semiconductor lithography systems used in the fabrication of memory devices and image sensors, and continued healthy sales of flat-panel-display lithography systems for large-sized panels, along with the launch of high-resolution machines used in the production of small- and medium-sized panels. Moreover, through the enhancement of our nanoimprint lithography technology, which makes possible the further miniaturization of electronic features, we are targeting the mass production of next-generation semiconductor lithography systems.

As for the medical equipment sector, we have been increasing sales of new digital radiography systems, including models featuring wireless static-image sensors and dynamic-image sensors.

*Based on a Canon survey

Achieving the Overwhelming No.1 Position



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The imageRUNNER ADVANCE series machines help make business processes more efficient through the handling of a range of document-management tasks from a single device.

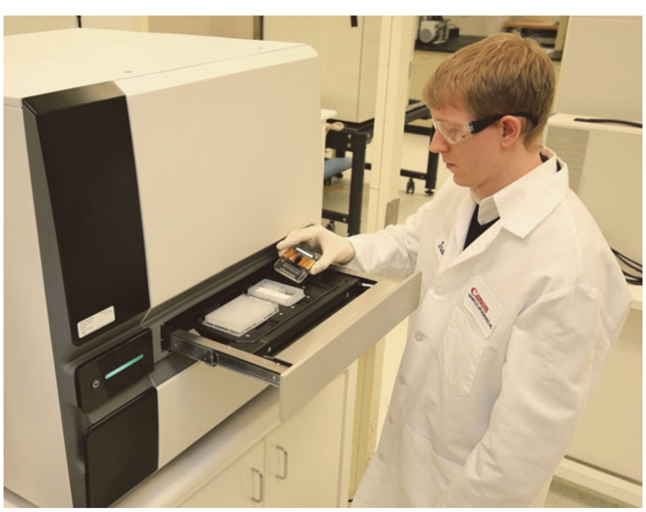
Strategy 2 Developing new business through globalized diversification and establishing the Three Regional Headquarters management system

Seeking to realize innovation beyond the boundaries of Japan, Canon is looking to Europe and the United States to contribute to global growth through the creation of new business in terms of both quality and quantity within the framework of the Three Regional Headquarters management system. By maintaining a highly profitable structure, we aim to join the ranks of the world's top 100 companies in terms of all key measures of business performance.

In the United States, Canon Virginia is preparing to commence mass production of a DNA diagnostic system developed by Canon U.S. Life Sciences, while in Europe, Océ is in the process of establishing its function as our headquarters for commercial printers.

In the meantime, we will make effective use of our healthy cash flows to establish new businesses while promoting measures to nurture and expand them. In 2014, with the aim of expediting the development of next-generation semiconductor lithography systems, we acquired Molecular Imprints (now Canon Nanotechnologies), a company with expertise in nanoimprint technologies that make possible high-resolution nanolithography processes. In addition, to secure our No. 1 position in the global network video surveillance market, we acquired Milestone Systems, a world-leading provider of open platform video management software. In 2015, we plan to acquire Axis AB, the global leader in network video solutions.

We have also been focusing our energies on strengthening our MR (mixed reality) system business, enhancing these systems that merge the real and virtual worlds in real time. Within the medical equipment segment, we are working to swiftly establish our remote image-diagnostic service business while accelerating our development efforts in such promising areas as photoacoustic tomography devices capable of the three-dimensional display of blood vessels.



Canon U.S. Life Sciences, Inc., Maryland, is carrying out research and development for a DNA diagnostic system, using applications of CMOS sensor and inkjet printer technologies.

The Network Cameras deliver high image quality, advanced functionality, and high performance, while being used in various places, such as urban areas, offices, and public institutions, to provide new values.

Strategy 3 Establishing a world-leading globally optimized production system

Based on a comprehensive evaluation of such factors as foreign exchange fluctuations, wages, taxation systems, infrastructure and country risk, Canon is building a globally optimized production system from the perspective of total optimization.

In the aftermath of the Lehman crisis, the yen's appreciation gave rise to disparities in production costs between Japan and overseas countries. As manufacturing in Japan became increasingly challenging, we began shifting production overseas. As a result, production in Japan declined, accounting for 40% of total production in 2014, down from 60% in 2007. But with the value of the yen expected to remain low over the long term, we are bringing back manufacturing to Japan, particularly for new products. Through the strong promotion of automated production lines, robots and in-house production, we are building a framework to realize a new dimension of cost reductions as we step up our efforts to bring production back to Japan.

With respect to overseas production, in the Americas and Europe, we will make use of automated production systems, primarily for consumables, to manufacture products locally. By shortening the distance from factory to market, we will be able to deliver products in a timely manner while reducing transportation costs and inventory in transit. In Asia, in order to diffuse risk, we are moving quickly to reassess the uneven distribution of our production operations. Accordingly, we will readjust production volumes between countries and regions to achieve an optimal production distribution.

In addition to expanding the domain covered by automated production, to further bolster our manufacturing capabilities, we will broaden the scope of in-house manufacturing to include not only key parts, but also mass production items such as molded components.

Manufacturing Bases in the Globally Optimized Production Structure

Strategy 4 Comprehensively reinforcing global sales capabilities

In developed countries, within the consumer segment, we will strengthen our response to diversifying sales channels in line with the proliferation of online sales. Additionally, to effectively satisfy the centralized procurement needs of global corporations for office products, we are moving to swiftly train highly skilled sales engineers capable of providing comprehensive consulting services, offering solutions not limited to hardware, but including software as well. Moreover, for our global clients, we provide the same high-quality products, solutions and services worldwide.

Among emerging countries, we are finding diversity in terms of economic scale, levels of growth, market characteristics, cultures and customs. To respond to these differing circumstances in each country, we are working to develop diverse sales channels in accordance with in-depth field investigations, including the strengthening of our distributor sales network.

We are opening more Canon Image Square retail stores mainly in Asian emerging countries. Visitors at the store can try our products by themselves to see features and performances. (a shop in Vietnam)

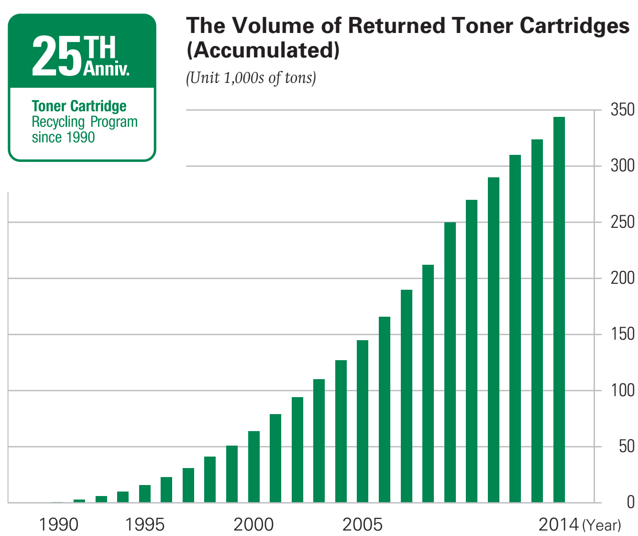
Strategy 5 Building the foundations of an environmentally advanced corporation

In addition to fulfilling our social responsibilities to the natural environment, Canon aims to be a company that actively achieves corporate growth while protecting the environment. As we strive to raise the performance of our products, we develop energy-saving technologies and materials with low environmental burden to minimize our environmental impact and cut carbon dioxide emissions.

During 2014, we reduced the use of raw materials by making products that were smaller and lighter, and accelerated the modal shift from air- to ocean-based transport. As a result, we successfully achieved a year-on-year reduction in life-cycle CO_2 emissions per product that exceeded our 3% target.

In 2015, Canon celebrates the 25th anniversary of the launch of our pioneering toner cartridge recycling program. We now offer toner cartridge collection services in 24 countries and carry out the localized recycling of cartridges in Japan, the United States, China and France. We will also continue our efforts to be a leader in the areas of waste reduction and efficient resource use.

The Volume of Returned Toner Cartridges (Accumulated)
(Unit 1,000s of tons)



*Data aggregation method changed after 2009.

Strategy 6 Imparting a corporate culture, and cultivating human resources befitting a truly excellent global company

The global economic map is changing dramatically in line with rapid advances in globalization and networking. To continue developing as a truly excellent global company worthy of admiration and respect for 100, and even 200, years, Canon must secure victory on the global playing field and, toward this objective, our workforce must continue to deliver innovation.

At Canon sales companies around the world, we already have many locally hired employees in upper management positions. Especially in Europe, our largest regional market, the presidents of all of our sales companies are from the region. Since 1980, moreover, we have held our Tokyo Seminar management training program for managers of overseas Canon Group companies to improve their managerial capabilities. We are working to foster and impart Canon's corporate culture, continuously embracing the challenge of innovation, while nurturing global human resources who can excel on the world stage.

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

In Conclusion

Since the Lehman crisis, Canon has built a rock-solid financial base in preparation for the next period of economic growth and has created many new businesses with promising futures. In short, we have fulfilled all the necessary conditions to make great progress.

The global economy is expected to gradually regain moment and head toward stable growth. We aim to ride this wave so that we will again be able to make great strides during Phase V of our Excellent Global Corporation Plan, which will begin in 2016. To this end, we will accelerate the development of new businesses to return to the growth track in 2015, bringing Phase IV to a successful close by further reinforcing our business foundation.

We look forward to your continued understanding and support.

FUJIO MITARAI
Chairman & CEO
Canon Inc.

Business Units	Main Products

OFFICE BUSINESS UNIT

Office Multifunction Devices (MFDs)

Digital Production Printing Systems

Laser Printers

High Speed Continuous Feed Printers

- Office Multifunction Devices (MFDs)
- Laser Multifunction Printers (MFPs)
- Laser Printers
- Digital Production Printing Systems
- High Speed Continuous Feed Printers
- Wide-Format Printers
- Document Solutions

IMAGING SYSTEM BUSINESS UNIT

Interchangeable Lens Digital Cameras

Digital Camcorders

Inkjet Printers

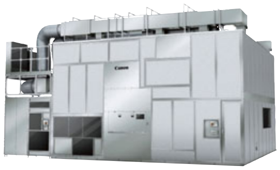
Multimedia Projectors

- Interchangeable Lens Digital Cameras
- Digital Compact Cameras
- Digital Camcorders
- Digital Cinema Cameras
- Interchangeable Lenses
- Inkjet Printers
- Large-Format Inkjet Printers
- Commercial Photo Printers
- Image Scanners
- Multimedia Projectors
- Broadcast Equipment
- Calculators

INDUSTRY AND OTHERS BUSINESS UNIT

Semiconductor Lithography Equipment

Digital Radiography Systems



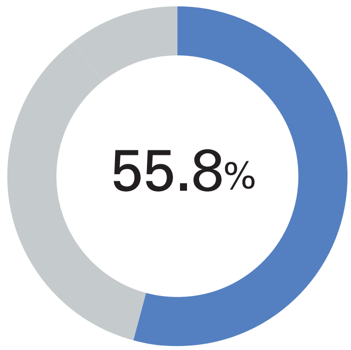
FPD (Flat Panel Display) Lithography Equipment

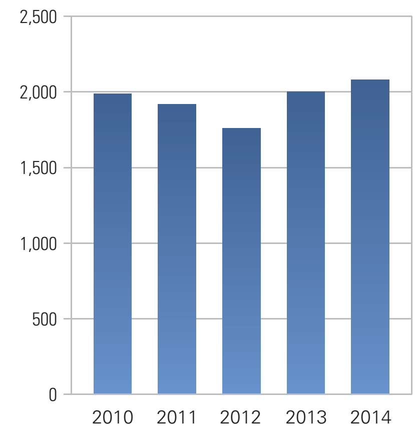
Network Cameras

- Semiconductor Lithography Equipment
- FPD (Flat Panel Display) Lithography Equipment
- Digital Radiography Systems
- Ophthalmic Equipment
- Vacuum Thin-Film Deposition Equipment
- Organic LED (OLED) Panel Manufacturing Equipment
- Die Bonders
- Micromotors
- Network Cameras
- Handy Terminals
- Document Scanners

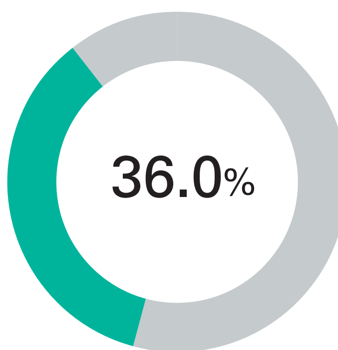
Outline | **Composition of Sales** *(%)* | **Net Sales** *(Billions of yen)*

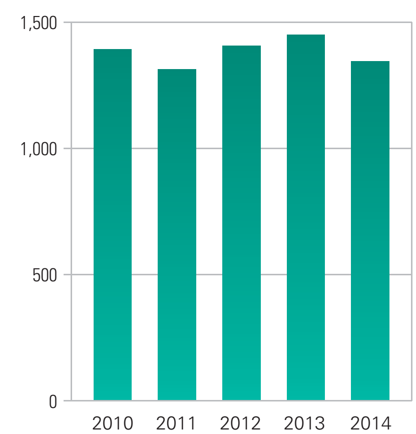
In this segment, Canon offers a comprehensive range of multifunction devices (MFDs), printers, and other equipment featuring high image quality, high resolution, and high speed. Leveraging these products, Canon works in close collaboration with various Group companies and alliance partners to deliver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



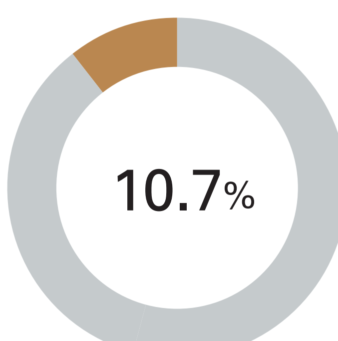


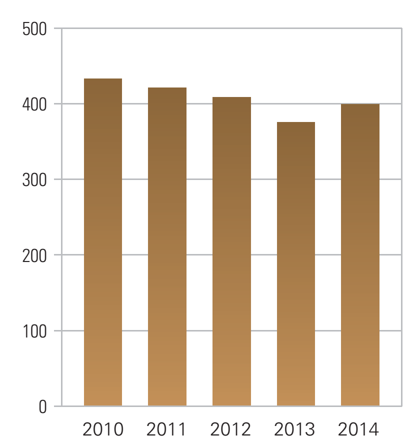
Canon's offerings in this segment include digital cameras, digital camcorders, digital cinema cameras, interchangeable lenses, inkjet printers, and calculators. Canon's digital cameras, digital camcorders and digital cinema cameras, designed to deliver unparalleled image quality, have earned particularly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





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





Note: The percentage figures for the three business units presented in the pie charts above do not add up to 100% because "Eliminations," recorded in consolidation accounting, were not included in calculation considerations.

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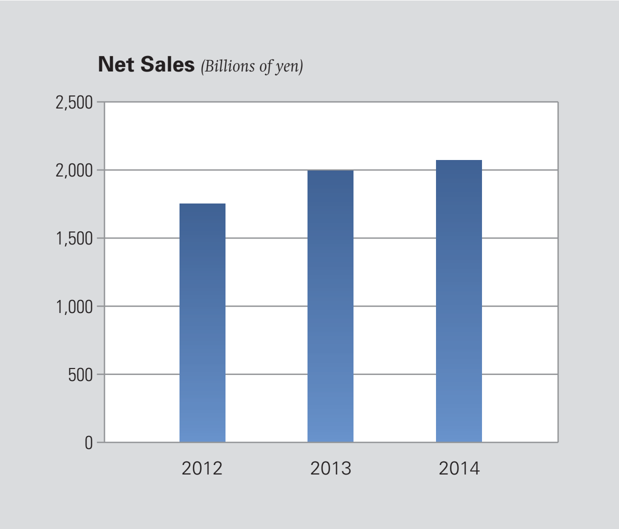
Canon has expanded the functions of its office multifunction devices, which realize enhanced coordination with IT systems and are compatible with various types of system application software, offering an optimal usage environment for all sorts of document-related tasks.



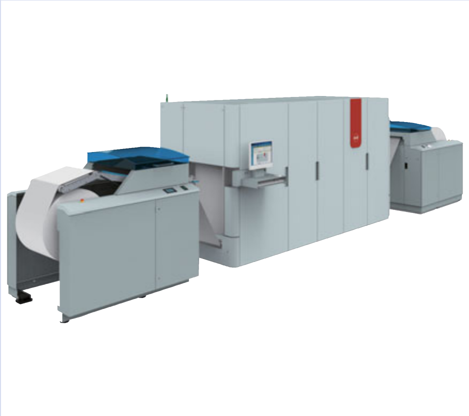
2014 Review

Amid healthy demand for office multifunction devices (MFDs) underpinned by improved corporate results, Canon launched the C350/C250-series models, the first color A4 models in its imageRUNNER ADVANCE series. The new models sold well, especially in Europe and North America. Accordingly, we now have a full lineup that can provide solutions for more precise office document environments. The imageRUNNER ADVANCE C5200 series of A3 models also performed well. As a result, sales of office MFDs increased year on year.

In digital production printing systems, we released the C800/C700 series, the first color models in the imagePRESS series targeting the light production market. The new models received worldwide acclaim, which helped generate significant sales growth for color printers. Overall sales for digital production printing systems, including monochrome models, surpassed the previous year.

The imageRUNNER ADVANCE C350/C250, first A4 color multifunction device in imageRUNNER ADVANCE series. It has the same functions and user convenience as the A3 multifunction device and contributes to higher work efficiency through system linkage.

The imagePRESS C800/C700, color multifunction device that delivers high-quality printing through the use of new technology. Aimed at the light-production market, it offers consistently vivid colors even in mass volume printing, it supports various paper types, and it is well suited to a wide range of needs from commercial printing to in-company printing.



The Océ ColorStream 3000 are high-speed, continuous-feed commercial printers for applications requiring high speed and high quality such as the printing of invoices, direct mail, etc. as demanded by the data print services (DPS) market.

Canon's laser multifunction printers (MFPs) and laser printers for small and mid-sized businesses performed well, driven by sales growth in Japan and the Americas.

In the area of OEM-brand laser MFPs and laser printers, difficult economic conditions, especially in Europe, restricted unit sales to previous-year levels. Sales of high-end models increased, however, resulting in an overall sales increase.

Sales of Océ ColorStream 3000 series were solid among high speed, continuous feed printers manufactured by Océ.

As a result, consolidated sales for this business unit amounted to ¥2,078.7 billion, up 3.9% from the previous year.

2015 Initiatives

The market for office MFDs is expected to expand for the time being. At the same time, there is increasing need to outsource specific operations and modernize administrative processes using IT solutions such as mobile technology, cloud computing, and social networking services (SNSs). Against this backdrop, Canon will further strengthen its hardware product offerings by measures such as releasing new products. Moreover, we will improve the framework for the one-stop delivery of comprehensive, high-quality services and solutions all over the world.

Océ has already built a strong position in high-volume document printing, such as direct mail, transaction, and computer-aided design (CAD) printing. In addition to that, Océ plans to enter profitable new printing sectors, including printing of graphic arts as well as printing for packages and home decoration materials. To achieve this smoothly, Océ further collaborates with Canon.

In the OEM business, Canon will work for cost reductions while making more compact products and providing highly competitive offerings.

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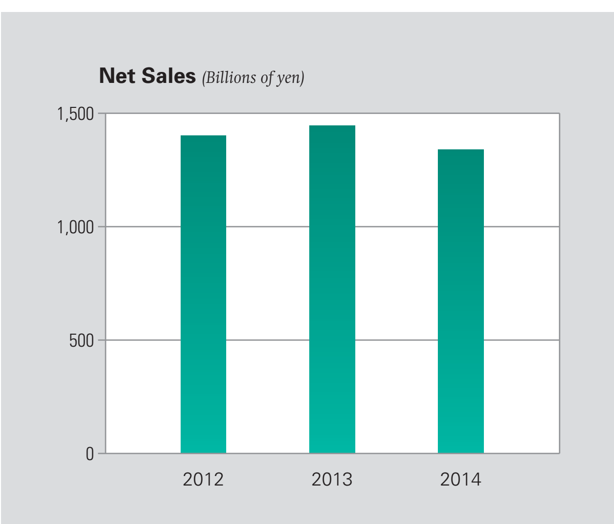
Canon's interchangeable lens digital cameras, which use groundbreaking technology such as proprietary lenses, CMOS sensors, and image processors, lead the world with their high image quality and contribute to sales.



2014 Review

In the interchangeable lens digital camera category, unit sales declined year on year, impacted by a generally difficult market environment caused by weak economic trends, particularly in Europe and China. Canon worked actively to boost sales and further enhance our lineup with the release of six new interchangeable lenses and the launch of the EOS 7D Mark II, which boasts exceptional high-speed continuous-shooting capabilities. As a result, we maintained the No. 1[*1] share of the world market.

As for digital compact cameras, Canon reported lower sales in both volume and value terms amid a shrinking market, but was successful in raising the sales ratio for high-value-added products.

Regarding digital cinema cameras, Canon responded to changing market conditions, including the spread of 4K models and the trend toward lower prices, and posted healthy sales as a result. Broadcasting equipment also sold well thanks to solid demand from the sports sector and in emerging economies. During the year, we unveiled the CN7x17KAS S zoom lens, which achieved

The EOS 7D Mark II is our flagship model equipped with an APS-C-size CMOS sensor offering further enhancements in continuous shooting and AF functions. The interchangeable lens digital camera offers an excellent tracking capability to capture moving subjects for decisive shots.

The EF cinema lens CN7x17 KAS S is a high-magnification zoom lens compatible with large-sensor cameras used for the production of broadcasting content and motion pictures. It is the first EF cinema lens to be equipped with a drive unit.

The DreamLabo commercial photo printer combines high image quality and high speed to provide excellent performance. It meets the demands of the retail photo industry, including the production of high-quality commercial photo materials such as photobooks.

downsizing while maintaining 4K-resolution performance throughout the entire 7x zoom range. It received quite a well response from the market.

In inkjet printers, Canon launched new products that have improved connectivity with mobile equipment and models targeting female customers[*2] as well as a new office brand MAXIFY in response to diversified demand in the market. Unit sales of inkjet printers declined moderately amid delayed global economic recovery, but sales of consumables increased year on year.

Sales of large-format inkjet printers rose steadily due partly to new contracts with large corporate customers, which resulted in an increase in the net sales of consumables.

However, the decline in unit sales of digital compact cameras had a major impact, causing a 7.3% year-on-year decrease in consolidated sales for this business unit, to ¥1,343.2 billion.

*1 Based on a Canon survey.
*2 These models are sold only in Japan.

2015 Initiatives

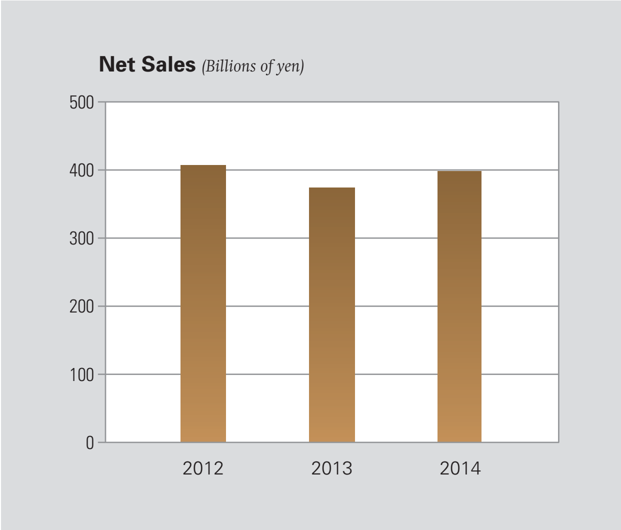
In interchangeable lens digital cameras, Canon will make further refinements to its lenses, sensors, and image processors and also step up our responses to trends such as cloud computing and SNSs. In digital compact cameras, we will enhance features of cameras' core appeals, such as operability, image quality, and image expression, to further distinguish our products from smartphone cameras, while raising affinity with mobile devices. In this way, we aim to achieve coexistence and co-prosperity of these devices.

With respect to the Cinema EOS System, we will further expand sales in emerging countries as well as focus on entering non-cinema-related sectors, such as news reporting and broadcasting.

In inkjet printers, we will step up rollouts targeting the office market, and in large-format inkjet printers we will respond meticulously to industry needs in order to expand market share.

In DreamLabo commercial photo printers, Canon will diversify sales methods including rental and leasing, while building highly profitable business models such as photobook services of editing and bookbinding.

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



2014 Review

In the business of semiconductor lithography equipment, unit sales of the FPA-5550iZ and FPA-6300ES6a increased significantly year on year. This is because manufacturers of memory devices continued making proactive capital investments to address healthy demand for smartphones and other mobile devices. As for FPD (Flat panel display) lithography equipment, unit sales of the MPAsp-H800 series increased year on year, benefiting from major growth in investment in equipment for manufacturing large-sized panels, such as high-resolution 4K displays.

In medical equipment, Canon posted higher sales than the previous year on the back of increased sales of high-value-added products in its core digital radiography systems operation; for example, high-image-quality wireless models featuring automatic X-ray detection mode.

Furthermore, Canon augmented its lineup of network cameras, adding new models suited to various indoor environments, such as offices and large retail stores, while working hard to boost sales. As a result, the sales of last year significantly increased. In June 2014, Denmark-based Milestone Systems A/S, one of the

The FPA-5550iZ i-line stepper employs the FPA-5500 platform with proven high performance and reliability, which enables high throughput through such means as short exposure times made possible by a high-acceleration wafer stage.

The Network Camera lineup delivers high image quality, advanced functionality, and high performance, while reducing the bandwidth burden on networks. It meets various needs in many places such as urban areas, offices, public institutions, factories, and shops.

The Wireless Digital Radiography System series enables wireless transmission of imaging data to computers and is suitable for various imaging areas. Canon is focusing on this equipment.

world's largest video management software companies, became a member of the Canon Group, further strengthening Canon's network camera business.

Sales of document scanners manufactured by Canon Electronics Inc. increased, helped by brisk sales in the Middle East, South America, India, and other emerging economies.

Both sales of semiconductor film deposition equipment manufactured by Canon ANELVA Corporation and organic LED (OLED) panel manufacturing equipment made by Canon Tokki Corporation declined as capital investments by corporate customers were postponed. However, sales of factory automation (FA) systems and semiconductor manufacturing equipment made by Canon Machinery Inc. increased steadily on the back of favorable demand.

As a result, sales for this business unit increased 6.4% year on year, to ¥398.8 billion.

2015 Initiatives

In the optical product field, the semiconductor lithography equipment market is expected to grow steadily. In response, Canon will bolster efforts to raise productivity of both i-line steppers and KrF scanners while reducing costs in order to further expand market share in this field. Furthermore, aiming to adapt our next-generation lithography equipment for the high-volume manufacturing of leading edge devices, we will also strengthen our nanoimprint lithography technologies, which we acquired through M&A in 2014. In FPD lithography equipment sector, where 4K and 8K displays are expected to gather momentum, we will take the lead in increasing resolution also for large-sized panels.

In medical equipment, Canon will solidify its business foundation in preparation for future growth by focusing on high-value-added offerings such as dynamic imaging technology in digital radiography systems and high-end products in ophthalmic equipment. Furthermore, we will continue steadily preparing for the launch of DNA diagnostic systems on the U.S. market.

As for network cameras, we acquired Milestone Systems in 2014. Moreover, in 2015 we plan to acquire Axis AB, the global leader in network video solutions, to secure our No.1 position in the global network video surveillance market.

OFFICE BUSINESS UNIT

imageRUNNER ADVANCE C7270 Office MFD

Canon Signed Global Partnership with Volkswagen for Managed Print Services

Canon signed a comprehensive agreement with German automobile manufacturer Volkswagen AG, under which we are delivering Canon multifunction office systems and laser printers to global Volkswagen group offices and factories, while providing assorted solutions and services. The agreement reflects Canon's advanced technological capabilities and highly reliable equipment, which make possible the same solutions in any region around the world, as well as the new development of applications tailored to meet unique customer needs. Another highly recognized point was Canon's proactive initiatives aimed at protecting the environment, including efforts to develop products that deliver high environmental performance.

Since 2004, we have operated the Canon Global Services Division as a dedicated in-house organization tasked with responding to the business machine needs of customers with global business operations. The Division uses Canon's sales channels and service networks across more than 220 countries and regions to actively offer our globally unified, high-quality services.

IMAGING SYSTEM BUSINESS UNIT

EF lens-series lineup

Canon Achieved World First as EF Interchangeable Lens Production Surpasses 100 Million Mark*1

In April 2014, Canon became the first in the world to reach the 100 million mark for production of interchangeable EF lenses for EOS-series AF (autofocus) interchangeable lens cameras; the production began in 1987.

Canon's EF lenses have continued to evolve over the years, leading the industry through the incorporation of a wide range of innovative technologies, including the world's first items*2, such as Image Stabilizer (IS), Ultrasonic Motor (USM) which enables fast auto focusing, and built-in extender super-telephoto zoom lens. Canon has expanded the optical technologies incorporated in its EF lenses into new fields, launching EF Cinema Lenses for digital cinematography in January 2012, and EF-M lenses for compact-system cameras in September 2012.

Furthermore, during the 12-year period from 2003 to 2014, Canon maintained the No. 1 unit share of the worldwide interchangeable lens digital camera market*3. The Company will continue striving to produce exceptional, highly reliable cameras and lenses that cater to the varying needs of photographers, from first-time users to advanced amateurs and professionals.

*1. Among interchangeable lenses, based on a Canon survey (as of April 22, 2014).
*2. Among interchangeable lenses for interchangeable lens cameras, based on a Canon survey.
*3. Based on a Canon survey.

IMAGING SYSTEM BUSINESS UNIT

Business inkjet printer MAXIFY MB5300 series

Canon Launched MAXIFY Inkjet Printers for Business Use

Canon unveiled MAXIFY, a new series of inkjet all-in-ones and printers for small- and medium-sized businesses. The lineup comprises five models, while meeting business needs and offering high productivity, high image quality, and high economic efficiency.

The MAXIFY series delivers significant increases in printing speed thanks to a newly developed print head and efficient paper feed system. The models contribute to enhanced office efficiency through the large-capacity ink tanks and sheet cassettes, which require fewer tank replacements and minimize the need for paper refills. Furthermore, their dedicated pigment ink system, newly developed by Canon, includes a high-density black ink for improved legibility, which makes text clear and easy to read, and inks that do not smudge when overwritten by highlighter while hard to erase. Moreover, the color arrangement has been designed to suit varied business needs, enabling vivid color printing of graphs, text, photographs, and web pages. Reflecting Canon's deep commitment to business needs, the MAXIFY series keeps ink costs and power consumption under control to deliver high economy and environmental performance.

INDUSTRY AND OTHERS BUSINESS UNIT

RV1100 3-D Machine Vision System

Canon Entered Machine Vision Market with Launch of RV1100

Canon launched the RV1100 3-D Machine Vision System. It uses a new three-dimensional recognition technology that Canon has developed based on its optical, image-recognition, and information-processing technologies, which were cultivated through the Company's research and development of cameras and business machines.

The RV1100 makes possible high-speed, high-precision, 3-D recognition of various objects arranged randomly in a pile on a production line, including parts with curved features, parts without distinguishing characteristics, and parts with complex structures. Encompassing a 3-D machine vision head, which acts as the sensor, and vision recognition software which works as the processor, the system transmits recognition data to the controller of the robotic arm in the production line. Accordingly, the RV1100 plays an important role in automating and expediting the supply of parts to production lines, leading to improve productivity at factories of each client manufacturer.

At a monthly meeting of all company executives, the CEO provides updates on earnings progress and important matters to implement in the future as a way to share crucial information.

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

Basic Policy

In order to establish a sound corporate governance structure and continuously raise corporate value, Canon believes that it is essential to improve management transparency and strengthen functions to supervise and monitor management. In this respect, a sense of ethics and mission held by each executive director and employee is very important for the Company.

Representative Directors, Directors, and Board of Directors

At Canon, the Chief Executive Officer (CEO), who is a Representative Director, decides the Company's management strategies and policies while managing the overall execution of the operations of the Company. The other Representative Director is the Chief Financial Officer (CFO), who controls financial matters.

Under the management of the CEO, each business segment takes responsibilities of its operational management on a consolidated basis in an integrated structure covering everything from product development to production and sales. In addition, the headquarters supports and controls finance and accounting, quality management, global environment, and global legal administration, undertaking administrative functions.

The Board of Directors, consisting of 17 Directors as of March 27, 2015, makes decisions on items prescribed in the Companies Act, including policies for establishing an internal control system, and other important matters on execution of the operations of the Company. Furthermore, the Board receives reports on execution of the Company operations controlled by the CEO on a regular basis, and otherwise as necessary, and oversees such execution of the operations of the Company.

Directors and Audit & Supervisory Board Members *(as of March 27, 2015)*

Chairman & CEO

Fujio Mitarai

Executive Vice President & CFO

Toshizo Tanaka
Group Executive of Finance & Accounting Headquarters
Group Executive of Facilities Management Headquarters
Group Executive of Human Resources Management & Organization Headquarters

Senior Managing Directors

Yoroku Adachi
Chairman & CEO of Canon U.S.A., Inc.

Shigeyuki Matsumoto
Group Executive of Device Technology Development Headquarters
Group Executive of Corporate R&D

Toshio Homma
Group Executive of Procurement Headquarters

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

Masaya Maeda
Chief Executive of Image Communication Products Operations

Managing Director

Yasuhiro Tani
Group Executive of Digital System Technology Development Headquarters

Directors

Kenichi Nagasawa
Group Executive of Corporate Intellectual Property & Legal Headquarters

Naoji Otsuka
Chief Executive of Inkjet Products Operations

Masanori Yamada
Group Executive of Network Visual Solution Business Promotion Headquarters

Aitake Wakiya
Deputy Group Executive of Finance & Accounting Headquarters

Akiyoshi Kimura
Chief Executive of Office Imaging Products Operations

Eiji Osanai
Group Executive of Production Engineering Headquarters

Masaaki Nakamura
Deputy Group Executive of Human Resources Management & Organization Headquarters

Kunitaro Saida *(Outside)*
Attorney

Haruhiko Kato *(Outside)*
President & CEO of Japan Securities Depository Center, Inc.

Audit & Supervisory Board Members

Makoto Araki

Kazuto Ono

Tadashi Ohe *(Outside)*

Osami Yoshida *(Outside)*

Kuniyoshi Kitamura *(Outside)*

Note: Although this annual report is on FY2014, the above list of Directors and Audit & Supervisory Board members is as of March 27, 2015.

The Company believes that well-developed knowledge of conditions on the ground is the key to swift and effective decision-making and appropriate business monitoring. For this reason, most Directors are involved in execution of the operations of the Company as Group Executives or Chief Executives in charge of the Company's main operations. In addition to that, Canon also has two Outside Directors as independent directors* who bring impartial perspectives to management that would differ from those of Canon career veterans.

To help directors focus more effectively on management and oversight, Canon has appointed Executive Officers who separately undertake execution of the operations of the Company. As of April 1, 2015, there will be 22 Executive Officers, including one woman.

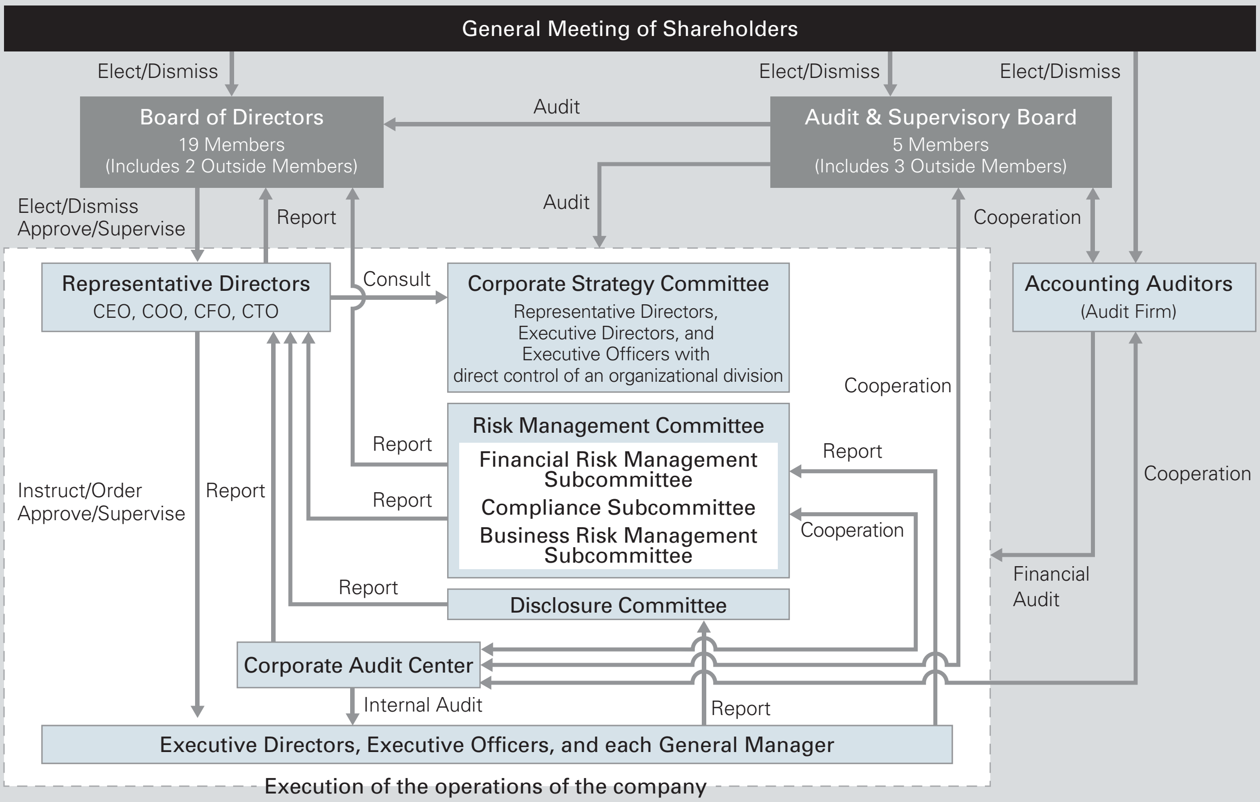
* Independent directors: Stock exchanges in Japan require listed companies to appoint outside directors and/or outside Audit & Supervisory Board members and to report their name. Outside directors and Audit & Supervisory Board members should have no possible conflict of interests with regular stockholders. People related to the parent company or major business partners, consultants who receive large remunerations from the company, and their close relatives cannot be selected as independent directors.

Corporate Strategy Committee, Risk Management Committee, and Disclosure Committee

The Corporate Strategy Committee, consisting of Representative Directors, Executive Directors, and some Executive Officers, functions as an advisory body to the CEO. Among items to be decided by the CEO, the Committee undertakes prior deliberations on important matters pertaining to Canon Group strategies. Outside directors and outside Audit & Supervisory Board members attend the Corporate Strategy Committee meetings and proffer their opinions.

Based on its policy on establishment of an internal control system, the Company set up the Risk Management Committee, which formulates policy and action proposals for improvement of the risk management system in the Canon Group under decisions of the Board of Directors. The Risk Management Committee consists of three entities: the Financial Risk Management Subcommittee, which improves systems on the credibility of financial reporting; the Compliance Subcommittee, which

Governance Structure *(as of January 1, 2015)*



ensures thorough implementation of corporate ethics and improves legal compliance systems; the Business Risk Management Subcommittee, which improves systems prepared for overall business risks, including insufficient product quality and information leakage. The Risk Management Committee verifies the risk management system and reports the status to the CEO.

In addition, the Disclosure Committee undertakes deliberations on information disclosure, including content and timing, to ensure timely and accurate disclosure of important company information.

Audit & Supervisory Board

Canon is a "Company with an Audit & Supervisory Board." The Board consists of five members, three of which are independent Outside Audit & Supervisory Board members. In accordance with auditing policies and plans decided at Audit & Supervisory Board meetings, members of the Audit & Supervisory Board attend Board of Directors meetings, Corporate Strategy Committee meetings, and other relevant meetings, while receiving verbal reports from directors, reviewing important approval documents, and examining the business and financial asset statuses of the Company and its subsidiaries. In these ways, the Audit & Supervisory Board meticulously checks directors' and others' execution of the company operations, including establishment and operation of the internal control system, thus is fulfilling a management oversight function. The Board also works in close alliance with the Internal Audit Division and the accounting auditors to improve the efficacy of monitoring.

Internal Audit Division

The Corporate Audit Center, with about 70 members, is the Company's internal auditing arm. It conducts audits and evaluations and provides guidance on all operations and sectors without exception, including those of Group companies, from various perspectives, such as

The *San-Ji* ("Three Selfs") Spirit, passed down from the initiation of the company, is one of Canon's guiding principles. The three are "take the initiative and be proactive in all things" (Self-motivation), "conduct oneself with responsibility and accountability" (Self-management), and "understand one's situation and role in all situations" (Self-awareness). (calligraphy by Canon's first president, Takeshi Mitarai)

business efficacy and efficiency, compliance, and information security. Audits results are reported to the CEO and Audit & Supervisory Board and complement audits conducted by members of that board.

Accounting Auditors

The Company has an auditing service contract with its independent auditor, Ernst & Young ShinNihon LLC, to audit its financial statements. To check the validity of the audits, the Company's Audit & Supervisory Board members receive detailed explanations from the accounting auditors about the quality management system regarding audits.

With the aim of monitoring the independence of the accounting auditors, the Company introduced a prior approval system by the Audit & Supervisory Board for contents of auditing and other service contracts and relevant fees. Based on "policies and procedures of the prior approval for both auditing and non-auditing services," each contract is closely reviewed for prior approval.

Compliance

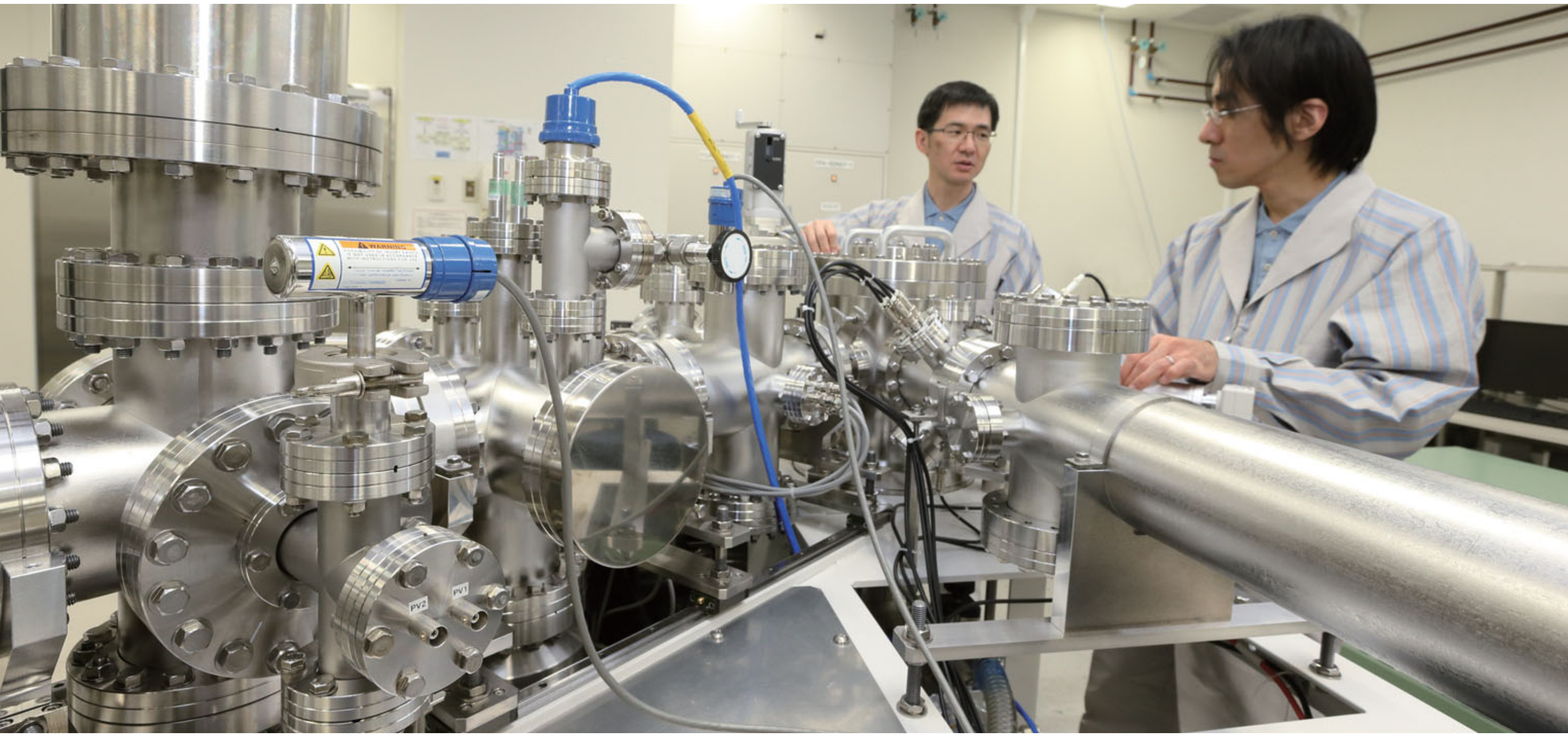
Shortly after its founding, Canon established the *San-Ji* ("Three Selfs") Spirit principles: "self-motivation," or taking the initiative and being proactive in all things; "self-management," or conducting oneself responsibly and being accountable for all one's actions; and "self-awareness," or understanding one's situation and role in it. In 2001, Canon established the Canon Group Code of Conduct, inspired by the above Three Selfs. The Code has been translated into 14 languages from Japanese, and each Group company makes efforts to enforce the Code.

Countering Antisocial Forces

Canon has a basic policy prohibiting relationships of any kind with antisocial forces that represent a threat to social order and security. To uphold this basic policy, Canon has established a department dedicated to activities aimed at countering such parties while reinforcing cooperative ties with applicable public authorities. In addition, Canon's Employment Regulations include a clause prohibiting such relationships, and the Company continues to step up efforts to ensure strict employee adherence.

Risk Management

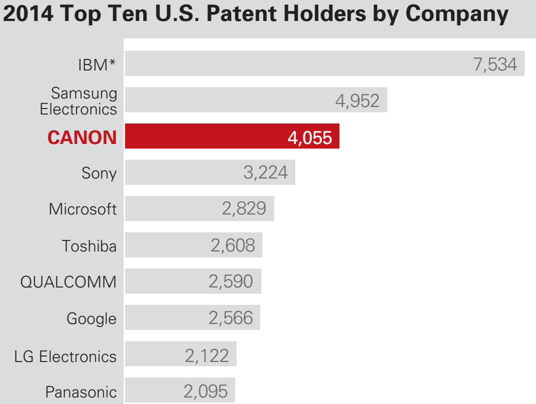
As Canon expands its business on a global scale, business and other risks to which it may be exposed continue to diversify. In accordance with policies of its Risk Management Committee, Canon calculates and investigates conceivable risks across the entire Group. Canon also strives to prevent or minimize the emergence of risk by formulating company regulations and other rules and conducting employee education.



Canon works to improve pathological diagnosis, which determines the presence and spread of cancer by observing shapes and interconnections of human cells. We are conducting R&D on an imaging mass spectrometer with high spatial resolution and high sensitivity that can detect a mass of molecules and reconstruct its spectrum to form an image, allowing users to identify the two-dimensional distribution of substances in tissues.

Seeking to create a new Canon, the Company is reinforcing an R&D structure spanning Japan, the United States, and Europe under the Three Regional Headquarters management system. At the same time, we are continuing to tackle challenges to develop products for professionals in unexplored fields.

2014 Top Ten U.S. Patent Holders by Company



*IBM is an abbreviation for International Business Machines Corporation.
Source: Preliminary data released by IFI CLAIMS Patent Services, a U.S. research company specialized in patent information

Strengthening Our Global R&D Structure

Pursuing globalized diversification of its operations, Canon is moving away from its existing structure, in which competitive, technologically advanced products have been made mostly in Japan. Today, we have established the foundation of the Three Regional Headquarters management system that leads to new businesses emerging from each operation in Japan, the United States, and Europe.

In the United States, Canon has set up research institutes covering from basic research into unexplored fields including healthcare to applied research on cutting-edge technologies. In Europe, we will make further use of existing R&D centers to advance R&D in new fields.

R&D Expenses and Patents

Canon is bolstering R&D activities to enable the ongoing development of innovative products and services. In the year under review, R&D expenses amounted to ¥309.0 billion, up 0.9%, or ¥2.7 billion, from the previous year. The ratio of R&D expenses to net sales was 8.3%. This focus on R&D activities has cemented Canon's

Canon's 120-megapixel ultrahigh-resolution CMOS sensor for video recording can output full HD video in real time from any approximately one-sixtieth-sized section of its total surface area. Accordingly, images captured with the sensor maintain high levels of definition and clarity even when cropped or digitally magnified.

high status in the field of intellectual property. In 2014, Canon was granted 4,055 patents in the United States, ranking it third in the world and the top ranked Japanese company for a tenth consecutive year.

Reinforcing Core Technologies

Canon is concentrating efforts on pre-competitive fields areas, involving research that can take more than ten years. At the same time, the Company is continually bolstering activities centered on key parts and key devices in order to enhance the competitiveness of its products.

For instance, we seek to boost the sensitivity, image quality, and noise reduction of CMOS sensors for interchangeable lens digital cameras to realize new types of visual expression for cameras. By raising the performance levels of these devices to the full extent, we are developing sensors applicable to functions used in such areas as medical research and surveillance and security. We are now promoting businesses of CMOS sensor components.

Initiatives to Establish New Businesses

In the medical equipment field toward the establishment of new pillars of growth, we are conducting research in Japan into photoacoustic tomography (PAT) technique for displaying blood vessels in three-dimensional images, using laser radiation and ultrasonic detectors. Canon in Japan is also conducting research into adaptive optics scanning laser ophthalmoscopy (AO-SLO), which enables examination of the retina at the cellular level. In the United States, we are complementing our work in DNA diagnostic systems with research in the fields of biomedical optical imaging and medical robotics technologies, with the aim of developing new medical devices and commercializing them.

In the industrial equipment field, Canon applies its optical, capturing and imaging technologies to advanced 3D measurement and recognition technologies. The technologies are part of our ongoing research on Super Machine Vision, which will serve as the eyes of intelligent robots.

Canon works to maintain and expand production, actively introducing our automation technologies and extending them in high-value-added products such as assembly of EF lens units. (the Utsunomiya Plant, Japan)

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

Belief in "Internal Production"

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

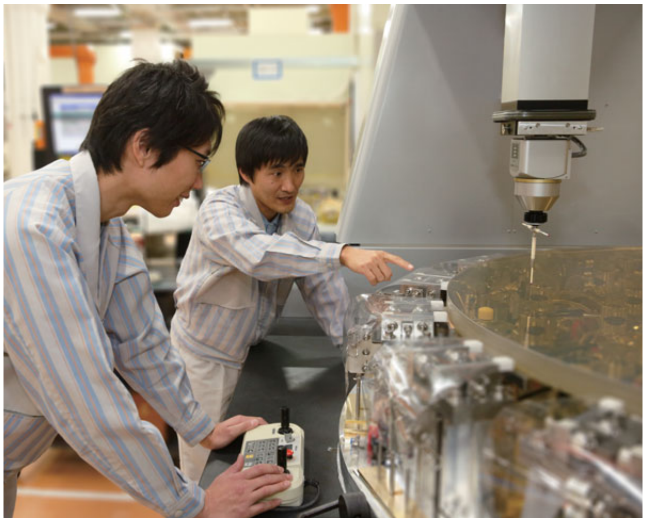
Internal Production

Establishing a Globally Optimized Production System

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

Improving Productivity

Canon continues to expedite production in optimal locations. At the same time, by putting a priority on conducting production operations in-house, we proceed to raise quality and reduce costs through progress in manufacturing by making full use of the expertise and insights of individual workers engaged in production. To this end, the Company has adopted a cell production system—an approach that fully utilizes the creativity of



Canon is participating in a next-generation ultra-large-telescope project aimed at fostering unparalleled and new astronomical research never seen before. Engaged in the project, Canon is pressing ahead with technological innovations in optical technologies and systems for high-precision measurement and processing.

Committed to offer customers products that are safe while also providing trust and satisfaction, Canon adheres stringent quality control measures at every process, reflecting its basic concept of quality: “no claims, no trouble.” (the Tamagawa Office, Japan)

individual workers. Canon continues to improve productivity by making efforts to increase production efficiencies in cell production while rolling out “man-machine cell” production systems that integrate manual and automated processes.

In the Americas and Europe, Canon accelerates localized production of consumables such as toner cartridges by using automated production lines. Our aim is to deliver products timely while reducing transportation costs and inventory in transit.

As for efforts to improve productivity in each region, Canon in Japan has introduced prototype-less production adopting simulation technology on supercomputer systems and has used 3D printers to make prototypes. With these technologies, we are pursuing ideal product designs and significantly shorter development times. Furthermore, with the aim of further cost reductions, we have expanded our in-house production range from key parts including image sensors to large-quantity-procured items including molded parts. We have also deployed automated production lines for assembly of EF lens focus units and then basic processing of camera bodies.

Environmental Friendly Manufacturing; Enhanced Product Quality

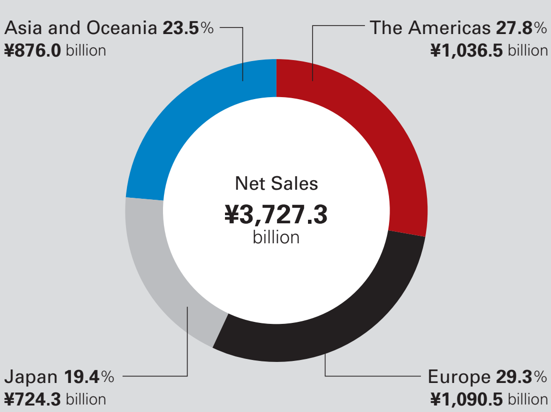
Canon actively seeks to prioritize purchases of environmentally conscious parts and materials as well as shift to transportation modes that have minimal environmental impact. We also focus on manufacturing initiatives that are friendly to the global environment.

Creating top-quality products is a relentless challenge at Canon. Grinding and processing of lenses is one of those that require advanced technologies. We have been entrusted with the responsibility of processing the 30-meter-diameter multi-segment primary mirror to be incorporated in the Thirty Meter Telescope (TMT), currently under construction near the summit of Mauna Kea, Hawaii, and scheduled for completion in 2021.

Canon (China) Co., Ltd. actively joins camera shows including the China International Photograph & Electrical Imaging Machinery and Technology Fair to promote our comprehensive capability as the leading imaging company.

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

Composition of Sales by Region



Japan

In the year under review, sales in Japan amounted to ¥724.3 billion, equivalent to 19.4% of consolidated net sales.

Due to the prolonged impact of the consumption tax hike, the market for consumer products became more challenging than in the previous year. Nevertheless, Canon secured the top market shares of its main products interchangeable lens digital cameras, compact digital cameras, and inkjet printers; our proactive sales promotion efforts including user-oriented campaigns contributed to this achievement. In the B2B field, we advanced a new business of 3D Solutions for manufacturers, which combines 3D printers with computer graphics (CG) technologies. We also used our data centers to broaden our cloud services. In one highlight, we provided infrastructure enabling observation of patients' medical examination images from remote locations.

The Americas

Sales in the Americas came to ¥1,036.5 billion, or 27.8%

New Come and See brand identity unveiled at Photokina in Cologne, Germany, September 2014 to inspire and engage the 180,000 visitors and hundreds of journalists.


Canon U.S.A. opened the Canon Experience Center in Costa Mesa, California, as a new customer service operation center covering the area of the West Coast.

of consolidated net sales.

Canon Americas has been making steady progress toward creating a regional headquarters that will handle product development, manufacturing, and sales functions. In 2014, we focused on enhancing customer services by opening new support service operations: the Canon Experience Center, in Southern California, and our second U.S. call center, in New Mexico. We also launched our new marketing slogan, Canon See Impossible, and devised a brand strategy aimed at addressing changing markets and conveying new levels of added value created by Canon.

Europe (Europe, Middle East, Africa)

In Europe sales amounted to ¥1,090.5 billion (29.3% of consolidated net sales).

In 2014, Canon Europe increased market share in key segments, while also focusing on developing new opportunities for diversification and future growth. Canon's acquisition of Milestone Systems A/S, a world leader in video management software, was a major strategic step in driving growth in network visual solutions. To appeal to new consumers, a new brand identity was launched—Come and See. A new cloud-based image management service, irista, was also launched in 2014. Canon strengthened its sales and marketing in the Middle East through the formation of a new Canon sales company in Qatar.

Asia and Oceania

In Asia and Oceania sales amounted to ¥876.0 billion (23.5% of consolidated net sales).

Canon has started Asia Traveler Protection Program (ATPP), seeking to offer added values to increasing international tourists in China and Southeast Asia. When our customers buy Canon's products such as cameras and lenses in mainland China and visit overseas countries, they can use the repair service for free in eleven countries and regions in Asia.

In Australia, Canon acquired a majority stake in Harbour IT Pty. Ltd., one of the largest managed services and cloud solutions providers, to enhance our business services offering.

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Canon India Pvt. Ltd. rolls out continuously various community welfare programs in the three areas of eye care, education and environment in villages without adequate educational and healthcare facilities. For example, we improve school facilities by setting up resource centers for children and installing solar panels. We also help villagers by providing eye check-ups with Canon's retinal cameras. (Ferozepur Namak Village)

Guided by its *kyosei* ("living and working together for the common good") philosophy, Canon is promoting CSR activities with the aim of becoming a truly excellent corporation that is admired and respected the world over.

Canon U.S.A. has made various efforts to reduce the environmental impact of its headquarters building including incorporating natural light and installing a rainwater capture and storage system that uses greenery.

Canon's Basic Approach to CSR

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

Environmental Activities

Canon Selected by CDP as Leading Company in Climate Change Information Disclosure

In 2014, CDP, an international nonprofit organization (NPO) that conducts environmental assessments, selected Canon for the first time as a leading company in climate change information disclosure under its environmental ratings. Canon was recognized for its initiatives such as the effort to ensure transparency by obtaining third party verification of its greenhouse gas emissions data.

LEED Certification

In February 2014, Canon Americas Headquarters received the Gold certification of the international standard LEED (Leadership in Energy & Environmental Design) as a highly resource-efficient, green building. In

Deleted due to portrait rights.

The “Eyes on Yellowstone”, an education and research program in partnership with Yellowstone National Park, releases videos of wildlife in their natural environment online. These videos are used to educate children around the world.

Under the Tsuzuri Project, in 2014 Canon made high-resolution reproductions of all 16 fusuma (sliding door) paintings of “Scene of Rice Cultivation.” This work, believed to have been painted by Kano Sanraku, are now in the possession of the Minneapolis Institute of Art. Canon donated the reproductions to the Daikakuji Temple at the former Saga Imperial Palace in Kyoto, Japan.

September 2014, the Canon U.S.A. distribution center in Atlanta was the first facility to receive LEED certification in the new “Building Design and Construction – Warehouses and Distribution Centers” category.

Conservation Activities at National Parks in the United States

Canon U.S.A. continues to provide support for environmental protection activities in U.S. national parks. The company began supporting Yellowstone National Park in 1995 and Acadia National Park in 2013. Canon imaging equipment is used to observe wildlife, create video libraries and support communication activities.

Social Contribution Activities

Canon conducts wide-ranging social contribution activities in various parts of the world to help create a better society.

Canon Foundation Announces Fifth Grant Program Recipients

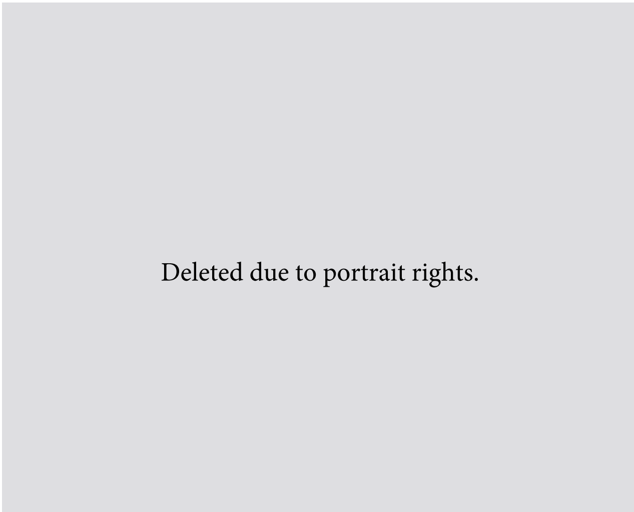
The Canon Foundation aims to contribute to the ongoing prosperity and well-being of mankind. It has offered two research grant programs, known as the Creation of Industrial Infrastructure grant and Pursuit of Ideals grant. In 2014, 17 projects were selected for the fifth research grant program.

The Tsuzuri Project

Canon and the non-profit organization Kyoto Culture Association jointly promote a project called the “Tsuzuri Project” (Official title: Cultural Heritage Inheritance Project). The aim of the project is to preserve original cultural assets while maximizing the effective use of high-resolution facsimiles of cultural assets. These facsimiles are created by blending Canon’s latest digital technology and traditional Japanese crafts, such as gold leaf craftwork. As a result of the project, original cultural assets can be kept in the more favorable environment of museums while facsimiles can be used for educational purposes and public exhibits. Since the program began in 2007, the cumulative total of reproduced and donated items has reached 31 (as of March 2015).

Partnership with the Red Cross EU Office

Canon Europe entered into a partnership agreement with the Red Cross in 2006 after having been a longtime supporter and endorser of the organization’s activities.



Canon Europe supports the German Red Cross's activities, such as emergency response training for children, in preparation for natural disasters. ©Red Cross

With the aim of promoting innovation by incorporating the opinions of our diverse human resources at all levels of decision-making, Canon recognizes the individual aptitudes and skills of employees, positively expanding the scope of activities of female staff.

The Company works with 16 Red Cross National Societies across Europe, giving support in a variety of ways, from donating equipment to providing funding for education and engagement projects for young people.

Canon Image Bridge

"Canon Image Bridge" is an initiative in which Canon China and other members of the Canon Asia Marketing Group serve as a bridge linking elementary and middle school children in Asia by delivering their photo cards. To date, around 5,600 children from 179 schools have taken part in the photo card exchange project. Children take photos and other children in foreign countries write messages on the pictures while exchanging photo cards. Canon helps them make photo cards and send them abroad to foster cross-cultural communication among children.

Addressing the Issue of Conflict Minerals

Seeking to ensure that customers can use Canon products with peace of mind, the Canon Group works together with its business partners as well as industry organizations to address the issue of conflict minerals.

In accordance with the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act, Canon filed a report at the end of May 2014 regarding the Company's status on this issue with the U.S. Securities and Exchange Commission. This report is also made available on Canon's website.

Based on data gathered through February 2015 regarding products manufactured, or contracted to manufacture, by the Canon Group, no specific parts or materials have been found to have contributed to funding armed groups in conflict regions as defined by U.S. legislation. Due, however, to the complex nature of the supply chain, inquiries may not have reached a number of smelters or refiners located upstream. In response, Canon will enhance its collaboration efforts across various industries and support activities aimed at encouraging smelters to avoid using conflict minerals that finance armed groups.

Cultivating Diverse Human Resources

Canon is committed to diversity of human resources. We welcome people of all types—irrespective of race, gender, age, customs, and value perceptions—and deploy such differences to foster our growth as an organization. Since 2012, we have engaged in in-house projects with top priority on helping maximize the potential of women in the workplace. Initiatives in 2014 included internal educational activities and leadership training for selected female employees. We also held seminars for employees returning from childcare leave and their superiors.

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GENERAL

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

OVERVIEW

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

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

Economic environment

Looking back at the global economy in 2014, although the United States and other developed countries were initially expected to bring about a return to a path of full-fledged growth, such expectations came up short due to the ongoing occurrence of such unforeseen circumstances as the conflict between Russia and Ukraine. In the U.S., despite the negative impact of the major cold wave that struck at the beginning of the year, the economy showed steady signs of recovery, buoyed by the improvement in employment conditions and healthy growth in consumer spending. In Europe, the economy remained sluggish due to such factors as the negative impact of Russia's deteriorating economy on neighboring euro area countries. The pace of economic expansion in China was modest while other emerging countries in Southeast Asia and South America faced slowdowns in market growth due to economic stagnation. In Japan, with the economy yet to recover from the decline following the rush in demand leading up to the hike in the country's consumption tax, growth fell short of the rate recorded in the previous year.

Market environment

Looking at the markets in which Canon operates amid these conditions, demand for MFDs and laser printers maintained steady growth. Demand for interchangeable-lens digital cameras continued to face harsh conditions due to the economic slowdown. Demand for digital compact cameras continued to shrink in both developed countries and emerging markets. Demand for inkjet printers, decreased due to the sluggish economies of Asia and Europe. In the industry and others sector, a rebound in capital investment for both memory devices and image sensors led to a pick-up in demand for semiconductor lithography equipment. Additionally, demand for lithography equipment used in the production of FPDs increased for large-size panels.

The average value of the yen during the year was ¥106.18 against the U.S. dollar, a year-on-year depreciation of approximately ¥8, and ¥140.62 against the euro, a year-on-year depreciation of approximately ¥11.

Summary of operations

MFDs and laser printers enjoyed solid demand during the year and industrial equipment sales increased significantly. Within the shrinking market for interchangeable-lens digital cameras and digital compact cameras, less-than-expected demand during the year-end shopping season led to a decline in net sales. As a result, despite the positive effects of favorable currency exchange rates, net sales for the year decreased by 0.1% year on year to ¥3,727.3 billion. The gross profit ratio, however, rose 1.7 points year on year to 49.9% thanks to the effects of ongoing cost-cutting efforts along with the depreciation of the yen. Despite an increase in foreign-currency-denominated operating expenses due to the depreciation of the yen, Group-wide efforts to reduce spending contributed to limiting operating expenses to ¥1,498.0 billion, an increase of just 2.5% year on year. As a result, operating profit increased by 7.8% year on year to ¥363.5 billion. Other income increased by ¥9.4 billion due to foreign currency exchange gains while income before income taxes increased by 10.3% to ¥383.2 billion. Net income attributable to Canon Inc. increased by 10.5% to ¥254.8 billion. Accordingly, despite the slight decline in net sales, Canon achieved profit growth.

Key performance indicators

The following are the key performance indicators ("KPIs") that Canon uses in managing its business. The changes from year to year in these KPIs are set forth in the table shown on page 35.

Revenues

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

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

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

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

Cash flow management

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

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

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

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

KEY PERFORMANCE INDICATORS

	2014	2013	2012	2011	2010
Net sales (Millions of yen)	¥3,727,252	¥3,731,380	¥3,479,788	¥3,557,433	¥3,706,901
Gross profit to net sales ratio	49.9%	48.2%	47.4%	48.8%	48.1%
R&D expense to net sales ratio	8.3%	8.2%	8.5%	8.7%	8.5%
Operating profit to net sales ratio	9.8%	9.0%	9.3%	10.6%	10.5%
Inventory turnover measured in days	50 days	52 days	57 days	46 days	35 days
Debt to total assets ratio	0.0%	0.1%	0.1%	0.3%	0.3%
Canon Inc. stockholders' equity to total assets ratio	66.8%	68.6%	65.7%	64.9%	66.4%

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and based on the selection and application of significant accounting policies which require management to make significant estimates and assumptions. These estimates and assumptions include future market conditions, net sales growth rate, gross margin and discount rate. Though Canon believes that the estimates and assumptions are reasonable, actual future results may differ from these estimates and assumptions. Canon believes that the following are the more critical judgment areas in the application of its accounting policies that currently affect its financial condition and results of operations.

Revenue recognition

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

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

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

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

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

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

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

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

Allowance for doubtful receivables

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

Valuation of inventories

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

Impairment of long-lived assets

Long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Determining the fair value of the asset involves the use of estimates and assumptions.

Property, plant and equipment

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

Goodwill and other intangible assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value. Fair value of a reporting unit is determined primarily based on the discounted cash flow analysis which involves estimates of projected future cash flows and discount rates. Estimates of projected future cash flows are primarily based on Canon's forecast of future growth rates. Estimates of discount rates are determined based on the weighted average cost of capital, which considers primarily market and industry data as well as specific risk factors. Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range primarily from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful lives, which range from 8 years to 16 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years.

Income tax uncertainties

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

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

In preparing its financial statements for 2014, Canon estimated a weighted-average discount rate used to determine benefit obligations of 1.1% for Japanese plans and 2.9% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.1% for Japanese plans and 4.9% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income government and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

Decreases in discount rates lead to increases in actuarial pension benefit obligations which, in turn, could lead to an increase in service cost and amortization cost through amortization of actuarial gain or loss, a decrease in interest cost, and vice versa. For 2014, a decrease of 50 basis points in the discount rate increases the projected benefit obligation by approximately ¥91,609 million. The net effect of changes in the discount rate, as well as the net effect of other changes in actuarial assumptions and experience, is deferred until subsequent periods.

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing the expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For 2014, a change of 50 basis points in the expected long-term rate of return on plan assets would cause a change of approximately ¥4,218 million in net periodic benefit cost. Canon multiplies management's expected long-term rate of return on plan assets by the value of its plan assets to arrive at the expected return on plan assets that is included in pension expense. Canon defers recognition of the difference between this expected return on plan assets and the actual return on plan assets. The net deferral affects future pension expense.

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

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen				
	2014	change	2013	change	2012
Net sales	**¥3,727,252**	**-0.1%**	¥3,731,380	+7.2%	¥3,479,788
Operating profit	**363,489**	**+7.8%**	337,277	+4.1%	323,856
Income before income taxes	**383,239**	**+10.3%**	347,604	+1.5%	342,557
Net income attributable to Canon Inc.	**254,797**	**+10.5%**	230,483	+2.6%	224,564

Sales

The shrinking market for interchangeable-lens digital cameras and digital compact cameras, and less-than-expected demand during the year-end shopping season led to a major decline in net sales in Imaging System Business Unit. However, due to the stable demand for MFDs and laser printers, and industrial equipment sales along with the positive effects of favorable currency exchange rates, Canon's consolidated net sales in 2014 totaled ¥3,727,252 million, a slight decrease of 0.1% from the previous year.

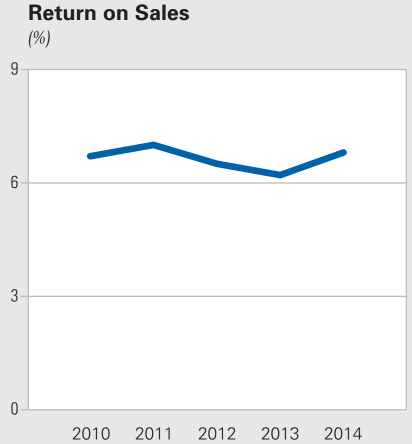
Overseas operations are significant to Canon's operating results and generated 80.6% of total net sales in 2014. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen relative to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

The average value of the yen during the year was ¥106.18 against the U.S. dollar, a year-on-year depreciation of approximately ¥8, and ¥140.62 against the euro, a year-on-year depreciation of approximately ¥11. The effects of foreign exchange rate fluctuations positively affected net sales by approximately ¥186,000 million in 2014. This favorable impact consisted of approximately ¥98,200 million for the U.S. dollar denominated sales, ¥66,800 million for the euro denominated sales and ¥21,000 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

Return on Sales



imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in foreign exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses, maintenance expenses, light and fuel expenses, and rent expenses. The ratio of cost of sales to net sales for 2014 and 2013 was 50.1% and 51.8%, respectively.

Gross profit

Canon's gross profit in 2014 increased by 3.5% to ¥1,861,472 million from 2013. The gross profit ratio also increased by 1.7 points year on year to 49.9%. The increase in the gross profit ratio reflects ongoing cost-cutting efforts along with the positive effects of the depreciation of the yen.

Operating expenses

The major components of operating expenses are payroll, R&D, advertising expenses and other marketing expenses. Despite the negative effect of depreciation of the yen, group-wide efforts to thoroughly reduce spending contributed to limit the increase year on year to 2.5% to a total of ¥1,497,983 million.

Operating profit

Operating profit in 2014 increased 7.8% from 2013 to a total of ¥363,489 million. The ratio of operating profit to net sales increased 0.8% to 9.8% from 2013.

Other income (deductions)

Other income (deductions) for 2014 increased ¥9,423 million to ¥19,750 million, mainly due to foreign currency exchange gain.

Income before income taxes

Income before income taxes in 2014 was ¥383,239 million, an increase of 10.3% from 2013, and constituted 10.3% of net sales.

Income taxes

Provision for income taxes in 2014 increased by ¥9,912 million from 2013. The effective tax rate during 2014 remained consistent with 2013. The effective tax rate for 2014 was 30.8%, which was lower than the statutory tax rate in Japan. This was mainly due to the tax credit for R&D expenses.

Net income attributable to Canon Inc.

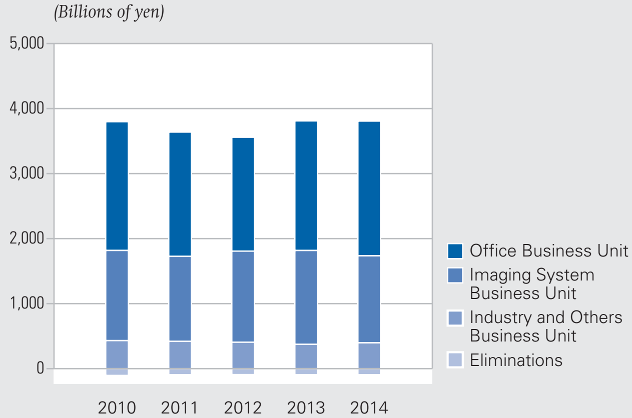
As a result, net income attributable to Canon Inc. in 2014 increased by 10.5% to ¥254,797 million, which represents 6.8% of net sales.

Segment information

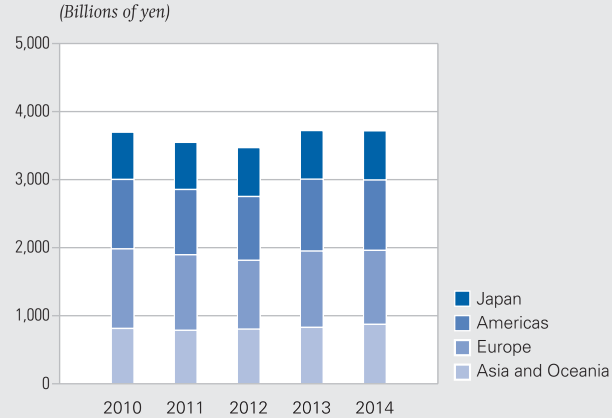
Canon divides its businesses into three segments: the Office Business Unit, the Imaging System Business Unit and the Industry and Others Business Unit.

- **The Office Business Unit** mainly includes Office multifunction devices ("MFDs") / Laser multifunction printers ("MFPs") / Laser printers / Digital production printing systems / High speed continuous feed printers / Wide-format printers / Document solutions
- **The Imaging System Business Unit** mainly includes Interchangeable lens digital cameras / Digital compact cameras / Digital camcorders / Digital cinema cameras / Interchangeable lenses / Inkjet printers / Large-format inkjet printers / Commercial photo printers / Image scanners / Multimedia projectors / Broadcast equipment / Calculators
- **The Industry and Others Business Unit** mainly includes Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Digital radiography systems / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED ("OLED") panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

Sales by Segment
(Billions of yen)



Sales by Geographic Area
(Billions of yen)



Sales by segment

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

Canon's sales by segment are summarized as follows:

SALES BY SEGMENT

	Millions of yen				
	2014	change	2013	change	2012
Office	¥2,078,732	+3.9%	¥2,000,073	+13.8%	¥1,757,575
Imaging System	1,343,194	-7.3%	1,448,938	+3.1%	1,405,971
Industry and Others	398,765	+6.4%	374,870	-8.1%	407,840
Eliminations	(93,439)	—	(92,501)	—	(91,598)
Total	¥3,727,252	-0.1%	¥3,731,380	+7.2%	¥3,479,788

Within the Office Business Unit, office MFDs sales increased steadily from the year-ago period, led by healthy demand for new imageRUNNER ADVANCE C350/C250-series models, Canon's first color A4 (letter and legal-sized)-model imageRUNNER ADVANCE machines, and the imagePRESS C800/C700, Canon's first color models targeting the light production market, along with the A3 (12" x 18")-model imageRUNNER ADVANCE C5200 series, which continues to be well accepted in the market. The Océ ColorStream 3000 series of high-speed continuous-feed printers continued to enjoy solid sales growth from the previous year. Among laser printers, although color models and multifunction models recorded sales growth, total sales volume decreased slightly from the year-ago period owing to the decrease in demand for monochrome models in European and other markets that have suffered prolonged economic stagnation. As a result, coupled with the positive effects of favorable currency exchange rates, sales for the business unit totaled ¥2,078.7 billion, a year-on-year increase of 3.9%, while operating profit totaled ¥292.1 billion, an increase of 9.4%.

Within the Imaging System Business Unit, although sales volume of interchangeable-lens digital cameras declined owing to the shrinking market—in Japan as a result of the reaction following the rush in demand prior to the consumption tax increase, and in Europe and other markets due to worsening economic conditions—the advanced-amateur-model EOS 7D Mark II achieved healthy growth, enabling Canon to maintain the market's top share. Despite a decline in total sales volume for digital compact cameras, sales of high-added-value models featuring high image quality and high-magnification zoom capabilities, such as the PowerShot G7 X and PowerShot SX60 HS/SX700 HS, recorded solid growth, contributing to an improvement in profitability. Inkjet printer hardware sales increased for the fourth quarter from the year-ago period thanks to the introduction of new products for the year-end shopping season and marketing tailored to geographical characteristics, but sales volume for the year decreased due to economic sluggishness in Asia and Europe. Sales of consumable supplies increased from the previous year owing to the steady accumulation of printer units currently operating in the market. As a result, including the positive effect of favorable currency change rates, sales for the business unit decreased by 7.3% to ¥1,343.2 billion year on year, while operating profit declined 4.5% to ¥194.6 billion.

In the Industry and Others Business Unit, ongoing investment following the recovery in the second half of the previous year by memory device manufacturers led to increased unit sales of semiconductor lithography equipment for memory devices and image sensors. Amid increasing market demand for higher definition tools, lithography systems for the creation of high-definition mid- and small-size panels, in addition to a model introduced in the second half of the previous year for large panels, recorded healthy growth, contributing to the boosting of both sales volume and market share. In medical equipment, sales volume of new digital radiography systems, including wireless static-image models and models capable of capturing dynamic images, grew steadily, fueling sales growth. Consequently, sales for the business unit totaled ¥398.8 billion, an increase of 6.4% year on year, while operating profit, although showing an improvement from the previous year, recorded a loss of ¥21.8 billion owing to investment, including R&D expenses, into next-generation technologies.

Intersegment sales of ¥93,439 million, representing 2.5% of total sales, are eliminated from total sales for the three segments, and are described as "Eliminations."

Sales by geographic area

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

A geographical analysis indicates that net sales in 2014 are summarized as follows.

In Japan, although sales volume of digital compact cameras declined, net sales increased by 1.2% from the previous year due to solid growth in office MFDs.

In the Americas, despite the favorable effect from depreciation of the yen against U.S. dollar and solid demand for inkjet printers, net sales decreased by 2.2% from the previous year owing to the decline of compact digital camera market.

Despite the favorable effect from depreciation of the yen against euros and solid demand for office MFDs in sluggish economic condition, net sales decreased by 3.1% from the previous year due to the price reduction of interchangeable-lens digital cameras and shrinking of digital compact camera market in Europe.

In Asia and Oceania, although sales volume of interchangeable-lens digital cameras and digital compact cameras declined, net sales increased by 5.4% from the previous year due to solid demand for office MFDs coupled with the positive effects of depreciation of the yen.

A summary of net sales by geographic area is provided below.

SALES BY REGION

	Millions of yen				
	2014	change	2013	change	2012
Japan	¥ 724,317	+1.2%	¥ 715,863	-0.6%	¥ 720,286
Americas	1,036,500	-2.2%	1,059,501	+12.7%	939,873
Europe	1,090,484	-3.1%	1,124,929	+10.9%	1,014,038
Asia and Oceania	875,951	+5.4%	831,087	+3.2%	805,591
Total	¥3,727,252	-0.1%	¥3,731,380	+7.2%	¥3,479,788

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

Operating profit by segment

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

Operating profit for the Office Business Unit in 2014 increased by 9.4% to ¥292,057 million, resulting from the sales increase including the positive effects of favorable currency exchange rates.

Despite operating profit for the Imaging System Business Unit in 2014 decreased by 4.5% to ¥194,601 million, in response to the sales decline, operating profit ratio increased from previous year, owing to the improvement in profitability from the sales shift to high-added-value models in camera, along with the positive effects of favorable currency exchange rates.

Operating profit for the Industry and Others Business Unit in 2014, despite an improvement from the previous year resulted from sales increase, recorded a loss of ¥21,801 million owing to investment, including R&D expenses, into next-generation technologies.

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

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

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by ¥55,671 million to ¥844,580 million in fiscal 2014 compared to the previous year. Canon's cash and cash equivalents are typically denominated in Japanese yen and in U.S. dollars, with the remainder denominated in other currencies.

Net cash provided by operating activities increased by ¥76,285 million to ¥583,927 million in fiscal 2014 compared to the previous year. The major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, R&D expenses and income taxes.

For fiscal 2014, cash inflow from operating activities increased, due to the increasing profit as well as an improvement in working capital. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials decreased, as a result of decreased inventory level. Cash outflow for income taxes increased due to an increase in taxable income.

Net cash used in investing activities increased by ¥19,086 million to ¥269,298 million in fiscal 2014. This reflects the acquisition of Milestone Systems, to enhance Canon's network camera business, and several other companies. Purchases of fixed assets were focused on items relevant to new products.

Canon defines "free cash flow" as cash flows from operating activities less cash flows from investing activities. For fiscal 2014, free cash flow totaled ¥314,629 million as compared with ¥257,430 million for fiscal 2013. Canon's management recognizes that constant and intensive investment in facilities and R&D is required to maintain and strengthen the competitiveness of its products.

Canon has also commenced a public tender offer for all of the issued shares of Axis AB on March 3, 2015, in order to further ensure its goal of becoming the world leader in network surveillance camera systems for consideration of a maximum amount of approximately 23.6 billion Swedish krona (approximately ¥333.7 billion with translation at the rate of ¥14.13 = 1 Swedish krona). Canon's management seeks to meet its capital requirements, including the acquisition of Axis AB, with generating cash flow principally from its operating activities. Therefore, its capital resources are primarily sourced from internally generated funds. Accordingly, Canon includes information with regard to free cash flow as management frequently monitors this indicator, and believes that such indicator is beneficial to an investor's understanding. Furthermore, Canon's management believes that this indicator is significant in understanding Canon's current liquidity and the alternatives of use in financing activities because it takes into consideration its operating and investing activities. Canon refers to this indicator together with relevant U.S. GAAP financial measures shown in its consolidated statements of cash flows and consolidated balance sheets for cash availability analysis.

Net cash used in financing activities totaled ¥300,886 million in fiscal 2014, mainly resulting from repurchase of treasury stock of ¥149,813 million, and dividends of ¥145,790 million. The Company paid dividends in fiscal 2014 of ¥130.00 per share.

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

Short-term loans (including the current portion of long-term debt) amounted to ¥1,018 million at December 31, 2014 compared with ¥1,299 million at December 31, 2013. Long-term debt (excluding the current portion) amounted to ¥1,148 million at December 31, 2014 compared with ¥1,448 million at December 31, 2013.

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

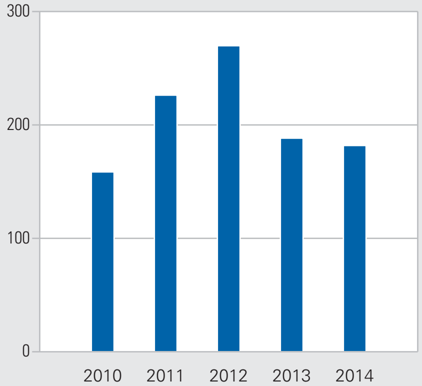
In order to facilitate access to global capital markets, Canon obtains credit ratings from two rating agencies: Moody's Investors Services, Inc. ("Moody's") and Standard and Poor's Ratings Services ("S&P"). In addition, Canon maintains a rating from Rating and Investment Information, Inc. ("R&I"), a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

As of March 13, 2015, 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.

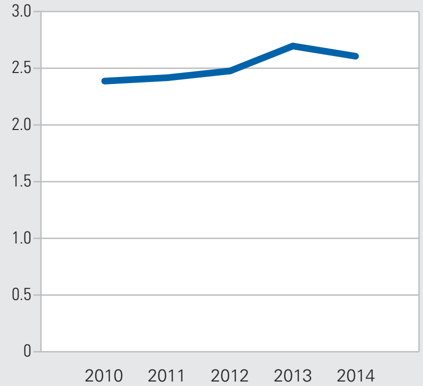
Canon's management policy in recent periods to optimize inventory levels is intended to maintain an appropriate balance among relevant imperatives, including minimizing working capital, avoiding undue exposure to the risk of inventory obsolescence, and maintaining the ability to sustain sales despite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

Reflecting the foregoing circumstances, Canon's total inventory turnover ratios were 50, 52, and 57 days at the end of the fiscal years 2014, 2013, and 2012, respectively and the improvements over the last three years are in line with Canon's expectations and its revised inventory management policy.

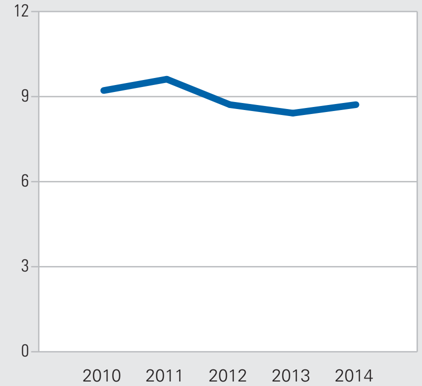
Increase in Property, Plant and Equipment
(Billions of yen)



Working Capital Ratio



Return on Canon Inc. Stockholders' Equity
(%)



Increase in property, plant and equipment on an accrual basis in 2014 amounted to ¥182,343 million compared with ¥188,826 million in 2013 and ¥270,457 million in 2012. For 2015, Canon projects its increase in property, plant and equipment will be approximately ¥205,000 million.

Employer contributions to Canon's worldwide defined benefit pension plans were ¥22,146 million in 2014, ¥48,515 million in 2013 and ¥30,421 million in 2012. Employer contributions to Canon's worldwide defined contribution pension plans were ¥15,077 million in 2014, ¥14,383 million in 2013, and ¥13,021 million in 2012. In addition, employer contributions to the multiemployer pension plan in which certain subsidiaries in Netherlands participated were ¥2,815 million in 2014.

Working capital in 2014 increased by ¥32,919 million to ¥1,470,554 million, compared with ¥1,437,635 million in 2013 and ¥1,237,821 million in 2012. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for 2014 was 2.60 compared to 2.69 for 2013 and to 2.47 for 2012.

Return on assets (net income attributable to Canon Inc. divided by the average of total assets) was 5.9% in 2014, compared to 5.6% in 2013 and 5.7% in 2012.

Return on Canon Inc. stockholders' equity (net income attributable to Canon Inc. divided by the average of total Canon Inc. stockholders' equity) was 8.7% in 2014 compared with 8.4% in 2013 and 8.7% in 2012.

The debt to total assets ratio was 0.0%, 0.1% and 0.1% as of December 31, 2014, 2013 and 2012, respectively. Canon had short-term loans and long-term debt of ¥2,166 million as of December 31, 2014, ¥2,747 million as of December 31, 2013 and ¥3,983 million as of December 31, 2012.

OFF-BALANCE SHEET ARRANGEMENTS

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

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon will have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years in the case of employees with housing loans, and 1 year to 5 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 ¥8,951 million at December 31, 2014. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2014 were insignificant.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2014.

		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	**¥ 2,018**	¥ 956	¥ 808	¥ 251	¥ 3
Other long-term debt	**145**	59	60	24	2
Operating lease obligations	**85,719**	26,450	34,508	14,528	10,233
Purchase commitments for:					
Property, plant and equipment	**52,668**	52,668	—	—	—
Parts and raw materials	**76,984**	76,984	—	—	—
Other long-term liabilities:					
Contribution to defined benefit pension plans	**26,257**	26,257	—	—	—
Total	**¥243,791**	¥183,374	¥35,376	¥14,803	¥10,238

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 12, Income Taxes in the Notes to Consolidated Financial Statements for further details. Contribution to defined benefit pension plans reflects the expected amount only for the next fiscal year, since contributions beyond the next fiscal year are not currently determinable due to uncertainties related to changes in actuarial assumptions, returns on plan assets and changes to plan membership.

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue are recognized and are included in selling, general and administrative expenses. Estimates for accrued product warranty costs are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2014, accrued product warranty costs amounted to ¥11,564 million.

At December 31, 2014, commitments outstanding for the purchase of property, plant and equipment were approximately ¥52,668 million, and commitments outstanding for the purchase of parts and raw materials were approximately ¥76,984 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 2015, Canon expects to contribute ¥14,674 million to its Japanese defined benefit pension plans and ¥11,583 million to its foreign defined benefit pension plans.

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

RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Year 2014 marks the fourth year of the Excellent Global Corporation Plan, Canon's 5-year (2011-2015) management plan. The slogan of the fourth phase ("Phase IV") is "Aiming for the Summit—Speed & Sound Growth" and there are three core strategies related to R&D:

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

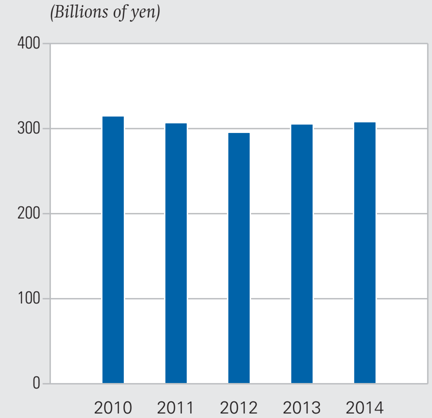
Canon has been striving to implement the three R&D related strategies as follows:

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

Canon is pursuing collaboration among government, industry and academia. Canon's collaboration effort can be seen in various activities such as fundamental research and development of leading-edge technologies with top universities and research institutes around the world, including Tokyo University, Kyoto University, Tokyo Institute of Technology, Tohoku University, Stanford University, and the University of Arizona, and also participation in the "ImPACT" (Impulsing Paradigm Change through Disruptive Technologies) program led by the Japanese government where Canon's physically-noninvasive and -nondestructive imaging technology is selected as one of twelve R&D programs. Additionally, Canon is currently working on collaborative research with Massachusetts General Hospital ("MGH") and Brigham and Women's Hospital ("BWH") to develop biomedical optical imaging and medical robotics technologies at the Healthcare Optics Research Laboratory in Cambridge, Massachusetts, founded in 2013.

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

R&D Expenses
(Billions of yen)



Canon's consolidated R&D expenses were ¥308,979 million in 2014, ¥306,324 million in 2013 and ¥296,464 million in 2012. The ratios of R&D expenses to the consolidated total net sales for 2014, 2013 and 2012 were 8.3%, 8.2% and 8.5%, respectively.

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

Canon obtained the third greatest number of private sector patents in 2014, according to the United States patent annual list, released by IFI CLAIMS® Patent Services.

MARKET RISK EXPOSURES

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

Equity price risk

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

Maturities and fair values of such marketable securities and investments with original maturities of more than three months, all of which were classified as available-for-sale securities, were as follows at December 31, 2014.

	Millions of yen	
Available-for-sale securities	*Cost*	*Fair value*
Debt securities		
Due after five years	¥ 843	¥ 961
Fund trusts	84	84
Equity securities	20,905	40,653
	¥21,832	¥41,698

Foreign currency exchange rate and interest rate risk

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

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

The following table provides information about Canon's major derivative financial instruments related to foreign currency exchange transactions existing at December 31, 2014. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2015.

Millions of yen	*U.S.$*	*Euro*	*Others*	*Total*
Forwards to sell foreign currencies:				
Contract amounts	¥193,195	¥141,815	¥23,852	¥358,862
Estimated fair value	(8,300)	(2,457)	(423)	(11,180)
Forwards to buy foreign currencies:				
Contract amounts	¥ 12,018	¥ 9,347	¥ —	¥ 21,365
Estimated fair value	316	(38)	—	278

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

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

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2014, 2013 and 2012. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥145 million, ¥111 million and ¥221 million for the years ended December 31, 2014, 2013 and 2012, respectively.

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

LOOKING FORWARD

As for the future of the global economy, although challenging conditions are expected to remain for some time in certain countries and regions, Canon anticipates sustained economic growth in countries such as the U.S. among developed countries, and India and ASEAN countries among emerging markets. Overall, the global economy is expected to gradually move toward stable growth.

In the businesses in which Canon operates, demand for MFDs is projected to continue to expand moderately, mainly for color models, while demand in the laser printer market is expected to remain at the same level as the previous year. As for the digital camera market, although projections indicate continued market contraction mainly for low-priced compact models, demand for interchangeable-lens digital cameras is expected to recover gradually. Looking at inkjet printers, with Asian markets gradually recovering following their extended period of stagnation, demand is expected to remain in line with the previous year. As for the industrial equipment market, with manufacturers expected to continue making capital outlays for semiconductor lithography equipment in response to increasing demand for memory devices and image sensors, demand is expected to remain at the same level as the previous year. And as for FPD lithography equipment, demand is projected to increase as device manufacturers boost capital investment amid growing panel demand projected for 4K televisions and mobile devices.

Amid these conditions, 2015 is the final year of Phase IV of the Excellent Global Corporation Plan and the year in which the Canon EXPO will be held as the culmination of the efforts carried out during Phase IV. In addition to returning to a path of growth, Canon aims to bring Phase IV to a successful close, further reinforcing its business foundation to enable great strides beginning from next year. Toward this objective, Canon will undertake the following various measures.

- **Reinforcing Existing Businesses Through the Introduction of Innovative Products and Services**
  For MFDs and other office products, in addition to improving hardware performance, efforts will be made to build a framework that will enable the Company to service as a one-stop shop that provides a broad range of high-quality services. For cameras, efforts will be made to comprehensively raise aspects such as image-quality, visual expression, and operability. At the same time, Canon will work to further strengthen the network capabilities of these products. Additionally, to facilitate the Company's aim of becoming the all around leader in printing, it will leverage its strength, derived from having prepared a broad lineup, spanning consumer printers to industrial printing. In the Industrial equipment area, Canon will devise and execute concrete plans to concentrate technologies and strengthen the competitiveness of Canon Group companies.

- **Expanding New and Future Businesses and Further Cultivating Technologies that will Pave the Way to the Future**
  Canon aims to produce next-generation lithography equipment in volume by strengthening nanoimprint technology that realizes further reduction in process geometries. In the area of network camera systems, Canon will work to enhance its product lineup and develop solutions that address customer needs. With regard to the MR (Mixed Reality) System, Canon will identify industries that can leverage the strength of this system, and will strive to make the system the de facto standard design tool in those industries. In the medical field, the Company will accelerating develop, focusing on promising themes such as photoacoustic tomography, which facilitates the viewing of vascular conditions in 3D. The Company will work to expand and steadily cultivate new businesses mainly targeting the B2B field, such as Super Machine Vision, a system capable of high-accuracy three-dimensional recognition of objects for potential use in production sites, and 4K reference displays.
- **Strengthening Global Marketing Capabilities Through Unified Effort Between Product Operations and Sales Companies**
  In developed countries, Canon aims to gain share in both consumer and office segments. In the consumer segment, Canon will address the popularity of online shopping and other trends that are contributing to the diversification of sales channels. In the office segment, Canon will strengthen its response towards centralized procurement of office equipment by global corporations. In emerging markets, Canon will promote enhancement of its various sales networks and product lineup, in line with situations in each country and region.
- **Accelerating a New Dimension of Cost-reduction Activities**
  In the area of procurement, Canon aims to reduce total costs, further deploying measures focused on reducing costs from the stage of product development. In the prototyping process, Canon will create next-generation development methodologies, through such means as expanding the application of simulation technologies as well as employing 3D printing. In production, Canon will realize further cost reduction by expanding the application of automation equipment and through measures aimed at the in-house production of molded parts and production equipment.
- **Building a Globally Optimized Production System**
  To maintain an optimized production system, Canon will take steps to revive domestic production, promoting measures such as automation and in-house production, while building new structural dimensions of cost reduction. At the same time, Canon will promote localized production through the use of automation equipment in the U.S. and Europe.

In addition to these measures, Canon will promote other initiatives such as product quality reforms to win top customer approval, information security improvement, and human resource development.

Forward looking statements

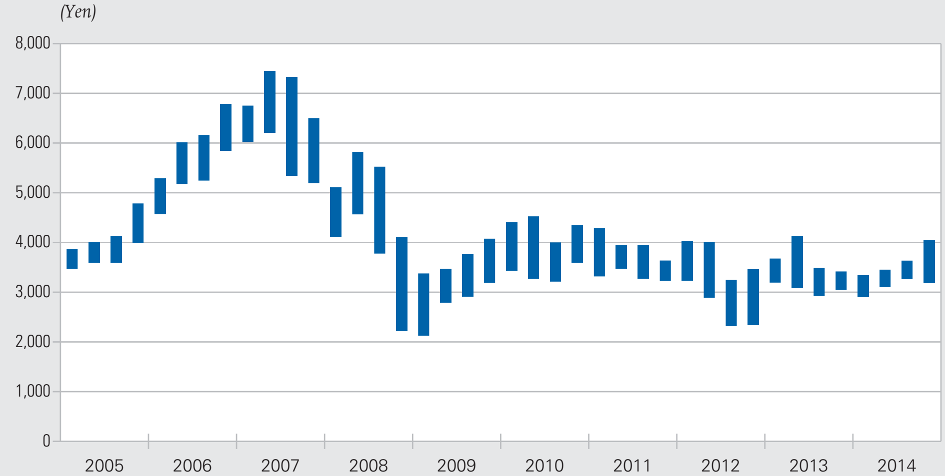
The foregoing discussion and other disclosure in this report contains forward-looking statements that reflect management's current views with respect to certain future events and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements.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

TEN-YEAR FINANCIAL SUMMARY

	Millions of yen (except per share amounts)			
	2014	2013	2012	2011
Net sales:				
Domestic	**¥ 724,317**	¥ 715,863	¥ 720,286	¥ 694,450
Overseas	**3,002,935**	3,015,517	2,759,502	2,862,983
Total	**3,727,252**	3,731,380	3,479,788	3,557,433
Percentage of previous year	**99.9%**	107.2%	97.8%	96.0%
Net income attributable to Canon Inc.	**254,797**	230,483	224,564	248,630
Percentage of sales	**6.8%**	6.2%	6.5%	7.0%
Advertising	**79,765**	86,398	83,134	81,232
Research and development expenses	**308,979**	306,324	296,464	307,800
Depreciation of property, plant and equipment	**213,739**	223,158	211,973	210,179
Increase in property, plant and equipment	**182,343**	188,826	270,457	226,869
Long-term debt, excluding current installments	**¥ 1,148**	¥ 1,448	¥ 2,117	¥ 3,368
Canon Inc. stockholders' equity	**2,978,184**	2,910,262	2,598,026	2,551,132
Total assets	**4,460,618**	4,242,710	3,955,503	3,930,727
Per share data:				
Net income attributable to Canon Inc. stockholders per share:				
Basic	**¥ 229.03**	¥ 200.78	¥ 191.34	¥ 204.49
Diluted	**229.03**	200.78	191.34	204.48
Dividend per share	**150.00**	130.00	130.00	120.00
Stock price:				
High	**4,045**	4,115	4,015	4,280
Low	**2,889**	2,913	2,308	3,220
Average number of common shares in thousands	**1,112,510**	1,147,934	1,173,648	1,215,832
Number of employees	**191,889**	194,151	196,968	198,307

Common Stock Price Range (Tokyo Stock Exchange)

(Yen)



						Thousands of U.S. dollars (except per share amounts)
2010	2009	2008	2007	2006	2005	2014
¥ 695,749	¥ 702,344	¥ 868,280	¥ 947,587	¥ 932,290	¥ 856,205	$ 5,986,091
3,011,152	2,506,857	3,225,881	3,533,759	3,224,469	2,897,986	24,817,645
3,706,901	3,209,201	4,094,161	4,481,346	4,156,759	3,754,191	30,803,736
115.5%	78.4%	91.4%	107.8%	110.7%	108.3%	99.9%
246,603	131,647	309,148	488,332	455,325	384,096	2,105,760
6.7%	4.1%	7.6%	10.9%	11.0%	10.2%	6.8%
94,794	78,009	112,810	132,429	116,809	106,250	659,215
315,817	304,600	374,025	368,261	308,307	286,476	2,553,545
232,327	277,399	304,622	309,815	235,804	205,727	1,766,438
158,976	216,128	361,988	428,549	379,657	383,784	1,506,967
¥ 4,131	¥ 4,912	¥ 8,423	¥ 8,680	¥ 15,789	¥ 27,082	$ 9,488
2,645,782	2,688,109	2,659,792	2,922,336	2,986,606	2,604,682	24,613,091
3,983,820	3,847,557	3,969,934	4,512,625	4,521,915	4,043,553	36,864,612
¥ 199.71	¥ 106.64	¥ 246.21	¥ 377.59	¥ 341.95	¥ 288.63	$ 1.89
199.70	106.64	246.20	377.53	341.84	288.36	1.89
120.00	110.00	110.00	110.00	83.33	66.67	1.24
4,520	4,070	5,820	7,450	6,780	4,780	33.43
3,205	2,115	2,215	5,190	4,567	3,460	23.88
1,234,817	1,234,482	1,255,626	1,293,296	1,331,542	1,330,761	
197,386	168,879	166,980	131,352	118,499	115,583	

Notes: 1. U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY121, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2014.
2. The Company made a three-for-two stock split on July 1, 2006. The average number of common shares and the per share data for the periods prior to the stock split have been adjusted to reflect the stock split.

CONSOLIDATED BALANCE SHEETS

Canon Inc. and Subsidiaries
December 31, 2014 and 2013

	Millions of yen	
ASSETS	**2014**	2013
Current assets:		
Cash and cash equivalents (Note 1)	**¥ 844,580**	¥ 788,909
Short-term investments (Note 2)	**71,863**	47,914
Trade receivables, net (Note 3)	**625,675**	608,741
Inventories (Note 4)	**528,167**	553,773
Prepaid expenses and other current assets (Notes 6, 12 and 17)	**321,648**	286,605
Total current assets	**2,391,933**	2,285,942
Noncurrent receivables (Note 18)	**29,785**	19,276
Investments (Note 2)	**65,176**	70,358
Property, plant and equipment, net (Notes 5 and 6)	**1,269,529**	1,278,730
Intangible assets, net (Notes 7 and 8)	**177,288**	145,075
Other assets (Notes 6, 7, 8, 11 and 12)	**526,907**	443,329
Total assets	**¥4,460,618**	¥ 4,242,710

LIABILITIES AND EQUITY		
Current liabilities:		
Short-term loans and current portion of long-term debt (Note 9)	**¥ 1,018**	¥ 1,299
Trade payables (Note 10)	**310,214**	307,157
Accrued income taxes (Note 12)	**57,212**	53,196
Accrued expenses (Notes 11 and 18)	**345,237**	315,536
Other current liabilities (Notes 5, 12 and 17)	**207,698**	171,119
Total current liabilities	**921,379**	848,307
Long-term debt, excluding current installments (Note 9)	**1,148**	1,448
Accrued pension and severance cost (Note 11)	**280,928**	229,664
Other noncurrent liabilities (Notes 7 and 12)	**116,405**	96,514
Total liabilities	**1,319,860**	1,175,933
Commitments and contingent liabilities (Note 18)		
Equity:		
Canon Inc. stockholders' equity:		
Common stock		
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2014 and 2013	**174,762**	174,762
Additional paid-in capital	**401,563**	402,029
Legal reserve (Note 13)	**64,599**	63,091
Retained earnings (Note 13)	**3,320,392**	3,212,692
Accumulated other comprehensive income (loss) (Note 14)	**28,286**	(80,646)
Treasury stock, at cost; 241,931,637 shares in 2014 and 196,764,060 shares in 2013	**(1,011,418)**	(861,666)
Total Canon Inc. stockholders' equity	**2,978,184**	2,910,262
Noncontrolling interests	**162,574**	156,515
Total equity	**3,140,758**	3,066,777
Total liabilities and equity	**¥4,460,618**	¥ 4,242,710

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2014, 2013 and 2012

	Millions of yen		
	2014	2013	2012
Net sales	¥3,727,252	¥3,731,380	¥3,479,788
Cost of sales (Notes 5, 8, 11 and 18)	1,865,780	1,932,959	1,829,822
Gross profit	1,861,472	1,798,421	1,649,966
Operating expenses (Notes 1, 5, 8, 11, 15 and 18):			
Selling, general and administrative expenses	1,189,004	1,154,820	1,029,646
Research and development expenses	308,979	306,324	296,464
	1,497,983	1,461,144	1,326,110
Operating profit	363,489	337,277	323,856
Other income (deductions):			
Interest and dividend income	7,906	6,579	6,792
Interest expense	(500)	(550)	(1,022)
Other, net (Notes 1, 2, 17 and 20)	12,344	4,298	12,931
	19,750	10,327	18,701
Income before income taxes	383,239	347,604	342,557
Income taxes (Note 12)	118,000	108,088	110,112
Consolidated net income	265,239	239,516	232,445
Less: Net income attributable to noncontrolling interests	10,442	9,033	7,881
Net income attributable to Canon Inc.	¥ 254,797	¥ 230,483	¥ 224,564
	Yen		
Net income attributable to Canon Inc. stockholders per share (Note 16):			
Basic	¥ 229.03	¥ 200.78	¥ 191.34
Diluted	229.03	200.78	191.34
Cash dividends per share	150.00	130.00	130.00

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Canon Inc. and Subsidiaries
Years ended December 31, 2014, 2013 and 2012

	Millions of yen		
	2014	2013	2012
Consolidated net income	¥265,239	¥239,516	¥232,445
Other comprehensive income (loss), net of tax (Note 14):			
Foreign currency translation adjustments	143,834	251,576	133,735
Net unrealized gains and losses on securities	2,524	6,612	3,265
Net gains and losses on derivative instruments	(195)	2,056	(4,880)
Pension liability adjustments	(37,985)	32,669	(12,787)
	108,178	292,913	119,333
Comprehensive income	373,417	532,429	351,778
Less: Comprehensive income attributable to noncontrolling interests	9,666	14,688	10,824
Comprehensive income attributable to Canon Inc.	¥363,751	¥ 517,741	¥340,954

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EQUITY

Canon Inc. and Subsidiaries
Years ended December 31, 2014, 2013 and 2012

	Millions of yen								
	Common stock	*Additional paid-in capital*	*Legal reserve*	*Retained earnings*	*Accumulated other comprehensive income (loss)*	*Treasury stock*	*Total Canon Inc. stockholders' equity*	*Noncontrolling interests*	*Total equity*
Balance at December 31, 2011	¥174,762	¥401,572	¥59,004	¥3,059,298	¥(481,773)	¥ (661,731)	¥2,551,132	¥162,535	¥2,713,667
Equity transactions with noncontrolling interests and other		(16)		152	(1,866)		(1,730)	(13,591)	(15,321)
Dividends paid to Canon Inc. stockholders				(142,362)			(142,362)		(142,362)
Dividends paid to noncontrolling interests								(3,492)	(3,492)
Transfer to legal reserve			2,659	(2,659)			—		—
Comprehensive income:									
Net income				224,564			224,564	7,881	232,445
Other comprehensive income (loss), net of tax (Note 14):									
Foreign currency translation adjustments					132,704		132,704	1,031	133,735
Net unrealized gains and losses on securities					3,148		3,148	117	3,265
Net gains and losses on derivative instruments					(4,882)		(4,882)	2	(4,880)
Pension liability adjustments					(14,580)		(14,580)	1,793	(12,787)
Total comprehensive income							340,954	10,824	351,778
Repurchase of treasury stock, net		(9)		(17)		(149,942)	(149,968)		(149,968)
Balance at December 31, 2012	174,762	401,547	61,663	3,138,976	(367,249)	(811,673)	2,598,026	156,276	2,754,302
Equity transactions with noncontrolling interests and other		489		295	(655)		129	(11,182)	(11,053)
Dividends to Canon Inc. stockholders				(155,627)			(155,627)		(155,627)
Dividends to noncontrolling interests								(3,267)	(3,267)
Transfer to legal reserve			1,428	(1,428)			—		—
Comprehensive income:									
Net income				230,483			230,483	9,033	239,516
Other comprehensive income, net of tax (Note 14):									
Foreign currency translation adjustments					249,791		249,791	1,785	251,576
Net unrealized gains and losses on securities					6,097		6,097	515	6,612
Net gains and losses on derivative instruments					2,056		2,056	—	2,056
Pension liability adjustments					29,314		29,314	3,355	32,669
Total comprehensive income							517,741	14,688	532,429
Repurchase of treasury stock, net		(7)		(7)		(49,993)	(50,007)		(50,007)
Balance at December 31, 2013	174,762	402,029	63,091	3,212,692	(80,646)	(861,666)	2,910,262	156,515	3,066,777
Equity transactions with noncontrolling interests and other		**(420)**		**216**	**(22)**		**(226)**	**(658)**	**(884)**
Dividends to Canon Inc. stockholders				**(145,790)**			**(145,790)**		**(145,790)**
Dividends to noncontrolling interests								**(2,949)**	**(2,949)**
Transfer to legal reserve			**1,508**	**(1,508)**			**—**		**—**
Comprehensive income:									
Net income				**254,797**			**254,797**	**10,442**	**265,239**
Other comprehensive income (loss), net of tax (Note 14):									
Foreign currency translation adjustments					**142,813**		**142,813**	**1,021**	**143,834**
Net unrealized gains and losses on securities					**2,301**		**2,301**	**223**	**2,524**
Net gains and losses on derivative instruments					**(195)**		**(195)**	**—**	**(195)**
Pension liability adjustments					**(35,965)**		**(35,965)**	**(2,020)**	**(37,985)**
Total comprehensive income							**363,751**	**9,666**	**373,417**
Repurchase of treasury stock, net		**(46)**		**(15)**		**(149,752)**	**(149,813)**		**(149,813)**
Balance at December 31, 2014	**¥ 174,762**	**¥401,563**	**¥ 64,599**	**¥ 3,320,392**	**¥ 28,286**	**¥(1,011,418)**	**¥ 2,978,184**	**¥ 162,574**	**¥ 3,140,758**

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Canon Inc. and Subsidiaries
Years ended December 31, 2014, 2013 and 2012

	Millions of yen		
	2014	2013	2012
Cash flows from operating activities:			
Consolidated net income	¥265,239	¥ 239,516	¥232,445
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	263,480	275,173	258,133
Loss on disposal of fixed assets	12,429	10,638	11,242
Impairment loss of investments	12	39	1,527
Equity in (earnings) losses of affiliated companies	(478)	664	(610)
Deferred income taxes	8,929	16,791	7,487
Decrease in trade receivables	9,323	45,040	5,030
(Increase) decrease in inventories	59,004	85,577	(24,805)
Decrease in trade payables	(24,620)	(108,622)	(102,293)
Increase (decrease) in accrued income taxes	3,586	(9,432)	12,427
Increase (decrease) in accrued expenses	11,124	(15,635)	(30,089)
Increase (decrease) in accrued (prepaid) pension and severance cost	(6,305)	(15,568)	5,515
Other, net	(17,796)	(16,539)	8,068
Net cash provided by operating activities	583,927	507,642	384,077
Cash flows from investing activities:			
Purchases of fixed assets (Note 5)	(218,362)	(233,175)	(316,211)
Proceeds from sale of fixed assets (Note 5)	3,994	1,763	4,861
Purchases of available-for-sale securities	(311)	(5,771)	(417)
Proceeds from sale and maturity of available-for-sale securities	2,606	4,528	344
(Increase) decrease in time deposits, net	(14,223)	(12,483)	103,137
Acquisitions of subsidiaries, net of cash acquired (Note 7)	(54,772)	(4,914)	(704)
Purchases of other investments	—	(296)	(796)
Other, net	11,770	136	(2,954)
Net cash used in investing activities	(269,298)	(250,212)	(212,740)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	1,377	1,483	614
Repayments of long-term debt	(2,152)	(2,334)	(3,732)
Decrease in short-term loans, net	(54)	(547)	(5,055)
Dividends paid	(145,790)	(155,627)	(142,362)
Repurchases of treasury stock, net	(149,813)	(50,007)	(149,968)
Other, net	(4,454)	(15,149)	(19,236)
Net cash used in financing activities	(300,886)	(222,181)	(319,739)
Effect of exchange rate changes on cash and cash equivalents	41,928	86,982	41,853
Net change in cash and cash equivalents	55,671	122,231	(106,549)
Cash and cash equivalents at beginning of year	788,909	666,678	773,227
Cash and cash equivalents at end of year	¥844,580	¥ 788,909	¥666,678
Supplemental disclosure for cash flow information:			
Cash paid during the year for:			
Interest	¥ 462	¥ 500	¥ 1,084
Income taxes	111,819	108,950	98,096

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 products, imaging system products and industry and other products. Office products consist mainly of office multifunction devices ("MFDs"), laser multifunction printers ("MFPs"), laser printers, digital production printing systems, high speed continuous feed printers, wide-format printers and document solutions. Imaging system products consist mainly of interchangeable lens digital cameras, digital compact cameras, digital camcorders, digital cinema cameras, interchangeable lenses, inkjet printers, large-format inkjet printers, commercial photo printers, image scanners, multimedia projectors, broadcast equipment and calculators. Industry and other products consist mainly of semiconductor lithography equipment, FPD (Flat panel display) lithography equipment, digital radiography systems, ophthalmic equipment, vacuum thin-film deposition equipment, organic LED ("OLED") panel manufacturing equipment, die bonders, micromotors, network cameras, handy terminals and document scanners. Canon's consolidated net sales for the years ended December 31, 2014, 2013 and 2012 were distributed as follows: the Office Business Unit 55.8%, 53.6% and 50.5%, the Imaging System Business Unit 36.0%, 38.8% and 40.4%, the Industry and Others Business Unit 10.7%, 10.0% and 11.7%, and elimination between segments 2.5%, 2.4% and 2.6%, respectively. These percentages were computed by dividing segment net sales, including intersegment sales, by consolidated net sales, based on the segment operating results described in Note 21.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographic area. 80.6%, 80.8% and 79.3% of consolidated net sales for the years ended December 31, 2014, 2013 and 2012 were generated outside Japan, with 27.8%, 28.4% and 27.0% in the Americas, 29.3%, 30.1% and 29.1% in Europe, and 23.5%, 22.3% and 23.2% in Asia and Oceania, respectively.

Canon sells laser printers on an OEM basis to Hewlett-Packard Company; such sales constituted 17.4%, 17.6% and 17.0% of consolidated net sales for the years ended December 31, 2014, 2013 and 2012, respectively, and are included in the Office Business Unit.

Canon's manufacturing operations are conducted primarily at 28 plants in Japan and 18 overseas plants which are located in countries or regions such as the United States, Germany, France, the Netherlands, Taiwan, China, Malaysia, Thailand, Vietnam and Philippines.

(b) Basis of Presentation

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

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

(c) Principles of Consolidation

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

(d) Use of Estimates

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

(e) Translation of Foreign Currencies

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

Gains and losses resulting from foreign currency transactions, including foreign exchange contracts, and translation of assets and liabilities denominated in foreign currencies are included in other income (deductions) in the consolidated statements of income. Foreign currency exchange gains and losses were a net gain of ¥2,628 million for the year ended December 31, 2014, a net loss of ¥1,992 million for the year ended December 31, 2013 and a net gain of ¥9,130 million for the year ended December 31, 2012, respectively.

(f) Cash Equivalents

All highly liquid investments acquired with original maturities of three months or less are considered to be cash equivalents. Certain debt securities with original maturities of less than three months, classified as available-for-sale securities of ¥139,240 million and ¥183,078 million at December 31, 2014 and 2013, respectively, are included in cash and cash equivalents in the consolidated balance sheets.

(g) Investments

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

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

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

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

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

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

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

(h) Allowance for Doubtful Receivables

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

(i) Inventories

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

(j) Impairment of Long-Lived Assets

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

(k) Property, Plant and Equipment

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

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

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

(l) Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are not amortized, but are instead tested for impairment annually in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Canon performs its impairment test of goodwill using the two-step approach at the reporting unit level, which is one level below the operating segment level. All goodwill is assigned to the reporting unit or units that benefit from the synergies arising from each business combination. If the carrying amount assigned to the reporting unit exceeds the fair value of the reporting unit, Canon performs the second step to measure an impairment charge in the amount by which the carrying amount of a reporting unit's goodwill exceeds its implied fair value.

Intangible assets with finite useful lives consist primarily of software, license fees, patented technologies and customer relationships. Software and license fees are amortized using the straight-line method over the estimated useful lives, which range primarily from 3 years to 5 years for software and 5 years to 10 years for license fees. Patented technologies are amortized using the straight-line method principally over the estimated useful lives, which range from 8 years to 16 years. Customer relationships are amortized principally using the declining-balance method over the estimated useful life of 5 years. Certain costs incurred in connection with developing or obtaining internal-use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal-use software are capitalized at the application development stage. In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(m) Environmental Liabilities

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

(n) Income Taxes

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

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

(o) Stock-Based Compensation

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

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

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

(q) Revenue Recognition

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

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

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

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

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

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

Canon records estimated reductions to sales at the time of sale for sales incentive programs including product discounts, customer promotions and volume-based rebates. Estimated reductions to sales are based upon historical trends and other known factors at the time of sale. Canon regularly adjusts its estimates each period in the ordinary course of establishing sales incentive program accruals based on current information. During the year ended December 31, 2012, Canon revised its estimates for sales incentive program accruals based on new information which was not available at the time that the accrual was established due to unique circumstances, such as the earthquake in Japan and the flooding in Thailand that occurred in 2011 as well as a recent shift in usage of incentive programs from mail-in rebates to instant rebates. This change in estimate caused an increase in net income attributable to Canon Inc. of ¥10,785 million, and an increase in basic and diluted net income attributable to Canon Inc. stockholders per share of ¥9.19 each. During the years ended December 31, 2014 and 2013, such adjustments were not significant. Canon also provides price protection to certain resellers of its products, and records reductions to sales for the estimated impact of price protection obligations when announced.

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

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

(r) Research and Development Costs

Research and development costs are expensed as incurred.

(s) Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were ¥79,765 million, ¥86,398 million and ¥83,134 million for the years ended December 31, 2014, 2013 and 2012, respectively.

(t) Shipping and Handling Costs

Shipping and handling costs totaled ¥49,576 million, ¥47,460 million and ¥38,499 million for the years ended December 31, 2014, 2013 and 2012, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(u) Derivative Financial Instruments

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

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

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

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

(v) Guarantees

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

(w) Recently Issued Accounting Guidance

In May 2014, the Financial Accounting Standards Board ("FASB") issued a new accounting standard related to revenue from contracts with customers. This standard requires an entity to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard is effective for annual reporting periods beginning after December 15, 2016 and is required to be adopted by Canon from the quarter beginning January 1, 2017. Early adoption is not permitted. This standard may be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this standard recognized at the date of initial application. Canon has not selected a transition method and is currently evaluating the effect that the adoption of this standard will have on its consolidated results of operations and financial condition.

2. INVESTMENTS

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities included in investments by major security type at December 31, 2014 and 2013 were as follows:

December 31 *Millions of yen*	*Cost*	*Gross unrealized holding gains*	*Gross unrealized holding losses*	*Fair value*
2014: Noncurrent:				
Government bonds	**¥ 331**	**¥ —**	**¥ 6**	**¥ 325**
Corporate bonds	**512**	**153**	**29**	**636**
Fund trusts	**84**	**—**	**—**	**84**
Equity securities	**20,905**	**19,765**	**17**	**40,653**
	¥21,832	**¥19,918**	**¥52**	**¥41,698**

Millions of yen	*Cost*	*Gross unrealized holding gains*	*Gross unrealized holding losses*	*Fair value*
2013: Noncurrent:				
Government bonds	¥ 338	¥ —	¥31	¥ 307
Corporate bonds	491	16	26	481
Fund trusts	68	—	—	68
Equity securities	18,112	16,450	26	34,536
	¥19,009	¥16,466	¥83	¥35,392

Maturities of available-for-sale debt securities included in investments in the accompanying consolidated balance sheets were as follows at December 31, 2014:

December 31	*Millions of yen*	
	Cost	*Fair value*
Due after five years	**¥843**	**¥961**
	¥843	**¥961**

Gross realized gains were ¥2,540 million, ¥2,360 million and ¥238 million for the years ended December 31, 2014, 2013 and 2012, respectively. Gross realized losses, including write-downs for impairments that were other-than-temporary, were ¥31 million, ¥2 million and ¥1,545 million for the years ended December 31, 2014, 2013 and 2012, respectively.

At December 31, 2014, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than twelve months.

Time deposits with original maturities of more than three months are ¥71,863 million and ¥47,914 million at December 31, 2014 and 2013, respectively, and are included in short-term investments in the accompanying consolidated balance sheets.

Aggregate cost of non-marketable equity securities accounted for under the cost method totaled ¥1,164 million and ¥14,794 million at December 31, 2014 and 2013, respectively. These investments were not evaluated for impairment at December 31, 2014 and 2013, respectively, because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥20,863 million and ¥18,937 million at December 31, 2014 and 2013, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), were earnings of ¥478 million, losses of ¥664 million and earnings of ¥610 million for the years ended December 31, 2014, 2013 and 2012, respectively.

3. TRADE RECEIVABLES

Trade receivables are summarized as follows:

December 31	*Millions of yen*	
	2014	2013
Notes	**¥ 18,476**	¥ 15,461
Accounts	**619,321**	606,010
	637,797	621,471
Less allowance for doubtful receivables	**(12,122)**	(12,730)
	¥625,675	¥608,741

4. INVENTORIES

Inventories are summarized as follows:

December 31	*Millions of yen*	
	2014	2013
Finished goods	**¥363,685**	¥406,443
Work in process	**144,394**	128,120
Raw materials	**20,088**	19,210
	¥528,167	¥553,773

5. 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*	
	2014	2013
Land	**¥ 286,336**	¥ 282,484
Buildings	**1,609,667**	1,570,024
Machinery and equipment	**1,822,026**	1,736,107
Construction in progress	**70,759**	73,645
	3,788,788	3,662,260
Less accumulated depreciation	**(2,519,259)**	(2,383,530)
	¥1,269,529	¥1,278,730

Depreciation expenses for the years ended December 31, 2014, 2013 and 2012 were ¥213,739 million, ¥223,158 million and ¥211,973 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥40,483 million and ¥33,585 million at December 31, 2014 and 2013, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows include property, plant and equipment and intangible assets.

6. FINANCE RECEIVABLES AND OPERATING LEASES

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the sales of Canon's and complementary third-party products primarily in foreign countries. These receivables typically have terms ranging from 1 year to 6 years.

The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

December 31	*Millions of yen*	
	2014	2013
Total minimum lease payments receivable	**¥308,733**	¥278,621
Unguaranteed residual values	**13,924**	9,566
Executory costs	**(1,680)**	(2,184)
Unearned income	**(31,919)**	(29,875)
	289,058	256,128
Less allowance for credit losses	**(6,276)**	(7,323)
	282,782	248,805
Less current portion	**(102,920)**	(91,025)
	¥179,862	¥157,780

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

Years ended December 31	*Millions of yen*	
	2014	2013
Balance at beginning of year	**¥ 7,323**	¥ 6,908
Charge-offs	**(1,171)**	(1,278)
Provision	**154**	212
Other	**(30)**	1,481
Balance at end of year	**¥ 6,276**	¥ 7,323

Canon has policies in place to ensure that its products are sold to customers with an appropriate credit history, and continuously monitors its customers' credit quality based on information including length of period in arrears, macroeconomic conditions, initiation of legal proceedings against customers and bankruptcy filings. The allowance for credit losses of finance receivables are evaluated collectively based on historical experience of credit losses. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. Finance receivables which are past due or individually evaluated for impairment at December 31, 2014 and 2013 are not significant.

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2014 and 2013 was ¥113,997 million and ¥103,403 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2014 and 2013 was ¥87,338 million and ¥78,821 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, 2014.

Year ending December 31:	*Millions of yen*	
	Financing leases	*Operating leases*
2015	¥121,619	¥ 8,541
2016	90,955	4,585
2017	56,672	3,064
2018	28,688	1,450
2019	10,013	678
Thereafter	786	220
	¥308,733	¥18,538

7. ACQUISITIONS

During the year ended December 31, 2014, Canon acquired several companies for a total cash consideration of ¥70,671 million, of which ¥30,696 million, ¥8,789 million, and ¥4,633 million was attributed to intangible assets, the related deferred tax liabilities, and other net assets acquired, respectively, and the residual amount of ¥44,131 million was recorded as goodwill. The goodwill recorded is attributable primarily to expected synergies from the combined operations of the acquired companies and Canon. None of the goodwill is expected to be deductible for tax purposes. Total acquisition-related costs were expensed as incurred and were not significant.

Intangible assets acquired, which are subject to amortization, consist of software of ¥13,290 million, customer relationships of ¥1,628 million and other intangible assets of ¥3,841 million. Canon has estimated the weighted average amortization period for the software and customer relationships to be 7 years and 6 years, respectively. The weighted average amortization period for all intangible assets is approximately 9 years. Intangible assets acquired, which are not subject to amortization, consist of in-process research and development of ¥11,937 million.

The results of operations of the acquired companies were included in Canon's consolidated financial statements from the respective acquisition dates and were not material. Pro forma results of operations have not been disclosed because the effects of these acquisitions were not material, individually and in the aggregate.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets subject to amortization acquired during the years ended December 31, 2014 and 2013, including those recorded from businesses acquired, totaled ¥62,189 million and ¥42,630 million, which primarily consist of software of ¥54,686 million and ¥37,419 million, respectively. The weighted average amortization periods for intangible assets in total acquired during the years ended December 31, 2014 and 2013 are approximately 5 years and 4 years, respectively. The weighted average amortization periods for software acquired during the years ended December 31, 2014 and 2013 are approximately 4 years.

The components of intangible assets subject to amortization at December 31, 2014 and 2013 were as follows:

December 31	**2014**		2013	
Millions of yen	*Gross carrying amount*	*Accumulated amortization*	*Gross carrying amount*	*Accumulated amortization*
Software	**¥312,069**	**¥185,885**	¥271,425	¥167,411
Customer relationships	**53,494**	**46,713**	50,792	39,957
Patented technologies	**13,059**	**9,052**	29,067	24,027
License fees	**11,765**	**7,860**	13,194	7,902
Other	**36,625**	**18,281**	32,319	16,094
	¥427,012	**¥267,791**	¥396,797	¥255,391

Aggregate amortization expense for the years ended December 31, 2014, 2013 and 2012 was ¥49,741 million, ¥52,015 million and ¥46,160 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥41,498 million in 2015, ¥32,853 million in 2016, ¥22,583 million in 2017, ¥14,115 million in 2018, and ¥8,457 million in 2019.

Intangible assets not subject to amortization other than goodwill at December 31, 2014 were ¥18,067 million, which primarily consist of in-process research and development recorded from businesses acquired. Intangible assets not subject to amortization other than goodwill at December 31, 2013 were not significant.

Goodwill is included in other assets in the consolidated balance sheets. For management reporting purposes, goodwill is not allocated to the segments. Goodwill has been allocated to its respective segment for impairment testing.

The changes in the carrying amount of goodwill by segment for the years ended December 31, 2014 and 2013 were as follows:

Years ended December 31 *Millions of yen*	*Office*	*Imaging System*	*Industry and Others*	*Total*
2014: Balance at beginning of year	**¥139,412**	**¥13,877**	**¥ 8,351**	**¥161,640**
Goodwill acquired during the year	**3,971**	**7,424**	**32,736**	**44,131**
Translation adjustments and other	**1,952**	**479**	**3,134**	**5,565**
Balance at end of year	**¥145,335**	**¥21,780**	**¥44,221**	**¥211,336**

Millions of yen	*Office*	*Imaging System*	*Industry and Others*	*Total*
2013: Balance at beginning of year	¥111,348	¥12,674	¥6,821	¥130,843
Goodwill acquired during the year	4,083	—	—	4,083
Translation adjustments and other	23,981	1,203	1,530	26,714
Balance at end of year	¥139,412	¥13,877	¥8,351	¥161,640

9. SHORT-TERM LOANS AND LONG-TERM DEBT

Short-term loans consisting of bank borrowings at December 31, 2014 and 2013 were ¥3 million and ¥54 million, respectively.

Long-term debt consisted of the following:

December 31	*Millions of yen*	
	2014	2013
Loans, principally from banks, maturing in installments through 2024; bearing weighted average interest of 2.79% and 1.15% at December 31, 2014 and 2013, respectively	**¥ 145**	¥ 211
Capital lease obligations	**2,018**	2,482
	2,163	2,693
Less current portion	**(1,015)**	(1,245)
	¥ 1,148	¥ 1,448

The aggregate annual maturities of long-term debt outstanding at December 31, 2014 were as follows:

Year ending December 31:	*Millions of yen*
2015	¥1,015
2016	519
2017	349
2018	200
2019	75
Thereafter	5
	¥2,163

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.

10. TRADE PAYABLES

Trade payables are summarized as follows:

December 31	*Millions of yen*	
	2014	2013
Notes	**¥ 14,112**	¥ 8,005
Accounts	**296,102**	299,152
	¥ 310,214	¥ 307,157

11. EMPLOYEE RETIREMENT AND SEVERANCE BENEFITS

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

Effective January 1, 2014, defined benefit pension plans of certain subsidiaries in the Netherlands were terminated, and the related plan assets and obligations were transferred to a multiemployer pension plan for the industry in which these subsidiaries operate. As a result, the Company recorded a gain on curtailments and settlements of ¥9,370 million in selling, general and administrative expenses in the consolidated statement of income for the year ended December 31, 2014.

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		*Millions of yen*	
	2014	2013	**2014**	2013
Change in benefit obligations:				
Benefit obligations at beginning of year	**¥ 684,842**	¥ 651,520	**¥ 486,572**	¥ 364,609
Service cost	**26,445**	26,005	**6,801**	9,448
Interest cost	**10,772**	11,655	**10,654**	14,299
Plan participants' contributions	**—**	—	**1,522**	2,617
Actuarial loss	**59,496**	14,959	**44,580**	8,981
Benefits paid	**(21,224)**	(19,297)	**(7,352)**	(9,415)
Curtailments and settlements	**—**	—	**(191,179)**	(2,868)
Foreign currency exchange rate changes	**—**	—	**13,064**	98,901
Benefit obligations at end of year	**760,331**	684,842	**364,662**	486,572
Change in plan assets:				
Fair value of plan assets at beginning of year	**581,996**	495,452	**360,527**	249,534
Actual return on plan assets	**43,714**	84,382	**17,851**	20,640
Employer contributions	**15,676**	19,810	**6,470**	28,705
Plan participants' contributions	**—**	—	**1,522**	2,617
Benefits paid	**(19,265)**	(17,648)	**(7,041)**	(9,106)
Settlements	**—**	—	**(165,640)**	(2,656)
Foreign currency exchange rate changes	**—**	—	**7,732**	70,793
Fair value of plan assets at end of year	**622,121**	581,996	**221,421**	360,527
Funded status at end of year	**¥(138,210)**	¥(102,846)	**¥(143,241)**	¥(126,045)

Amounts recognized in the consolidated balance sheets at December 31, 2014 and 2013 are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2014	2013	2014	2013
Other assets	¥ 532	¥ 559	¥ —	¥ 1,106
Accrued expenses	—	—	(1,055)	(892)
Accrued pension and severance cost	(138,742)	(103,405)	(142,186)	(126,259)
	¥ (138,210)	¥ (102,846)	¥ (143,241)	¥ (126,045)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2014 and 2013 before the effect of income taxes are as follows:

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2014	2013	2014	2013
Actuarial loss	¥209,829	¥186,052	¥69,287	¥50,344
Prior service credit	(92,527)	(105,327)	(57)	(118)
	¥117,302	¥ 80,725	¥69,230	¥50,226

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

December 31	Japanese plans		Foreign plans	
	Millions of yen		Millions of yen	
	2014	2013	2014	2013
Accumulated benefit obligation	¥720,034	¥631,887	¥343,023	¥464,195

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		Millions of yen	
	2014	2013	2014	2013
Plans with projected benefit obligations in excess of plan assets:				
Projected benefit obligations	¥756,941	¥676,308	¥364,662	¥485,466
Fair value of plan assets	618,199	572,903	221,421	358,315
Plans with accumulated benefit obligations in excess of plan assets:				
Accumulated benefit obligations	¥716,940	¥611,602	¥339,305	¥463,089
Fair value of plan assets	618,199	560,093	216,560	358,315

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, 2014, 2013 and 2012 consisted of the following components:

Years ended December 31	*Japanese plans*			*Foreign plans*		
	Millions of yen			*Millions of yen*		
	2014	2013	2012	**2014**	2013	2012
Service cost	**¥ 26,445**	¥ 26,005	¥ 25,738	**¥ 6,801**	¥ 9,448	¥ 5,884
Interest cost	**10,772**	11,655	11,788	**10,654**	14,299	13,176
Expected return on plan assets	**(18,018)**	(15,273)	(13,791)	**(10,637)**	(13,949)	(11,806)
Amortization of prior service credit	**(12,800)**	(12,306)	(13,079)	**(61)**	(143)	(116)
Amortization of actuarial loss	**10,023**	13,546	16,277	**1,698**	2,005	1,351
(Gain) loss on curtailments and settlements	**—**	—	—	**(9,370)**	146	—
	¥ 16,422	¥ 23,627	¥ 26,933	**¥ (915)**	¥ 11,806	¥ 8,489

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2014, 2013 and 2012 are summarized as follows:

Years ended December 31	*Japanese plans*			*Foreign plans*		
	Millions of yen			*Millions of yen*		
	2014	2013	2012	**2014**	2013	2012
Current year actuarial (gain) loss	**¥ 33,800**	¥(54,150)	¥(21,753)	**¥ 37,366**	¥ 2,290	¥ 31,661
Amortization of actuarial loss	**(10,023)**	(13,546)	(16,277)	**(1,698)**	(2,005)	(1,351)
Amortization of prior service credit	**12,800**	12,306	13,079	**61**	143	116
Curtailments and settlements	**—**	—	—	**(16,725)**	(358)	—
	¥ 36,577	¥(55,390)	¥(24,951)	**¥ 19,004**	¥ 70	¥30,426

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

	Japanese plans	*Foreign plans*
	Millions of yen	*Millions of yen*
Prior service credit	¥(12,591)	¥ (55)
Actuarial loss	11,031	1,993

Assumptions

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

December 31	*Japanese plans*		*Foreign plans*	
	2014	2013	**2014**	2013
Discount rate	**1.1%**	1.6%	**2.9%**	3.8%
Assumed rate of increase in future compensation levels	**3.0%**	3.0%	**2.0%**	2.3%

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

Years ended December 31	*Japanese plans*			*Foreign plans*		
	2014	2013	2012	**2014**	2013	2012
Discount rate	**1.6%**	1.8%	1.9%	**3.9%**	3.6%	4.6%
Assumed rate of increase in future compensation levels	**3.0%**	3.0%	3.0%	**2.3%**	2.2%	2.4%
Expected long-term rate of return on plan assets	**3.1%**	3.1%	3.1%	**4.9%**	5.2%	5.4%

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

Plan assets

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

Canon's model portfolio for Japanese plans consists of three major components: approximately 20% is invested in equity securities, approximately 55% is invested in debt securities, and approximately 25% is invested in other investment vehicles, primarily consisting of investments in life insurance company general accounts.

Outside Japan, investment policies vary by country, but the long-term investment objectives and strategies remain consistent. Canon's model portfolio for foreign plans has been developed as follows: approximately 30% is invested in equity securities, approximately 50% is invested in debt securities, and approximately 20% is invested in other investment vehicles, primarily consisting of investments in real estate assets.

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

The three levels of input used to measure fair value are more fully described in Note 20. The fair values of Canon's pension plan assets at December 31, 2014 and 2013, by asset category, are as follows:

December 31, 2014	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (a)	¥ 51,805	¥ —	¥ —	¥ 51,805	¥ —	¥ —	¥—	¥ —
Foreign companies	10,233	—	—	10,233	31,963	—	—	31,963
Pooled funds (b)	—	124,388	—	124,388	—	74,744	—	74,744
Debt securities:								
Government bonds (c)	143,431	—	—	143,431	7,899	—	—	7,899
Municipal bonds	—	573	—	573	—	3,221	—	3,221
Corporate bonds	—	11,775	—	11,775	—	24,014	—	24,014
Pooled funds (d)	—	118,606	—	118,606	—	23,260	—	23,260
Mortgage backed securities (and other asset backed securities)	—	12,310	—	12,310	—	—	—	—
Life insurance company general accounts	—	123,575	—	123,575	—	7,049	—	7,049
Other assets	—	23,825	1,600	25,425	—	49,271	—	49,271
	¥205,469	¥415,052	¥1,600	¥622,121	¥39,862	¥181,559	¥—	¥221,421

December 31, 2013	Millions of yen							
	Japanese plans				Foreign plans			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Equity securities:								
Japanese companies (e)	¥ 51,159	¥ —	¥ —	¥ 51,159	¥ —	¥ —	¥—	¥ —
Foreign companies	10,347	—	—	10,347	43,681	—	—	43,681
Pooled funds (f)	—	145,417	—	145,417	—	104,933	—	104,933
Debt securities:								
Government bonds (g)	124,800	—	—	124,800	44,192	—	—	44,192
Municipal bonds	—	1,027	—	1,027	—	2,246	—	2,246
Corporate bonds	—	10,543	—	10,543	—	32,921	—	32,921
Pooled funds (h)	—	101,583	—	101,583	—	57,518	—	57,518
Mortgage backed securities (and other asset backed securities)	—	9,569	—	9,569	—	5,098	—	5,098
Life insurance company general accounts	—	109,097	—	109,097	—	15,420	—	15,420
Other assets	—	17,636	818	18,454	—	54,518	—	54,518
	¥186,306	¥394,872	¥818	¥581,996	¥87,873	¥272,654	¥—	¥360,527

(a) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥197 million.
(b) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign companies for Japanese plans, and mainly foreign companies for foreign plans.
(c) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.
(d) These funds invest in approximately 25% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 20% corporate bonds for Japanese plans. These funds invest in approximately 85% foreign government bonds and 15% corporate bonds for foreign plans.
(e) The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥572 million.
(f) These funds invest in listed equity securities consisting of approximately 25% Japanese companies and 75% foreign

companies for Japanese plans, and mainly foreign companies for foreign plans.

(g) This class includes approximately 85% Japanese government bonds and 15% foreign government bonds for Japanese plans, and mainly foreign government bonds for foreign plans.

(h) These funds invest in approximately 30% Japanese government bonds, 50% foreign government bonds, 5% Japanese municipal bonds, and 15% corporate bonds for Japanese plans. These funds invest in approximately 85% foreign government bonds and 15% corporate bonds for foreign plans.

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

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

The fair value of Level 3 assets, consisting of hedge funds, was ¥1,600 million and ¥818 million at December 31, 2014 and 2013, respectively. Amounts of actual returns on, and purchases and sales of, these assets during the years ended December 31, 2014 and 2013 were not significant.

Contributions

Canon expects to contribute ¥14,674 million to its Japanese defined benefit pension plans and ¥11,583 million to its foreign defined benefit pension plans for the year ending December 31, 2015.

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	*Millions of yen*
2015	¥ 18,521	¥ 7,351
2016	20,326	7,704
2017	21,610	7,889
2018	23,826	8,446
2019	25,989	9,035
2020–2024	163,611	54,765

Multiemployer pension plans

Effective January 1, 2014, certain subsidiaries in the Netherlands participated in a multiemployer pension plan determined in accordance with collective bargaining agreements for the industry in which these subsidiaries operate. The collective bargaining agreements have no expiration date. Canon is not liable for other participating employers' obligations under the terms and conditions of the agreements. The amount of contributions to the multiemployer pension plan which was expensed for the year ended December 31, 2014 was ¥2,815 million.

Defined contribution plans

The amounts of cost recognized for the defined contribution pension plans of the Company and certain of its subsidiaries for the years ended December 31, 2014, 2013 and 2012 were ¥15,077 million, ¥14,383 million and ¥13,021 million, respectively.

12. INCOME TAXES

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

Years ended December 31	*Millions of yen*		
	Japanese	*Foreign*	*Total*
2014: Income before income taxes	**¥277,041**	**¥106,198**	**¥383,239**
Income taxes:			
Current	**¥ 83,221**	**¥ 25,850**	**¥109,071**
Deferred	**6,796**	**2,133**	**8,929**
	¥ 90,017	**¥ 27,983**	**¥118,000**

Years ended December 31	Millions of yen		
	Japanese	Foreign	Total
2013: Income before income taxes	¥251,351	¥ 96,253	¥347,604
Income taxes:			
Current	¥ 75,134	¥ 16,163	¥ 91,297
Deferred	4,005	12,786	16,791
	¥ 79,139	¥ 28,949	¥108,088
2012: Income before income taxes	¥257,640	¥ 84,917	¥342,557
Income taxes:			
Current	¥ 73,573	¥ 29,052	¥102,625
Deferred	13,900	(6,413)	7,487
	¥ 87,473	¥ 22,639	¥ 110,112

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 38% for the years ended December 31, 2014 and 2013, respectively, and approximately 40% for the year ended December 31, 2012.

Amendments to the Japanese tax regulations were enacted into law on November 30, 2011. As a result of these amendments, the statutory income tax rate was reduced from approximately 40% to 38% effective from the year ended December 31, 2013, and to approximately 35% effective from the year ending December 31, 2016. On March 20, 2014, further amendments were enacted into law, and the reduction of the statutory income tax rate to approximately 35% became effective one year earlier, from the year ending December 31, 2015. Consequently, the statutory income tax rate utilized for deferred tax assets and liabilities which were expected to be settled or realized in the period from January 1, 2015 is approximately 35%. The adjustments of deferred tax assets and liabilities for this further amendment to tax law, which were reflected in income taxes for the year ended December 31, 2014, were not material.

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

Years ended December 31	**2014**	2013	2012
Japanese statutory income tax rate	**38.0%**	38.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.7**	0.9	0.8
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(3.7)**	(3.3)	(4.3)
Tax credit for research and development expenses	**(5.0)**	(5.4)	(5.7)
Change in valuation allowance	**(0.5)**	0.2	(1.7)
Other	**1.3**	0.7	3.0
Effective income tax rate	**30.8%**	31.1%	32.1%

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

December 31	Millions of yen	
	2014	2013
Prepaid expenses and other current assets	**¥ 61,943**	¥ 61,902
Other assets	**117,636**	103,539
Other current liabilities	**(3,456)**	(3,621)
Other noncurrent liabilities	**(80,459)**	(63,129)
	¥ 95,664	¥ 98,691

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2014 and 2013 are presented below:

December 31	*Millions of yen*	
	2014	2013
Deferred tax assets:		
Inventories	¥ 16,085	¥ 12,988
Accrued business tax	3,951	4,448
Accrued pension and severance cost	79,392	59,964
Research and development—costs capitalized for tax purposes	8,616	10,978
Property, plant and equipment	29,558	26,626
Accrued expenses	43,706	37,153
Net operating losses carried forward	38,351	38,439
Other	34,673	44,482
	254,332	235,078
Less valuation allowance	(37,498)	(35,055)
Total deferred tax assets	216,834	200,023
Deferred tax liabilities:		
Undistributed earnings of foreign subsidiaries	(10,368)	(10,876)
Net unrealized gains on securities	(6,801)	(5,740)
Tax deductible reserve	(5,696)	(6,160)
Financing lease revenue	(58,958)	(50,605)
Prepaid pension and severance cost	(1,671)	(671)
Other	(37,676)	(27,280)
Total deferred tax liabilities	(121,170)	(101,332)
Net deferred tax assets	¥ 95,664	¥ 98,691

The net changes in the total valuation allowance were an increase of ¥2,443 million for the year ended December 31, 2014, and an increase of ¥2,888 million for the year ended December 31, 2013, and a decrease of ¥1,621 million for the year ended December 31, 2012.

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, 2014. At December 31, 2014, Canon had net operating losses which can be carried forward for income tax purposes of ¥194,572 million to reduce future taxable income.

Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to an indefinite period as follows:

	Millions of yen
Within one year	¥ 1,211
After one year through five years	31,393
After five years through ten years	60,913
After ten years through twenty years	63,783
Indefinite period	37,272
Total	¥194,572

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 ¥28,318 million for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2014 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, 2014, such undistributed earnings of these subsidiaries were ¥961,917 million.

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

Years ended December 31	Millions of yen		
	2014	2013	2012
Balance at beginning of year	¥ 6,201	¥ 7,711	¥ 2,933
Additions for tax positions of the current year	1,649	312	869
Additions for tax positions of prior years	216	388	4,903
Reductions for tax positions of prior years	(114)	(3,141)	(1,546)
Settlements with tax authorities	(1,808)	(347)	(41)
Other	287	1,278	593
Balance at end of year	¥ 6,431	¥ 6,201	¥ 7,711

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥6,431 million and ¥6,201 million at December 31, 2014 and 2013, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in a future period. Based on each of the items of which Canon is aware at December 31, 2014, no significant changes to the unrecognized tax benefits are expected within the next twelve months.

Canon recognizes interest and penalties accrued related to unrecognized tax benefits in income taxes. Both interest and penalties accrued at December 31, 2014 and 2013, and interest and penalties included in income taxes for the years ended December 31, 2014, 2013 and 2012 are not significant.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2012. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2007. In other major foreign tax jurisdictions, including the United States and the Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2006 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2005 in major foreign tax jurisdictions.

13. LEGAL RESERVE AND RETAINED EARNINGS

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

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2014, 2013 and 2012 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2014 did not reflect current year-end dividends in the amount of ¥92,806 million which were approved by the stockholders in March 2015.

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 ¥935,504 million at December 31, 2014.

Retained earnings at December 31, 2014 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥16,919 million.

14. OTHER COMPREHENSIVE INCOME (LOSS)

Changes in accumulated other comprehensive income (loss) for the year ended December 31, 2012 are as follows:

Millions of yen	Foreign currency translation adjustments	Unrealized gains and losses on securities	Gains and losses on derivative instruments	Pension liability adjustments	Total
Balance at December 31, 2011	¥(378,863)	¥1,003	¥ 455	¥(104,368)	¥(481,773)
Adjustments for the year	131,129	3,143	(4,917)	(14,831)	114,524
Balance at December 31, 2012	¥(247,734)	¥4,146	¥(4,462)	¥(119,199)	¥(367,249)

Changes in accumulated other comprehensive income (loss) for the years ended December 31, 2014 and 2013 are as follows:

Millions of yen	*Foreign currency translation adjustments*	*Unrealized gains and losses on securities*	*Gains and losses on derivative instruments*	*Pension liability adjustments*	*Total*
Balance at December 31, 2012	¥(247,734)	¥ 4,146	¥(4,462)	¥(119,199)	¥(367,249)
Equity transactions with noncontrolling interests and other	(323)	(1)	(2)	(329)	(655)
Other comprehensive income (loss) before reclassifications	249,791	7,449	(7,551)	27,153	276,842
Amounts reclassified from accumulated other comprehensive income (loss)	—	(1,352)	9,607	2,161	10,416
Net change during the year	249,468	6,096	2,054	28,985	286,603
Balance at December 31, 2013	**1,734**	**10,242**	**(2,408)**	**(90,214)**	**(80,646)**
Equity transactions with noncontrolling interests and other	**10**	**3**	**—**	**(35)**	**(22)**
Other comprehensive income (loss) before reclassifications	**142,813**	**3,933**	**(2,204)**	**(47,840)**	**96,702**
Amounts reclassified from accumulated other comprehensive income (loss)	**—**	**(1,632)**	**2,009**	**11,875**	**12,252**
Net change during the year	**142,823**	**2,304**	**(195)**	**(36,000)**	**108,932**
Balance at December 31, 2014	**¥ 144,557**	**¥12,546**	**¥(2,603)**	**¥(126,214)**	**¥ 28,286**

Reclassifications out of accumulated other comprehensive income (loss) for the years ended December 31, 2014 and 2013 are as follows:

Years ended December 31	*Amount reclassified from accumulated other comprehensive income (loss)*[*1] *Millions of yen* 2014	2013	*Affected line items in consolidated statements of income*
Unrealized gains and losses on securities	**¥(2,509)**	¥ (2,358)	Other, net
	879	613	Income taxes
	(1,630)	(1,745)	Consolidated net income
	(2)	393	Net income attributable to noncontrolling interests
	(1,632)	(1,352)	Net income attributable to Canon Inc.
Gains and losses on derivative instruments	**3,260**	15,387	Other, net
	(1,248)	(5,780)	Income taxes
	2,012	9,607	Consolidated net income
	(3)	—	Net income attributable to noncontrolling interests
	2,009	9,607	Net income attributable to Canon Inc.
Pension liability adjustments	**15,585**	3,460	See Note 11
	(3,710)	(1,037)	Income taxes
	11,875	2,423	Consolidated net income
	—	(262)	Net income attributable to noncontrolling interests
	11,875	2,161	Net income attributable to Canon Inc.
Total amount reclassified, net of tax and noncontrolling interests	**¥12,252**	¥ 10,416	

*1 Amounts in parentheses indicate gains in consolidated statements of income.

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments, including amounts attributable to noncontrolling interests, are as follows:

Years ended December 31	*Millions of yen*		
	Before-tax amount	*Tax (expense) or benefit*	*Net-of-tax amount*
2014:			
Foreign currency translation adjustments	**¥144,826**	**¥ (992)**	**¥143,834**
Net unrealized gains and losses on securities:			
Amount arising during the year	**6,379**	**(2,225)**	**4,154**
Reclassification adjustments for gains and losses realized in net income	**(2,509)**	**879**	**(1,630)**
Net change during the year	**3,870**	**(1,346)**	**2,524**
Net gains and losses on derivative instruments:			
Amount arising during the year	**(3,309)**	**1,102**	**(2,207)**
Reclassification adjustments for gains and losses realized in net income	**3,260**	**(1,248)**	**2,012**
Net change during the year	**(49)**	**(146)**	**(195)**
Pension liability adjustments:			
Amount arising during the year	**(71,166)**	**21,306**	**(49,860)**
Reclassification adjustments for gains and losses realized in net income	**15,585**	**(3,710)**	**11,875**
Net change during the year	**(55,581)**	**17,596**	**(37,985)**
Other comprehensive income (loss)	**¥ 93,066**	**¥ 15,112**	**¥ 108,178**
2013:			
Foreign currency translation adjustments	¥253,707	¥ (2,131)	¥251,576
Net unrealized gains and losses on securities:			
Amount arising during the year	12,669	(4,312)	8,357
Reclassification adjustments for gains and losses realized in net income	(2,358)	613	(1,745)
Net change during the year	10,311	(3,699)	6,612
Net gains and losses on derivative instruments:			
Amount arising during the year	(12,145)	4,594	(7,551)
Reclassification adjustments for gains and losses realized in net income	15,387	(5,780)	9,607
Net change during the year	3,242	(1,186)	2,056
Pension liability adjustments:			
Amount arising during the year	51,860	(21,614)	30,246
Reclassification adjustments for gains and losses realized in net income	3,460	(1,037)	2,423
Net change during the year	55,320	(22,651)	32,669
Other comprehensive income (loss)	¥322,580	¥(29,667)	¥292,913
2012:			
Foreign currency translation adjustments	¥134,930	¥ (1,195)	¥133,735
Net unrealized gains and losses on securities:			
Amount arising during the year	3,418	(1,004)	2,414
Reclassification adjustments for gains and losses realized in net income	1,307	(456)	851
Net change during the year	4,725	(1,460)	3,265
Net gains and losses on derivative instruments:			
Amount arising during the year	(10,647)	4,041	(6,606)
Reclassification adjustments for gains and losses realized in net income	2,440	(714)	1,726
Net change during the year	(8,207)	3,327	(4,880)
Pension liability adjustments:			
Amount arising during the year	(13,888)	(1,738)	(15,626)
Reclassification adjustments for gains and losses realized in net income	4,433	(1,594)	2,839
Net change during the year	(9,455)	(3,332)	(12,787)
Other comprehensive income (loss)	¥121,993	¥ (2,660)	¥119,333

15. STOCK-BASED COMPENSATION

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

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

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

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

The compensation cost recognized for these stock options for the years ended December 31, 2014, 2013 and 2012 was nil, ¥95 million and ¥364 million, respectively, and is included in selling, general and administrative expenses in the consolidated statements of income.

A summary of option activity under the stock option plans as of and for the years ended December 31, 2014, 2013 and 2012 is presented below:

	Shares	*Weighted-average exercise price*	*Weighted-average remaining contractual term*	*Aggregate intrinsic value*
		Yen	*Year*	*Millions of yen*
Outstanding at January 1, 2012	3,042,200	¥4,268	2.0	¥ 88
Exercised	(10,800)	3,287		
Forfeited	(305,000)	4,493		
Outstanding at December 31, 2012	2,726,400	4,247	1.6	37
Exercised	(8,600)	3,287		
Forfeited	(60,400)	4,461		
Outstanding at December 31, 2013	2,657,400	4,245	1.0	28
Exercised	**(67,200)**	**3,287**		
Forfeited/Expired	**(728,400)**	**4,869**		
Outstanding at December 31, 2014	**1,861,800**	**¥4,036**	**0.7**	**¥248**
Exercisable at December 31, 2014	**1,861,800**	**¥4,036**	**0.7**	**¥248**

At December 31, 2014, all outstanding option awards were vested.

The total fair value of shares vested during the years ended December 31, 2014, 2013 and 2012 was nil, ¥570 million and ¥848 million, respectively. Cash received from the exercise of stock options for the years ended December 31, 2014, 2013 and 2012 was ¥221 million, ¥28 million and ¥35 million, respectively.

16. NET INCOME ATTRIBUTABLE TO CANON INC. STOCKHOLDERS PER SHARE

A reconciliation of the numerators and denominators of basic and diluted net income attributable to Canon Inc. stockholders per share computations is as follows:

Years ended December 31	*Millions of yen*		
	2014	2013	2012
Net income attributable to Canon Inc.	**¥254,797**	¥230,483	¥224,564

	Number of shares		
Average common shares outstanding	**1,112,509,931**	1,147,933,835	1,173,647,835
Effect of dilutive securities:			
Stock options	**4,393**	8,466	20,574
Diluted common shares outstanding	**1,112,514,324**	1,147,942,301	1,173,668,409

	Yen		
Net income attributable to Canon Inc. stockholders per share:			
Basic	**¥229.03**	¥200.78	¥191.34
Diluted	**229.03**	200.78	191.34

The computation of diluted net income attributable to Canon Inc. stockholders per share for the years ended December 31, 2014, 2013 and 2012 excludes certain outstanding stock options because the effect would be anti-dilutive.

17. DERIVATIVES AND HEDGING ACTIVITIES

Risk management policy

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

Foreign currency exchange rate risk management

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

Cash flow hedge

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

Derivatives not designated as hedges

Canon has entered into certain foreign exchange contracts to primarily offset the earnings impact related to fluctuations in foreign currency exchange rates associated with certain assets denominated in foreign currencies. Although these foreign exchange contracts have not been designated as hedges as required in order to apply hedge accounting, the contracts are effective from an economic perspective. The changes in the fair value of these contracts are recorded in earnings immediately.

Contract amounts of foreign exchange contracts at December 31, 2014 and 2013 are set forth below:

December 31	*Millions of yen*	
	2014	2013
To sell foreign currencies	**¥358,862**	¥374,699
To buy foreign currencies	**21,365**	44,726

Fair value of derivative instruments in the consolidated balance sheets

The following tables present Canon's derivative instruments measured at gross fair value as reflected in the consolidated balance sheets at December 31, 2014 and 2013.

Derivatives designated as hedging instruments

December 31		*Fair value*	
		Millions of yen	
	Balance sheet location	**2014**	2013
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**¥ 8**	¥ 44
Liabilities:			
Foreign exchange contracts	Other current liabilities	**1,597**	2,267

Derivatives not designated as hedging instruments

December 31		*Fair value*	
		Millions of yen	
	Balance sheet location	**2014**	2013
Assets:			
Foreign exchange contracts	Prepaid expenses and other current assets	**¥ 257**	¥ 210
Liabilities:			
Foreign exchange contracts	Other current liabilities	**9,570**	12,678

Effect of derivative instruments in the consolidated statements of income

The following tables present the effect of Canon's derivative instruments in the consolidated statements of income for the years ended December 31, 2014, 2013 and 2012.

Derivatives in cash flow hedging relationships

Years ended December 31	*Gain (loss) recognized in OCI (effective portion)*	*Gain (loss) reclassified from accumulated OCI into income (effective portion)*		*Gain (loss) recognized in income (ineffective portion and amount excluded from effectiveness testing)*	
Millions of yen	*Amount*	*Location*	*Amount*	*Location*	*Amount*
2014: Foreign exchange contracts	**¥ (49)**	Other, net	**¥ (3,260)**	Other, net	**¥(145)**
2013: Foreign exchange contracts	3,242	Other, net	(15,387)	Other, net	(111)
2012: Foreign exchange contracts	(8,207)	Other, net	(2,440)	Other, net	(221)

Derivatives not designated as hedging instruments

Years ended December 31		*Gain (loss) recognized in income on derivative*		
		Millions of yen		
	Location	**2014**	2013	2012
Foreign exchange contracts	Other, net	**¥(21,728)**	¥(61,787)	¥(30,602)

18. COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

At December 31, 2014, commitments outstanding for the purchase of property, plant and equipment approximated ¥52,668 million, and commitments outstanding for the purchase of parts and raw materials approximated ¥76,984 million.

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥13,847 million and ¥13,448 million at December 31, 2014 and 2013, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under such operating lease arrangements amounted to ¥43,215 million, ¥44,562 million and ¥40,273 million for the years ended December 31, 2014, 2013 and 2012, 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, 2014 are as follows:

Year ending December 31:	*Millions of yen*
2015	¥26,450
2016	18,937
2017	15,571
2018	8,753
2019	5,775
Thereafter	10,233
Total future minimum lease payments	¥85,719

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 1 year to 5 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 ¥8,951 million at December 31, 2014. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2014 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 costs for the years ended December 31, 2014 and 2013 are summarized as follows:

Years ended December 31	*Millions of yen*	
	2014	2013
Balance at beginning of year	**¥ 10,890**	¥ 12,163
Additions	**15,699**	13,467
Utilization	**(12,039)**	(12,922)
Other	**(2,986)**	(1,818)
Balance at end of year	**¥ 11,564**	¥ 10,890

Legal proceedings

Canon is involved in various claims and legal actions arising in the ordinary course of business. Canon has recorded provisions for liabilities when it is probable that liabilities have been incurred and the amount of loss can be reasonably estimated. Canon reviews these provisions at least quarterly and adjusts these provisions to reflect the impact of the negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Based on its experience, although litigation is inherently unpredictable, Canon believes that any damage amounts claimed in outstanding matters are not a meaningful indicator of Canon's potential liability. In the opinion of management, any reasonably possible range of losses from outstanding matters would not have a material adverse effect on Canon's consolidated financial position, results of operations, or cash flows.

19. DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS AND CONCENTRATIONS OF CREDIT RISK

Fair value of financial instruments

The estimated fair values of Canon's financial instruments at December 31, 2014 and 2013 are set forth below. The following summary excludes cash and cash equivalents, trade receivables, finance receivables, noncurrent receivables, short-term loans, trade payables and accrued expenses for which fair values approximate their carrying amounts. The summary also excludes investments which are disclosed in Note 2.

December 31	*Millions of yen*			
	2014		2013	
	Carrying amount	*Estimated fair value*	*Carrying amount*	*Estimated fair value*
Long-term debt, including current installments	**¥ (2,163)**	**¥ (2,146)**	¥ (2,693)	¥ (2,693)
Foreign exchange contracts:				
Assets	**265**	**265**	254	254
Liabilities	**(11,167)**	**(11,167)**	(14,945)	(14,945)

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

Long-term debt
Canon's long-term debt instruments are classified as Level 2 instruments and valued based on the present value of future cash flows associated with each instrument discounted using current market borrowing rates for similar debt instruments of comparable maturity. The levels are more fully described in Note 20.

Foreign exchange contracts
The fair values of foreign exchange contracts are measured using quotes obtained from counterparties or third parties, which are periodically validated by pricing models using observable market inputs, such as foreign currency exchange rates and interest rates, based on market approach.

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

Concentrations of credit risk
At December 31, 2014 and 2013, one customer accounted for approximately 16% and 15% of consolidated trade receivables, respectively. Although Canon does not expect that the customer will fail to meet its obligations, Canon is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

20. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy that prioritizes the inputs used to measure fair value is as follows:

Level 1— Inputs are quoted prices in active markets for identical assets or liabilities.
Level 2— Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3— Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

Assets and liabilities measured at fair value on a recurring basis
The following tables present Canon's assets and liabilities that are measured at fair value on a recurring basis consistent with the fair value hierarchy at December 31, 2014 and 2013.

December 31 *Millions of yen*	*Level 1*	*Level 2*	*Level 3*	*Total*
2014: Assets:				
Cash and cash equivalents	¥ —	¥139,240	¥ —	¥139,240
Available-for-sale (noncurrent):				
Government bonds	325	—	—	325
Corporate bonds	—	162	474	636
Fund trusts	12	72	—	84
Equity securities	40,653	—	—	40,653
Derivatives	—	265	—	265
Total assets	¥40,990	¥139,739	¥474	¥181,203
Liabilities:				
Derivatives	¥ —	¥ 11,167	¥ —	¥ 11,167
Total liabilities	¥ —	¥ 11,167	¥ —	¥ 11,167

Millions of yen	*Level 1*	*Level 2*	*Level 3*	*Total*
2013: Assets:				
Cash and cash equivalents	¥ —	¥183,078	¥ —	¥183,078
Available-for-sale (noncurrent):				
Government bonds	307	—	—	307
Corporate bonds	—	141	340	481
Fund trusts	11	57	—	68
Equity securities	34,536	—	—	34,536
Derivatives	—	254	—	254
Total assets	¥34,854	¥183,530	¥340	¥218,724
Liabilities:				
Derivatives	¥ —	¥ 14,945	¥ —	¥ 14,945
Total liabilities	¥ —	¥ 14,945	¥ —	¥ 14,945

Level 1 investments are comprised principally of Japanese equity securities, which are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions. Level 2 cash and cash equivalents are valued based on market approach, using quoted prices for identical assets in markets that are not active. Level 3 investments are mainly comprised of corporate bonds, which are valued based on cost approach, using unobservable inputs as the market for the assets was not active at the measurement date.

Derivative financial instruments are comprised of foreign exchange contracts. Level 2 derivatives are valued using quotes obtained from counterparties or third parties, which are periodically validated by pricing models using observable market inputs, such as foreign currency exchange rates and interest rates, based on market approach.

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting primarily of corporate bonds, for the years ended December 31, 2014 and 2013.

Years ended December 31	*Millions of yen*	
	2014	2013
Balance at beginning of year	**¥340**	¥444
Total gains or losses (realized or unrealized):		
Included in earnings	**—**	1
Included in other comprehensive income (loss)	**(18)**	36
Purchases, issuances, and settlements	**152**	(141)
Balance at end of year	**¥474**	¥340

Gains and losses included in earnings are mainly related to corporate bonds still held at December 31, 2014 and 2013, and are reported in “Other, net” in the consolidated statements of income.

Assets and liabilities measured at fair value on a nonrecurring basis

During the years ended December 31, 2014 and 2013, there were no circumstances that required any significant assets or liabilities to be measured at fair value on a nonrecurring basis.

21. SEGMENT INFORMATION

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

The primary products included in each segment are as follows:

Office Business Unit:

Office multifunction devices (MFDs) / Laser multifunction printers (MFPs) / Laser printers / Digital production printing systems / High speed continuous feed printers / Wide-format printers / Document solutions

Imaging System Business Unit:

Interchangeable lens digital cameras / Digital compact cameras / Digital camcorders / Digital cinema cameras / Interchangeable lenses / Inkjet printers / Large-format inkjet printers / Commercial photo printers / Image scanners / Multimedia projectors / Broadcast equipment / Calculators

Industry and Others Business Unit:

Semiconductor lithography equipment / FPD (Flat panel display) lithography equipment / Digital radiography systems / Ophthalmic equipment / Vacuum thin-film deposition equipment / Organic LED (OLED) panel manufacturing equipment / Die bonders / Micromotors / Network cameras / Handy terminals / Document scanners

The accounting policies of the segments are substantially the same as those described in the significant accounting policies in Note 1. Canon evaluates performance of, and allocates resources to, each segment based on operating profit.

Information about operating results and assets for each segment as of and for the years ended December 31, 2014, 2013 and 2012 is as follows:

Millions of yen	*Office*	*Imaging System*	*Industry and Others*	*Corporate and eliminations*	*Consolidated*
2014: Net sales:					
External customers	**¥2,075,788**	**¥1,342,501**	**¥308,963**	**¥ —**	**¥3,727,252**
Intersegment	**2,944**	**693**	**89,802**	**(93,439)**	**—**
Total	**2,078,732**	**1,343,194**	**398,765**	**(93,439)**	**3,727,252**
Operating cost and expenses	**1,786,675**	**1,148,593**	**420,566**	**7,929**	**3,363,763**
Operating profit	**¥ 292,057**	**¥ 194,601**	**¥ (21,801)**	**¥ (101,368)**	**¥ 363,489**
Total assets	**¥1,025,499**	**¥ 517,524**	**¥342,695**	**¥2,574,900**	**¥4,460,618**
Depreciation and amortization	**87,058**	**53,912**	**37,544**	**84,966**	**263,480**
Capital expenditures	**69,704**	**31,124**	**15,976**	**107,956**	**224,760**
2013: Net sales:					
External customers	¥1,993,898	¥1,448,186	¥289,296	¥ —	¥3,731,380
Intersegment	6,175	752	85,574	(92,501)	—
Total	2,000,073	1,448,938	374,870	(92,501)	3,731,380
Operating cost and expenses	1,733,165	1,245,144	400,201	15,593	3,394,103
Operating profit	¥ 266,908	¥ 203,794	¥ (25,331)	¥ (108,094)	¥ 337,277
Total assets	¥ 954,803	¥ 584,856	¥328,202	¥2,374,849	¥4,242,710
Depreciation and amortization	88,344	56,564	37,072	93,193	275,173
Capital expenditures	54,644	44,112	27,040	101,682	227,478
2012: Net sales:					
External customers	¥1,751,960	¥1,404,394	¥323,434	¥ —	¥3,479,788
Intersegment	5,615	1,577	84,406	(91,598)	—
Total	1,757,575	1,405,971	407,840	(91,598)	3,479,788
Operating cost and expenses	1,553,997	1,195,653	401,930	4,352	3,155,932
Operating profit	¥ 203,578	¥ 210,318	¥ 5,910	¥ (95,950)	¥ 323,856
Total assets	¥ 927,543	¥ 614,328	¥337,899	¥2,075,733	¥3,955,503
Depreciation and amortization	77,660	53,664	34,264	92,545	258,133
Capital expenditures	58,402	58,142	44,086	146,031	306,661

Intersegment sales are recorded at the same prices used in transactions with third parties. Expenses not directly associated with specific segments are allocated based on the most reasonable measures applicable. Corporate expenses include certain corporate research and development expenses. Segment assets are based on those directly associated with each segment. Corporate assets primarily consist of cash and cash equivalents, investments, deferred tax assets, goodwill and corporate properties. Capital expenditures represent the additions to property, plant and equipment and intangible assets measured on an accrual basis.

In 2013, based on the realignment of Canon's internal reporting structure, certain financial assets were transferred from Corporate to the Office Business Unit. Accordingly, corresponding amounts of total assets as of December 31, 2012 were reclassified.

Information about product sales to external customers by business unit for the years ended December 31, 2014, 2013 and 2012 is as follows:

Years ended December 31	*Millions of yen*		
	2014	2013	2012
Office			
Monochrome copiers	**¥ 322,398**	¥ 312,973	¥ 274,021
Color copiers	**401,447**	381,848	324,851
Printers	**862,000**	841,436	766,382
Others	**489,943**	457,641	386,706
Total	**2,075,788**	1,993,898	1,751,960
Imaging System			
Cameras	**861,196**	973,517	990,549
Inkjet printers	**366,946**	363,070	312,429
Others	**114,359**	111,599	101,416
Total	**1,342,501**	1,448,186	1,404,394
Industry and Others			
Lithography equipment	**90,395**	62,116	62,892
Others	**218,568**	227,180	260,542
Total	**308,963**	289,296	323,434
Consolidated	**¥3,727,252**	¥3,731,380	¥3,479,788

Information by major geographic area as of and for the years ended December 31, 2014, 2013 and 2012 is as follows:

	Millions of yen		
	2014	2013	2012
Net sales:			
Japan	**¥ 724,317**	¥ 715,863	¥ 720,286
Americas	**1,036,500**	1,059,501	939,873
Europe	**1,090,484**	1,124,929	1,014,038
Asia and Oceania	**875,951**	831,087	805,591
Total	**¥3,727,252**	¥3,731,380	¥3,479,788
Long-lived assets:			
Japan	**¥ 950,719**	¥ 984,231	¥1,032,598
Americas	**157,748**	131,660	112,163
Europe	**127,700**	111,609	91,904
Asia and Oceania	**210,650**	196,305	159,435
Total	**¥1,446,817**	¥1,423,805	¥1,396,100

Net sales are attributed to areas based on the location where the product is shipped to the customers. Other than in Japan and the United States, Canon does not conduct business in any individual country in which its sales in that country exceed 10% of consolidated net sales. Net sales in the United States were ¥938,411 million, ¥960,213 million and ¥763,870 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Long-lived assets represent property, plant and equipment and intangible assets for each geographic area.

The following information is based on the location of the Company and its subsidiaries as of and for the years ended December 31, 2014, 2013 and 2012. In addition to the disclosure requirements under U.S. GAAP, Canon discloses this information in order to provide financial statements users with useful information.

Millions of yen	*Japan*	*Americas*	*Europe*	*Asia and Oceania*	*Corporate and eliminations*	*Consolidated*
2014: Net sales:						
External customers	**¥ 836,801**	**¥ 1,033,797**	**¥ 1,088,293**	**¥ 768,361**	**¥ —**	**¥ 3,727,252**
Intersegment	**1,752,378**	**8,738**	**59,493**	**821,600**	**(2,642,209)**	**—**
Total	**2,589,179**	**1,042,535**	**1,147,786**	**1,589,961**	**(2,642,209)**	**3,727,252**
Operating cost and expenses	**2,245,930**	**1,018,661**	**1,135,515**	**1,522,244**	**(2,558,587)**	**3,363,763**
Operating profit	**¥ 343,249**	**¥ 23,874**	**¥ 12,271**	**¥ 67,717**	**¥ (83,622)**	**¥ 363,489**
Total assets	**¥ 1,134,484**	**¥ 531,122**	**¥ 484,858**	**¥ 674,672**	**¥ 1,635,482**	**¥ 4,460,618**
2013: Net sales:						
External customers	¥ 797,501	¥1,056,096	¥1,124,603	¥ 753,180	¥ —	¥3,731,380
Intersegment	1,855,181	11,774	53,281	881,765	(2,802,001)	—
Total	2,652,682	1,067,870	1,177,884	1,634,945	(2,802,001)	3,731,380
Operating cost and expenses	2,326,351	1,043,487	1,171,357	1,574,125	(2,721,217)	3,394,103
Operating profit	¥ 326,331	¥ 24,383	¥ 6,527	¥ 60,820	¥ (80,784)	¥ 337,277
Total assets	¥1,152,398	¥ 447,039	¥ 496,549	¥ 631,827	¥ 1,514,897	¥4,242,710
2012: Net sales:						
External customers	¥ 834,406	¥ 932,987	¥1,010,922	¥ 701,473	¥ —	¥3,479,788
Intersegment	1,829,834	23,767	5,650	781,836	(2,641,087)	—
Total	2,664,240	956,754	1,016,572	1,483,309	(2,641,087)	3,479,788
Operating cost and expenses	2,336,536	937,111	972,585	1,437,527	(2,527,827)	3,155,932
Operating profit	¥ 327,704	¥ 19,643	¥ 43,987	¥ 45,782	¥ (113,260)	¥ 323,856
Total assets	¥1,206,702	¥ 339,918	¥ 457,592	¥ 548,583	¥ 1,402,708	¥3,955,503

22. SUBSEQUENT EVENT

On March 3, 2015, the Company commenced a public tender offer for all of the issued shares of Axis AB (“Axis”), a Sweden-based company listed on Nasdaq Stockholm, a global leader in the network video solutions industry, for a consideration of 340 Swedish krona (¥4,804) in cash per share or a maximum amount of approximately 23.6 billion Swedish krona (approximately ¥333.7 billion). Through the transaction, the Company aims to make Axis a consolidated subsidiary, acquiring 100% of Axis’s issued shares. The Company views its network surveillance camera business as a promising new business area for Canon. Corresponding Japanese yen amounts as noted above are translated at the rate of ¥14.13 = 1 Swedish krona.

SCHEDULE OF VALUATION AND QUALIFYING ACCOUNTS

Years ended December 31 *Millions of yen*	*Balance at beginning of period*	*Addition-charged to income*	*Deduction bad debts written off*	*Translation adjustments and other*	*Balance at end of period*
2014: Allowance for doubtful receivables					
Trade receivables	**¥12,730**	**¥ 878**	**¥(2,236)**	**¥ 750**	**¥12,122**
Finance receivables	**7,323**	**154**	**(1,171)**	**(30)**	**6,276**
2013: Allowance for doubtful receivables					
Trade receivables	¥12,970	¥1,235	¥(4,173)	¥2,698	¥12,730
Finance receivables	6,908	212	(1,278)	1,481	7,323
2012: Allowance for doubtful receivables					
Trade receivables	¥11,563	¥2,149	¥(2,382)	¥1,640	¥12,970
Finance receivables	7,039	1,922	(1,304)	(749)	6,908

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Canon is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

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

Canon's management assessed the effectiveness of internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria established in internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the "COSO criteria").

Based on its assessment, management concluded that, as of December 31, 2014, Canon's internal control over financial reporting was effective based on the COSO criteria.

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

Fujio Mitarai
Chairman & CEO

Toshizo Tanaka
Executive Vice President and CFO

March 27, 2015

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Building a better working world

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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, 2014 and 2013, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the schedule of valuation and qualifying accounts (the "schedule"). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 27, 2015 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 27, 2015

Ernst & Young ShinNihon LLC
Hibiya Kokusai Bldg.
2-2-3 Uchisaiwai-cho, Chiyoda-ku
Tokyo, Japan 100-0011

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www.shinnihon.or.jp

The Board of Directors and Stockholders of
Canon Inc.

We have audited Canon Inc. and subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Canon Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Canon Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2014, and our report dated March 27, 2015 expressed an unqualified opinion thereon.

Ernst & Young ShinNihon LLC

March 27, 2015

TRANSFER AND REGISTRAR'S OFFICE

Canon Inc.

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

Manager of the Register of Shareholders

Mizuho Trust & Banking Co., Ltd.
2-1, Yaesu 1-chome, Chuo-ku, Tokyo 103-8670, Japan

Depositary and Agent with Respect to American Depositary Receipts for Common Shares

JPMorgan Chase Bank, N.A.
1 Chase Manhattan Plaza, Floor 58, New York, N.Y.
10005-1401, U.S.A.

STOCKHOLDER INFORMATION

Stock Exchange Listings:

Tokyo, Nagoya, Fukuoka, Sapporo and New York stock exchanges

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

Ordinary General Meeting of Shareholders:

March 27, 2015, in Tokyo

Further Information:

For publications or information, please contact the Public Affairs Headquarters, Canon Inc., Tokyo, or access Canon's Website at
www.canon.com

MAJOR CONSOLIDATED SUBSIDIARIES

(As of December 31, 2014)

Manufacturing

Canon Precision Inc.
Fukushima Canon Inc.
Canon Chemicals Inc.
Canon Components, Inc.
Canon Electronics Inc.
Canon Finetech Inc.
Nisca Corporation
Canon Tokki Corporation
Canon ANELVA Corporation
Nagahama Canon Inc.
Canon Machinery Inc.
Oita Canon Materials Inc.
Oita Canon Inc.
Nagasaki Canon Inc.
Canon Virginia, Inc.
Canon Bretagne S.A.S.
Océ-Technologies B.V.
OPTOPOL Technology Sp. z o.o.
Canon Dalian Business Machines, Inc.
Canon (Suzhou) Inc.
Canon Zhongshan Business Machines Co., Ltd.
Canon Zhuhai, Inc.
Canon Inc., Taiwan
Canon Vietnam Co., Ltd.
Canon Hi-Tech (Thailand) Ltd.
Canon Opto (Malaysia) Sdn. Bhd.
Canon Prachinburi (Thailand) Ltd.
Canon Business Machines (Philippines), Inc.

Research & Development

Canon Research Centre France S.A.S.
Canon Information Systems Research Australia Pty. Ltd.

Marketing & Other

Canon Marketing Japan Inc.
Canon System and Support Inc.
Canon Software Inc.
Canon IT Solutions Inc.
Canon U.S.A., Inc.
Canon Canada Inc.
Canon Solutions America, Inc.
Canon Latin America, Inc.*
Canon Europa N.V.
Canon Europe Ltd.
Canon Ru LLC
Canon (UK) Ltd.
Canon Deutschland GmbH
Canon (Schweiz) AG
Canon Nederland N.V.
Canon France S.A.S.
Canon Middle East FZ-LLC
Canon (China) Co., Ltd.
Canon Hongkong Co., Ltd.
Canon Singapore Pte. Ltd.
Canon Australia Pty. Ltd.

* Canon Latin America, Inc. was merged into Canon U.S.A., Inc. on January 1, 2015.

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