CANON ANNUAL REPORT 2008

Fiscal Year Ended December 31, 2008

CORPORATE PROFILE

Canon is engaged in the development, manufacture and sale of a growing lineup of copying machines, printers, cameras, optical and other products that meet a diverse range of customer needs. The Canon brand is well recognized and trusted throughout the world by the individuals, families, offices and industries that use Canon products. In 1996, Canon launched its Excellent Global Corporation Plan and has since delivered a series of strong performances. After this period of sustained growth, however, the Company is confronting an unprecedented downturn in worldwide financial and economic markets. Despite the onset of harsh operating conditions, Canon remains at the forefront of an industry that continues to experience the spread of globalization and broadband networks. Leveraging its strengths in cross-media imaging through advanced synergies among digital imaging equipment and technologies, Canon will reinforce its robust position in preparation for the next economic upturn. As a part of these endeavors, and in its efforts to fulfill its duties to investors and society, Canon will continue to emphasize good corporate governance and promote activities that contribute to the environment and society.

CORPORATE PHILOSOPHY: *Kyosei*

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

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

CORPORATE GOAL

Canon is shifting its emphasis more toward improved management quality from sound growth, carrying out its medium- to long-term management plan, the Excellent Global Corporation Plan. This decision was made in light of the current worldwide financial crisis and unprecedented downturn in the global economy. With the aim of attaining the status of being among the global top 100 companies in terms of key performance indicators, Canon is accelerating management quality improvement initiatives.

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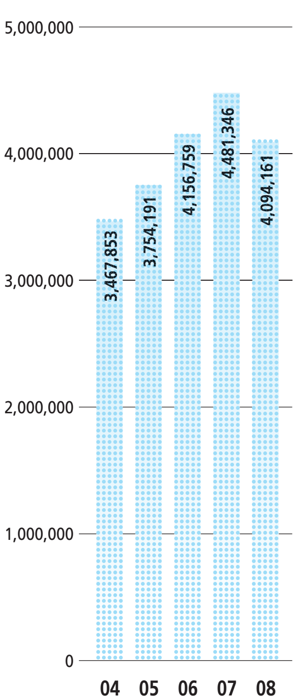
Cover Photo:
Equipped with Dual Flash Memory, this lightweight and compact video camcorder realizes reduced noise through Canon's CMOS sensor and 1,920 x 1,080 Full HD high image quality. The dual memory allows users to enjoy capturing, viewing and saving images with ease.

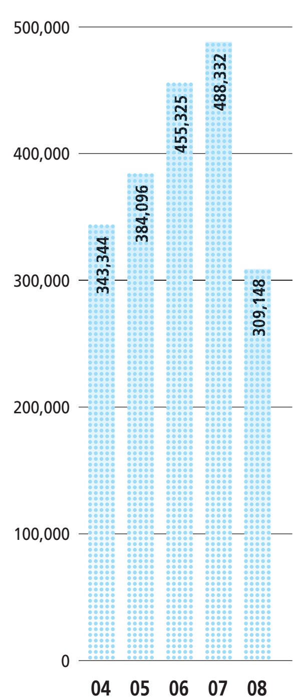
	Millions of yen (except per share amounts)			Thousands of U.S. dollars (except per share amounts)
	2008	2007	Change (%)	**2008**
Net sales	**¥ 4,094,161**	¥ 4,481,346	-8.6	**$ 44,990,780**
Operating profit	**496,074**	756,673	-34.4	**5,451,363**
Income before income taxes and minority interests	**481,147**	768,388	-37.4	**5,287,330**
Net income	**309,148**	488,332	-36.7	**3,397,231**
Net income per share:				
-Basic	**¥ 246.21**	¥ 377.59	-34.8	**$ 2.71**
-Diluted	**246.20**	377.53	-34.8	**2.71**
Total assets	**¥ 3,969,934**	¥ 4,512,625	-12.0	**$ 43,625,648**
Stockholders' equity	**¥ 2,659,792**	¥ 2,922,336	-9.0	**$ 29,228,484**

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 JPY91=U.S.$1, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2008, solely for the convenience of the reader.

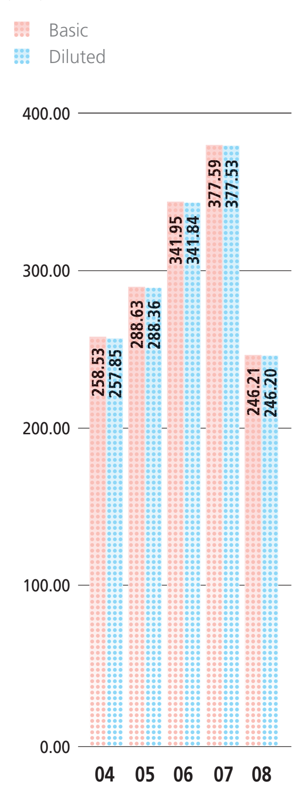
Net Sales
(Millions of yen)



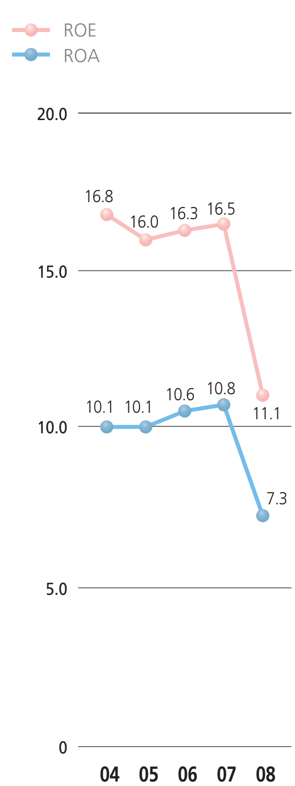
Net Income
(Millions of yen)



Net Income per Share
(Yen)



ROE / ROA
(%)



Bolstering Management Quality in the Face of Adversity

In 2008, the world economy found itself facing an unprecedented crisis triggered primarily by the global recession following the collapse of Lehman Brothers in the United States.

In 2009, the economic environment will continue to be extremely harsh. Nevertheless, we view these drastic economic changes as an ideal opportunity to further restructure in order to bolster our overall management strength. In 2009, Canon will make a major change in course from sound growth to improved management quality while preparing to rapidly leap forward when the economic environment recovers.

Improved management quality means that Canon will make decisions swiftly as needed so that we can rapidly move to the execution stage and increase the overall strength of the Company, even when market conditions suddenly turn turbulent. In other words, we will achieve real-time management. To that end, we will further strengthen our cash-flow management and supply chain management (SCM) as we raise product competitiveness and profitability. Canon is boldly pushing forward its Excellent Global Corporation Plan with the aim of entering the ranks of the global top 100 companies in terms of key performance indicators.

Overview of Fiscal 2008

In the first half of 2008, energy and raw material prices skyrocketed, which had a major impact on corporate earnings. Moreover, during the severe economic recession that began in September, stock prices dropped precipitously due to the expanding financial crisis. At the same time, heavy yen buying in foreign exchange markets caused the already high yen to sharply appreciate. During 2008, the average exchange rate of the yen was ¥103.23 against the dollar and ¥151.46 against the euro, appreciating approximately 14% and 7% year on year, respectively.

Turning to each region, in the United States a grave situation has been created by the recession triggered by the subprime loan problem, with a sharp decline in new housing starts along with growing unemployment in the auto and financial industries—all leading economic indicators.

In Europe, the financial crisis has also affected the real economy, leading to a decline in regional trade, which had been an engine of growth.

In Japan as well, the financial crisis sent economic conditions into a rapid tailspin. Exports, a growth driver, plunged and production dropped substantially for most manufacturers.

In Asia and emerging countries in other areas, economic growth abruptly declined due to decreased exports.

Fiscal 2008 Performance Results

As a result of the above-mentioned factors, Canon's consolidated net sales declined 8.6% to ¥4,094.2 billion and net income dropped 36.7% to ¥309.1 billion compared with the previous fiscal year. By product category, sales decreased 9.4% to ¥2,660.0 billion for business machines (includes office imaging products and computer peripherals) and 9.6% to ¥1,042.0 billion for cameras. However, sales of optical and other products were largely in line with those of the previous fiscal year at ¥392.2 billion. By operating region, in Europe sales fell 10.5% to ¥1,341.4 billion. Sales also decreased in the Americas, declining 13.6% to ¥1,154.6 billion. In Japan sales slipped 8.4% to ¥868.3 billion, and elsewhere in Asia and Oceania sales climbed 4.5% to ¥729.9 billion.

Turning to operating expenses, Canon's selling, general and administrative expenses declined 4.8% year on year to ¥1,067.9 billion. The Company's R&D expenses increased 1.6% to ¥374.0 billion, or 9.1% of net sales. Even in a major economic downturn, Canon's aggressive R&D spending was at a higher rate than in the previous fiscal year. The gross profit ratio declined 2.8 percentage points to 47.3%. Net income per share, basic and diluted, came in at ¥246.21 and ¥246.20, respectively.

As for returning profits to stockholders, Canon emphasizes the stable return of free cash flow to stockholders, and intends to pay a full-year dividend per share of ¥110, the same amount as in the previous fiscal year. Moreover, Canon purchased a total of ¥100 billion in treasury stock during fiscal 2008.

Management Policies for Fiscal 2009

We have defined 2009 as the year to prepare for making our next leap forward. We will focus on surmounting the adversity caused by the economic crisis and promote measures and policies to improve the quality of management.

First, Canon will thoroughly strengthen its SCM. To remain successful in the midst of major market changes, we must continue to expeditiously launch competitive new products. This cannot be achieved with only development and product planning capabilities. We will build a higher level of SCM through IT innovations that consolidate information on everything from development through sales, as well as through pull production, or the timely manufacture of products to meet the exact level of demand.

Canon will promote a two-pronged production strategy of further developing cost-reducing technologies and building a globally optimized production system based on localized production.

With respect to the development of cost-reducing technologies, the Company will work to expand the scope of automation with the goal of establishing fully automated production systems. In addition to the assembly of toner and inkjet cartridges, We will continue to promote automation, even in the product body assembly process. We are developing intelligent robots that can carry out highly precise and sophisticated actions that will enable them to perform more complex assembly work.

Canon promotes the in-house production of parts as a strategy for innovation and increasing profitability. In-house production leads to the accumulation of technological know-how as well as higher quality and lower costs. In 2008, the Company raised the ratio of in-house production of key parts, such as electrophotographic and optical parts, as well as metal molds.

Canon's globally optimized production system is a new production strategy that comprehensively considers such factors as consumer markets, employment conditions and transportation costs. Canon Virginia, Inc. in the United States has initiated the construction of a new plant in which we will build an integrated system that manufactures, sells, recovers and recycles toner cartridges.

In order to launch businesses in a timely manner ahead of the market, it is essential that Canon possess the technological capacity to develop technologies that will serve as seeds for promising future businesses. As a measure to strengthen the R&D system, in 2009 Canon established its Corporate R&D Headquarters. Along with the appointment of Dr. Toshiaki Ikoma as Executive Vice President and Chief Technical Officer, Canon has taken steps to consolidate its R&D Divisions and will fortify upstream technological research and speed up the promotion of new domains. As a result, we will achieve greater efficiency through the selection and concentration of research themes, and investments in R&D will also contribute.

In addition, Canon is strengthening and increasing the business autonomy of Group companies while fortifying its global sales system.

Toward a Truly Excellent Global Company

Finally, in order to become a truly excellent global company that sustains growth and continues to thrive for 100 or even 200 years, it is essential that we develop our management resources. Canon will pass on its DNA—respect for human dignity, an emphasis on technology, and an enterprising spirit—to the next generation of managers and implement practical human resource development training that will also apply to its executive officer system. Canon will also redouble its efforts to contribute to society. The presence of a truly excellent global company must be welcome—even in fields outside of its direct business activities. Therefore, we will fulfill our social responsibilities as a good corporate citizen.

One of those responsibilities is that of striking an optimal balance between business operations and environmental conservation. While Canon reexamines its business processes and thoroughly eliminates waste that affects the environment, the Company will enhance the environmental performance of its products and continuously innovate in a wide range of fields, including materials and design. In addition, as a global company, Canon established the Canon Institute for Global Studies and the Canon Foundation in 2008 with the goal of contributing to the global community. These institutions analyze important issues pertaining to the world's future, disseminate information, and broadly support groups and individuals involved in academic research, including in science and technology areas, as well as cultural research, business and education in the areas of technology.

The economic crisis has had a major impact throughout the world and a great many uncertainties lie ahead. Nevertheless, guided by the strategies of Phase III of our Excellent Global Corporation Plan, Canon will make a shift back to achieving increased revenue and earnings, specifically, net sales of ¥3,700 billion or more and net income of ¥150 billion or more by fiscal 2010, the final year of Phase III. Thereafter in the three-year period to fiscal 2012, the Company will work diligently toward building a corporate structure that is capable of achieving the level of sales and profits necessary to surpass its fiscal 2008 performance based on current foreign currency exchange rates.

I would like to thank everyone for their continued understanding and support.

Fujio Mitarai
Chairman and CEO
Canon Inc.

With speed and quality in mind, we will reorganize the Company into a firm structure that completely eliminates inefficiencies

Priority Goals for Fiscal 2009

In 2009, we are charting a major change of course from sound growth to improved management quality as we direct our energies over the year toward preparing for the Company's next leap forward. Moreover, we have returned to the original intent of our Excellent Global Corporation Plan to achieve speed and quality with the realization that now is the time to start everything anew. Specifically, we will pursue the following priority goals.

Our first priority goal is the timely launch of highly competitive new products that excel in terms of functionality, design, ease-of-use, reliability and cost performance. The essence of competitiveness is innovation, beginning with the enhancement of the Company's key components. Furthermore, we consider "cross-media imaging" to be the guideline for innovation. Drawing on the Company's shared digital platforms of color management, wireless and user interface technologies, cross-media imaging enables a high level of collaboration among input and output devices and increases product synergies and added value.

Our second priority goal is to lower the cost to sales ratio. We believe that achieving sustainable growth into the future requires the dedication of a considerable volume of resources to R&D and, consequently, the Company must maintain steady cash flows. That is our main reason for working to establish optimal SCM. For this purpose, at the end of January 2009, Canon had already completed the introduction of a new, highly effective production information system to 20 production facilities, following its initial deployment at Oita Canon Inc. in 2003. This system not only centralizes production information for the entire Group, but also links technical information from the development side and information related to demand from sales and marketing.

In addition to this system, in the future we will move forward with the establishment of an integrated system for managing product quality information as well as a next-generation logistics system that links information from the marketplace directly to production while handling the shipping, storage and transport of allocated products. We are carrying out innovation initiatives, including our pull production system, which allows us to efficiently respond to demand fluctuations. By unifying all the information through IT reforms, Canon will further improve its management efficiency.

The main advantage realized by centralizing information through these IT reforms is the ability to make progress in all business processes at the same time. Fully implemented, this unparalleled system will enable such results as timing the completion of product design to coincide with the completion of production equipment design, keeping inventories of goods in transit only and entirely eliminating the need for warehouses. The Company is determined to ultimately realize such a system of centralized information.

Closely connected with these activities is our third priority goal of carrying out sweeping reforms to further raise quality. Problems with quality can cause considerable damage to a brand image and lead to a loss of public trust. Moreover, lack of quality during product design results in wasted materials and energy. With this in mind, the Company has established new rules covering all product commercialization processes. In the event that any problem should arise, we will strictly adhere to the basic quality control principle of diligently facing and working to resolve it. This

approach will enable us to improve product quality.

Our fourth priority goal is to cultivate the Company's core businesses of the future. Canon is making steady progress in its development of displays, including organic light-emitting diode (OLED) displays and surface-conduction electron-emitter displays (SEDs). Furthermore, along with establishing device and process technologies for displays, we are bolstering our research and development efforts for the Company's medical equipment.

Our final priority goal is to strengthen the Group's environmental management. Solving environmental problems requires a fundamental reexamination of existing technology—that is the wellspring of innovation. This brings new approaches to current technologies, and at the same time, greatly increases the possibility of uncovering a path leading to a paradigm shift in the industry. From this standpoint, Canon will continue working diligently to reduce environmental burdens with an eye to developing beneficial environmental technologies and thoroughly eliminating waste.

We expect to face many hurdles in 2009 given the extent of the global economic crisis. Undaunted by the challenges ahead, the Group is unified in its commitment to pursuing speed and quality in all of its activities and to further improve its business structure by eliminating any inefficiencies.

Tsuneji Uchida

Tsuneji Uchida
President and COO
Canon Inc.

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Photo:
The large-format imagePROGRAF inkjet printers have been adopted by the School of the Art Institute of Chicago, earning high praise for combining professional-level photographic image quality and outstanding print speed.

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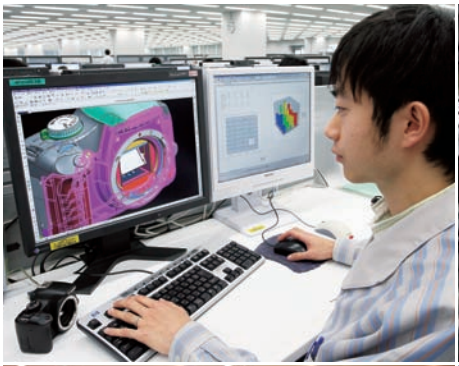

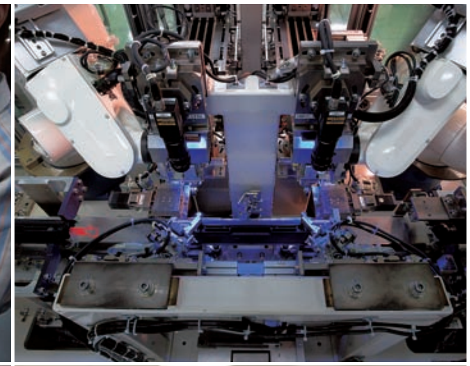

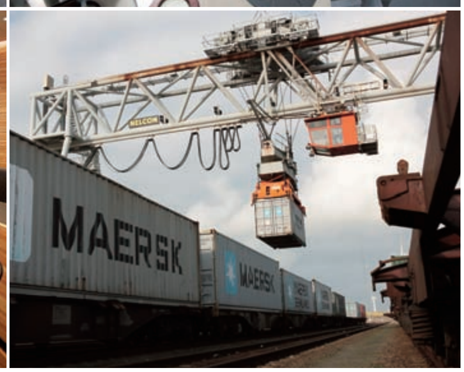

Canon will improve management quality in preparation for the next stage of growth

In the face of an unprecedented global economic crisis, 2008 was a turbulent year of world economic collapse. Taking these conditions into account, Canon responded decisively and significantly changed the course of its Excellent Global Corporation Plan from sound growth to improved management quality.

Having reconsidered our targets for fiscal 2010, we are aiming for net sales of ¥3,700 billion or more and net income of ¥150 billion or more. Over the three years through fiscal 2012, our objective is to establish a business structure that is capable of achieving the level of sales and profits necessary to surpass our fiscal 2008 performance based on current foreign currency exchange rates and to attain our original goal of joining the global top 100 companies in terms of key performance indicators.

In 2009, Canon will undertake exhaustive efforts aimed at fully realizing SCM that eliminates all inefficient processes. The year will be a time to continue with steady investment in the development of high-value-added products while aggressively preparing for the next wave of growth.

Excellent Global Corporation Plan

In 1996, Canon kicked off its medium- and long-term Excellent Global Corporation Plan, which is divided into a series of five-year terms with distinct strategies and targets under a single overarching vision: "In accordance with the philosophy of *kyosei,* Canon will continue contributing to society through technological innovation, aiming to be a corporation worthy of admiration and respect worldwide."

Phase I—Strengthening Financial Health

In Phase I of the Excellent Global Corporation Plan, Canon set out to strengthen its financial health with reforms in all aspects of its business. The Company made all-out efforts to establish the policies of "total optimization" and "focus on profit" while carrying out the selection and concentration of business areas.

Phase II—Becoming No. 1 in Core Businesses

Having solidified its financial foundation in Phase I, Canon launched Phase II with the goal of becoming No. 1 globally in all its major areas of business. Placing strong emphasis on product competitiveness, the Company captured the top global market share for many of its core products. Sales and income grew steadily each year.

5 KEY STRATEGIES

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

External Ratings

- **Financial Times Global 500**
  (March 31, 2008 issue)
  Market value ranking: 110
  (9th in the Technology Hardware & Equipment Category)
- **FORTUNE Global 500**
  (July 21, 2008 issue)
  Revenues ranking: 189
  (5th in the Computers, Office Equipment category)
  Profits ranking: 126
  (5th in the Computers, Office Equipment category)
- **BusinessWeek "Best Global Brands" of 2008**
  (September 29, 2008 issue)
  Ranking: 36
  (4th among all Japanese companies)

FORTUNE Global 500 is a registered trademark of FORTUNE Magazine, a division of Time Inc. in the United States of America.

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

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EF lenses for EOS cameras enjoy wholehearted popularity as the telephoto lenses of choice for sports media on site at international soccer matches and other sporting events around the world.

Despite severe conditions in the global economy, in 2008 Canon held its No. 1 position for core products, including digital cameras, laser beam printers (LBPs), exposure equipment for LCDs and broadcasting lenses. To maintain the top position, the Company will work to differentiate its product technologies and release new products to the marketplace with opportune timing.

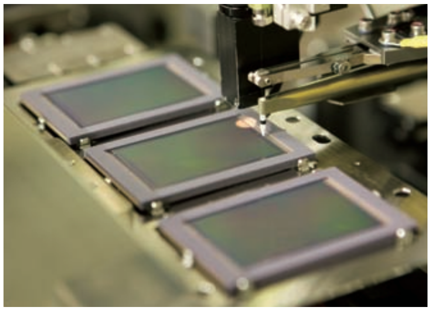
Canon is strengthening the in-house development of its key components as a means to differentiate and accumulate its technologies, increase product quality and reduce costs. In 2008, the Company completed a new facility in Kawasaki, Japan, to develop and produce in-house semiconductor devices, including Complementary Metal Oxide Semiconductor (CMOS) sensors, which are key components of digital cameras.

Also in cameras, Canon strengthened its lineups and released digital single lens reflex (SLR) cameras for advanced amateurs. In addition, the Company worked to improve the performance and processing power of its DigitalImagingIC (DIGIC) imaging processors, another key component of digital cameras.

In office imaging products, Canon is strengthening its solutions business by leveraging its Multifunction Embedded Application Platform (MEAP), which allows the customization of networked multifunctional devices (MFDs). In 2008, we surpassed the 100,000 mark for cumulative MEAP application licenses. Aiming to press ahead in 2009, the Company has further stepped up the development of its next-generation platforms for multifunction products with greatly enhanced systems and operability.

In exposure equipment for LCDs, Canon maintained its No. 1 position in 2008, enhancing its sales of the MPAsp-H700 LCD exposure system for eighth-generation panels.

Looking ahead, an important element for achieving the overwhelming No. 1 position in the market is cross-media imaging, a concept that realizes high-level synergies among Canon's input and output products as a means to meet the needs of our information society.



In-house production of CMOS sensors

2. Expanding business operations through diversification

Canon is accelerating the development of OLED displays for incorporation into its products.

Canon pursues business diversification to ensure future business growth. We are currently placing priority on building up the display business, which is a key of cross-media imaging. In 2008, we acquired a capital stake in Hitachi Displays, Ltd., and strengthened operations centered on OLED displays and small- to medium-size LCDs. While focusing on efforts to further enhance the basic properties of the Company's unique SEDs, we are placing additional weight on the establishment of technologies for mass production.

Canon is also bolstering its digital radiography business with the development of digital radiography systems capable of viewing dynamic images and capturing static X-ray images, which will greatly improve diagnostic accuracy.

Strengthening its position in the print-on-demand (POD) market, which it entered in 2007, Canon released several new products in the imagePRESS lineup in 2008. We will continue to enhance our POD lineups to consolidate our position in this market.

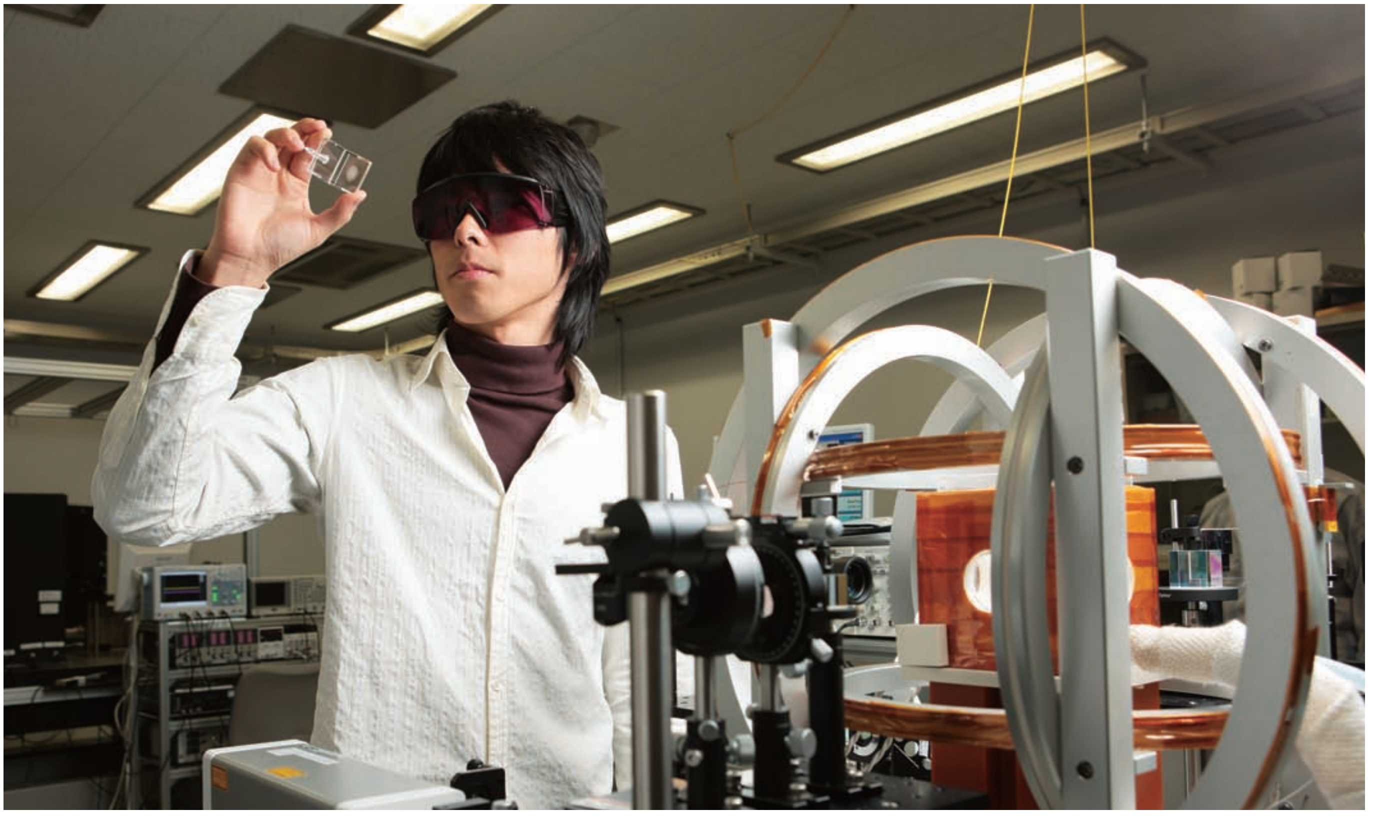
Canon is also promoting the Group's expansion of independent businesses. In 2008, Canon Finetech Inc., which develops and manufactures office MFDs and their peripherals, increased its equity in Nisca Corporation, a Japanese developer and manufacturer of peripheral devices for office machines, with the aim of enabling the further expansion of the office machine and peripheral business as well as accelerating the development of differentiated products. To this end, Nisca was included in Canon's scope of consolidation as a wholly owned subsidiary.

As a part of its business diversification efforts, Canon U.S.A., Inc. is endeavoring to commercialize molecular diagnostic equipment for the U.S. market, where gene diagnosis is a highly advanced and rapidly growing field, through the application of its imaging and high-precision processing technologies.

Canon has been focusing on its solutions business to provide optimal solutions to networked printing environments in offices. In particular, we are putting emphasis on the area of security, applying our original MEAP to meet the characteristics of each region. In 2008, we acquired NEWCAL Industries, a California-based reseller of document and print solutions, to expand our solution business in the United States. In addition, Canon Marketing Japan Inc. established Canon IT Solutions Inc. with an eye to cultivating IT solutions as a core business.

The popular digital color press imagePRESS contributes to greater printing efficiency in the POD market.
The image in the print sample was designed by Europe Quality & Style Inc. N.Y.

3. Identifying new business domains and accumulating required technologies



Canon and Japan's Kyoto University have teamed up to promote R&D of high sensitivity magnetic sensors.

Canon pursues next-generation business domains with due consideration given to such factors as strong prospects for market growth, technological innovation potential, consistency with the Company's core capabilities and the likelihood of the business positively impacting the Company's prospects for sound growth.

We have identified medical imaging as an important new business domain. As a key initiative, we have launched the Canon-Kyoto University Joint Research Project together with Kyoto University in Japan. With a commitment to developing next-generation diagnostic instruments capable of detecting disease at the earliest stages, the Company is applying its sensing and imaging technologies to research covering a broad range of areas, including new technologies and clinical applications, while continuing to carry out collaborative research.

Industrial robotics is another next-generation business domain for Canon. The Company has already used robots to assemble toner and inkjet cartridges and is now working on developing intelligent robots that can carry out an even higher level of precise and sophisticated actions.

In other promising fields, Canon is promoting R&D activities in such leading-edge technologies as nanotechnology and biotechnology.

Collaborative research into semiconductor devices for medical imaging with Stanford University

4. Establishing new production systems to sustain international competitiveness

Canon is aggressively accumulating valuable technologies toward the establishment of fully automated production systems that consistently realize high quality and improved productivity.

In 2008, Canon improved the precision and efficiency of its automated toner cartridge production with the installation of new machinery at Oita Canon Materials Inc. The machinery is based on a concept of Canon automated production wherein the entire production process is optimized through the integration of development, manufacturing and engineering technologies.

To decrease the environmental burden associated with transportation and to flexibly meet changes in global demand, Canon has begun a shift to localized production. In the United States, we are carrying out plans for large-scale expansion at Canon Virginia. The expansion will include a new toner cartridge manufacturing plant that will introduce high-speed automated production systems, while also making feasible the efficient transport of Canon products.

Canon is also taking further steps toward automated production by introducing automated machinery into sections of the assembly of inkjet printers and LBPs.

Development of automation technology to ensure a fully automated production system

5. Nurturing truly autonomous individuals and promoting effective corporate reforms

For Canon to become a company that flourishes far into the future, it is vital that the Company's corporate culture is passed down to new generations of employees. Therefore, we further strengthen the cultivation of management and general employees to pass on Canon's accumulated corporate DNA—respect for human dignity, an emphasis on technology, and an enterprising spirit. Specifically, Canon carries out various kinds of management training for managers and communicates the Canon corporate DNA. The Company's executive officer system, introduced in 2008, provides opportunities for management to directly put their ideas into practice.

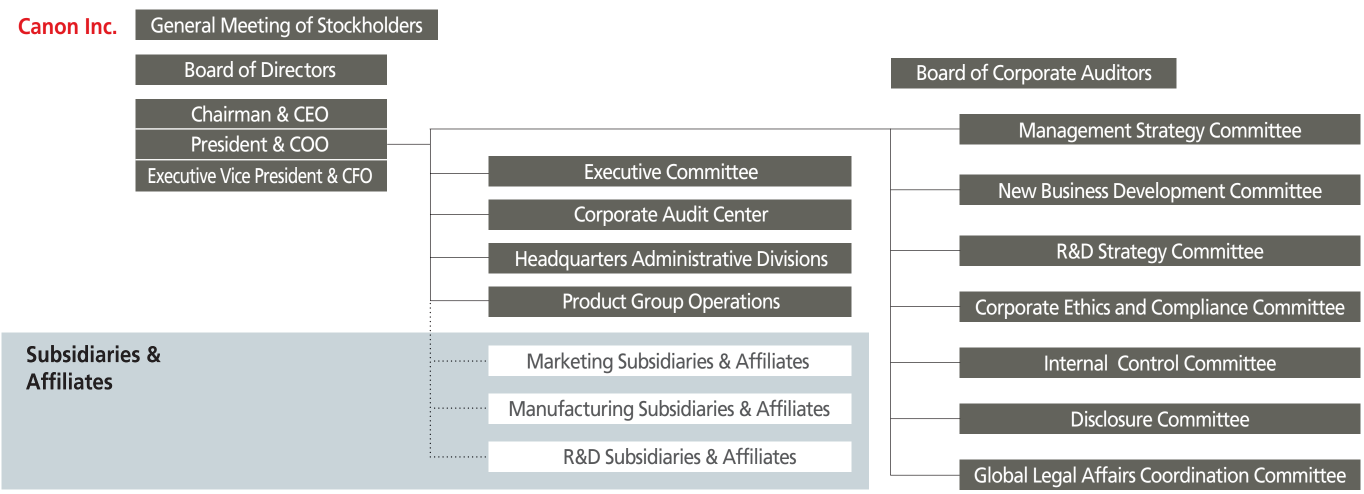
In addition to corporate culture, we recognize the necessity of passing down competency in and knowledge of the Company's highly advanced technologies to future employees. From 2009, Canon will commence activities at Oita Manufacturing Training Center, Japan. Equipped with various manufacturing equipment, the center aims to nurture, through technical skills training, new generations of employees that will lead the manufacturing industry worldwide in the future.

To realize our vision of being "a corporation worthy of admiration and respect worldwide," we recognize that compliance must be thorough and rooted in all Group activities. With this in mind, we work continuously to strengthen compliance activities across the Group.

Oita Manufacturing Training Center strengthens the technical skills of Canon Group employees.

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

Governance Structure (as of December 31, 2008)



Directors & Corporate Auditors (as of December 31, 2008)

Chairman & CEO

Fujio Mitarai

President & COO

Tsuneji Uchida

Executive Vice President & CFO

Toshizo Tanaka
Group Executive, Policy & Economy Research Headquarters

Senior Managing Directors

Nobuyoshi Tanaka
Group Executive, Corporate Intellectual Property & Legal Headquarters

Junji Ichikawa
Chief Executive, Optical Products Operations

Akiyoshi Moroe
Group Executive, External Relations Headquarters
Group Executive, General Affairs Headquarters

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

Managing Directors

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

Yasuo Mitsuhashi
Chief Executive, Peripheral Products Operations

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

Masahiro Osawa
Group Executive, Finance & Accounting Headquarters

Shigeyuki Matsumoto
Group Executive, Device Technology Development Headquarters
Deputy Group Executive, Core Technology Development Headquarters

Katsuichi Shimizu
Chief Executive, Inkjet Products Operations

Ryoichi Bamba
President, Canon Europa N.V.
President & CEO, Canon Europe Ltd.

Toshio Homma
Chief Executive, L Printer Products Operations

Masaki Nakaoka
Chief Executive, Office Imaging Products Operations

Haruhisa Honda
Group Executive, Production Engineering Headquarters

Directors

Shunichi Uzawa
Executive Vice President, Canon U.S.A., Inc.

Toshiyuki Komatsu
Deputy Group Executive, Corporate Planning Development Headquarters

Tetsuro Tahara
Group Executive, Global Manufacturing & Logistics Headquarters

Seijiro Sekine
Group Executive, Information & Communication Systems Headquarters

Shunji Onda
Group Executive, Global Procurement Headquarters

Kazunori Fukuma
President & CEO, SED Inc.

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

Masaya Maeda
Chief Executive, Image Communication Products Operations

Corporate Auditors

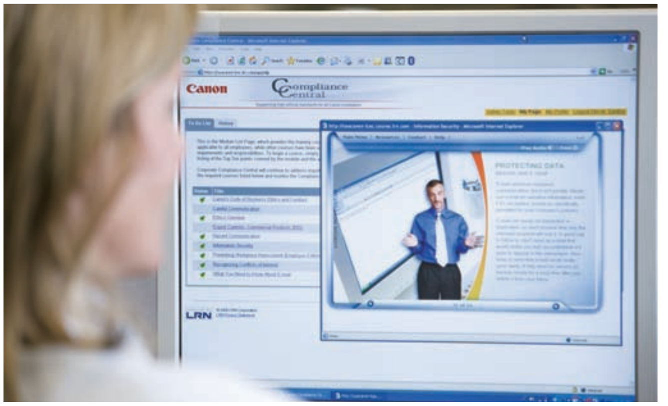
Keijiro Yamazaki
Kunihiro Nagata

(Outside)

Tadashi Ohe
Yoshinobu Shimizu
Minoru Shishikura

Basic Policy and Corporate Governance Structure

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



Compliance training via e-learning is conducted for employees at Canon U.S.A.

Board of Directors

Important business matters are discussed and ratified during meetings of the Board of Directors and Executive Committee, which are attended, in principle, by all directors. As of December 31, 2008, the Board consisted of 25 directors. In order to realize a more streamlined and efficient management decision-making process, Canon has not adopted an outside director system. The main reason why directors are chosen from among Canon personnel is that they have followed the same codes of behavior and have been subject to close scrutiny within the Group over many years.

Executive Officer System

On April 1, 2008, Canon adopted an executive officer system.

Taking into consideration the growth in the scope of its scale of operations, Canon recognizes the need to bolster its management execution structure. The Company is endeavoring to realize more flexible and efficient management operations by maintaining an appropriately sized organization of directors and promoting capable human resources with accumulated executive knowledge across specific business areas. To this end, Canon will gradually increase the number of executive officers and further solidify its management systems.

Executive officers are appointed and discharged by the Board of Directors and have a term of office of one year. The number of executive officers was 10 as of April, 2009.

Auditing System

The Company has five corporate auditors, including three outside auditors who have no personal or business affiliations with Canon. Auditors' duties include attending meetings of the Board of Directors, Executive Committee and various management committees, listening to business reports from directors, carefully examining documents related to important decisions and conducting strict audits of the Group's business and assets. Corporate auditors also work closely with accounting auditors and the Corporate Audit Center, which, with 58 members as of December 31, 2008, monitors compliance, risk management and internal control systems and provides assessments and recommendations.

Internal Control Committee

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

In order to strengthen internal controls, Canon conducts comprehensive evaluations of internal controls across areas that include accounting, management oversight, legal compliance, IT systems and the promotion of corporate ethics. As of December 31, 2008, internal control over financial reporting has been assessed as effective by the management and the independent registered public accounting firm. (Please refer to pages 95 and 97)

Other Corporate Governance Committees

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

Compliance

Shortly after its founding, Canon established the *San-Ji,* or "Three Selfs" spirit, namely "self-motivation," or taking the initiative and being proactive in all things; "self-management," or conducting oneself responsibly and being accountable for all one's actions; and "self-awareness," or understanding one's situation and role in it. These principles remain the basis for employee education and provide the platform for the Canon Group Code of Conduct.

Canon recognizes personal information as an important form of information asset and does its utmost to protect it in order to fulfill its social responsibilities. With the aim of keeping its employees informed and aware, the Company conducts e-learning-based personal information protection education programs on an annual basis.

Disclosure

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

With 44.2% of Canon's shares owned by non-Japanese investors as of December 31, 2008, the Group goes to great lengths to promote close relations with non-Japanese institutional investors, maintaining investor relations bases in Europe and the United States and working to ensure that investors inside and outside Japan have access to the same information. Canon will continue to promote transparency and understanding of its activities by practicing thoroughgoing disclosure.

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

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

1. Directors

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

2. Committees

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

(ii) have a board of corporate auditors.

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

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

3. Audit Committee

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

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

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

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

4. Shareholder Approval of Equity Compensation Plans

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

Photo:
A Canon Hope elementary school, located in Xinglong, Hebei Province, northeast of Beijing, completed in November 2008. Canon supported the construction of schools including this school in China in 2008.

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PRODUCTION 24
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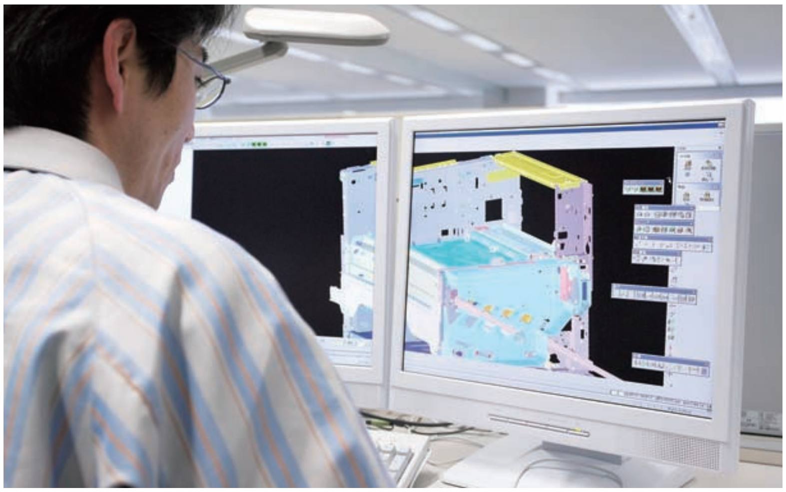
Canon nurtures its technological strengths to ensure its future growth while developing and introducing new products to markets in a timely manner.



Canon utilizes 3D-CAD for the development of office network MFDs.

R&D Expenditure and Patents

Despite harsh market conditions in 2008, Canon continued to allocate a significant percentage of net sales to R&D. R&D expenditure amounted to ¥374.0 billion, and the ratio to net sales rose from 8.2% in fiscal 2007 to 9.1% in fiscal 2008. By business segment, ¥123.5 billion, or 33.0% of the total expenditure, was allocated to Business Machines; ¥45.5 billion, or 12.2%, to Cameras; ¥50.8 billion, or 13.6%, to Optical and Other Products; and ¥154.2 billion, or 41.2%, to basic R&D.

Canon's commitment to R&D has also contributed to its leading position in intellectual property. In 2008, Canon was granted 2,114* patents in the United States, marking the 17th consecutive year it has placed among the top three.

Cognizant that R&D is crucial to the next stage of growth, Canon will continue to place high priority on R&D expenditure.

Strengthening Our R&D Infrastructure

In January 2009, Canon improved its R&D management system by consolidating several research divisions into one headquarters to enhance efficiency and speed. We are also strengthening cooperation between product operations and R&D divisions while bolstering strategic investments and collaborative partnerships in an effort to further enhance technology development capabilities.

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

Bolstering Product Competitiveness

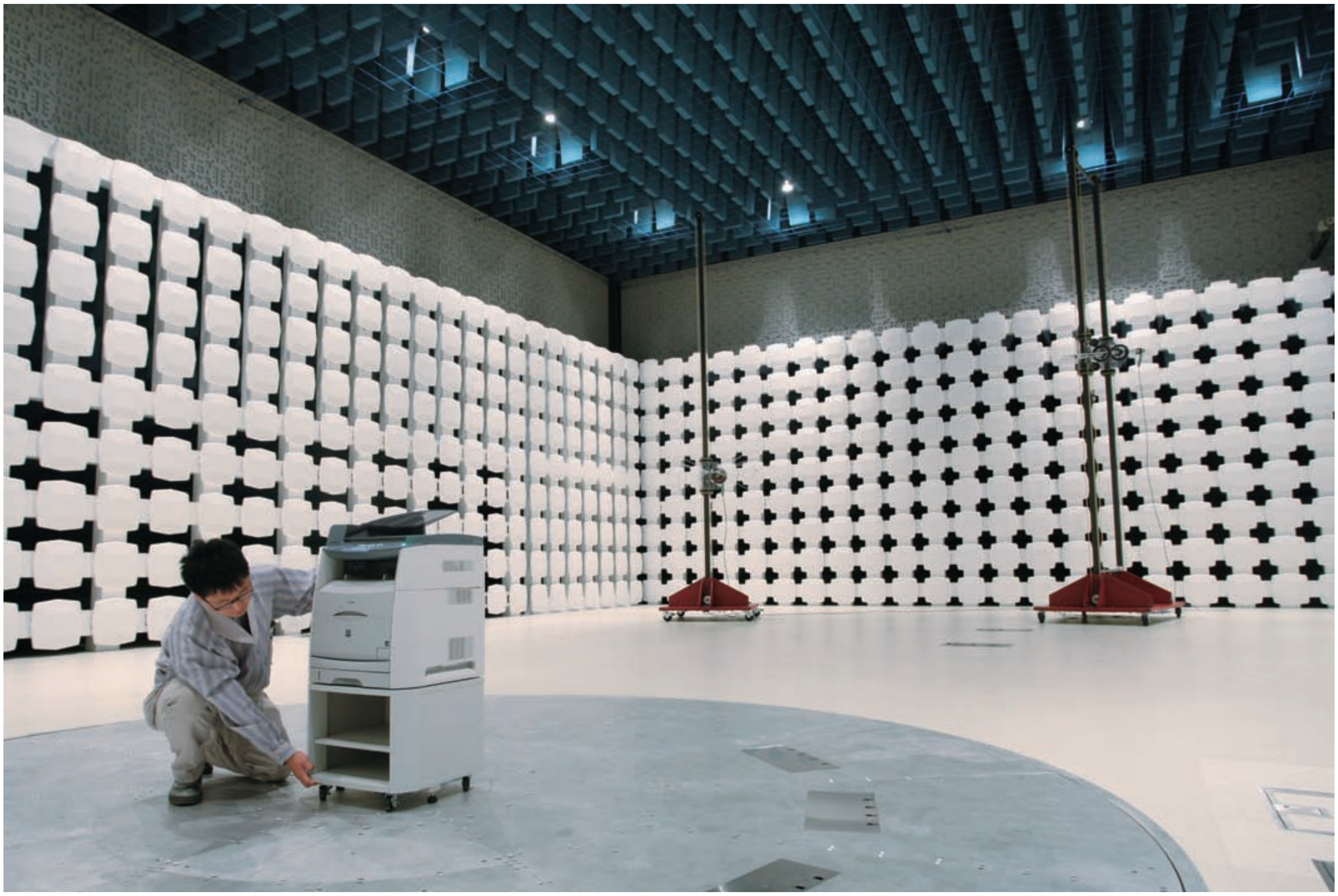
Canon continuously strengthens the development of its key components and devices to differentiate its products and further strengthen product competitiveness. In 2008, Canon released the DIGIC 4 imaging processor, which boasts even faster processing power for digital cameras and improved noise reduction. Another highlight of the year was the Company's development of Liquid Crystal on Silicon (LCOS) reflective LCD panels, ideal for LCD projectors, which project high-resolution images free of lattice-like grid patterns. Canon has developed in-house all of the main parts for its LCD projectors.

Canon is promoting cross-media imaging that enables advanced synergies among input devices like cameras or camcorders and output devices like displays or printers. The achievement of such outstanding product collaboration is attributable to Canon's long experience in developing leading-edge digital platform technologies shared across the Company, such as the high-accuracy color management system Kyuanos, system integration and telecommunication technologies. Canon will continue to enhance these digital platform technologies as well as individual products to lead the digital imaging world.

Raising Development Efficiency

To speed up product development and reduce costs, Canon is constantly working to improve the efficiency

DIGIC 4 imaging processor offers exceptionally fast signal processing for Canon's digital cameras.



Measuring electromagnetic waves emitted by printers: the Tamagawa measurement and testing facility contributes to enhancing the efficiency of testing operations and raising the level of precision measurement technology.

of its development processes. In 2008, we continued to promote our integrated IT systems based on a unified 3D-CAD system that facilitates the sharing of design information and links design through production to strengthen concurrent processes.

The Company also started new initiatives to reduce failure costs that stem from design changes and to completely eliminate the need for prototypes. We will pursue innovations of our current virtual prototyping technologies, which include Digital Mockup and Computer-Aided Engineering.

Efforts to improve product development quality were boosted by the 2008 completion of the state-of-the-art Tamagawa measurement and testing facility, which can test for industry accreditation specifications such as noise and radio frequencies and flame retardance. Located in Kawasaki, Japan, the laboratory will upgrade the Group's measurement precision capabilities and compliance with public standards.

Canon is actively advancing R&D on materials technologies, including anti-reflection coatings for lenses.

Exploring Next-Generation Technologies

Canon is strengthening its basic research in domains that offer considerable future potential. For materials technology in particular, the Company has been pursuing extensive research on numerous materials, including nanomaterials and various semiconductor materials, for the development of new devices and components. Canon will promote research into its capabilities in these areas and develop technologies that trigger paradigm shifts.

To keep pace with global technology trends, Canon collaborates in advanced research with leading universities and institutes worldwide. In 2008, Canon announced plans for collaborative research with the University of Arizona's College of Optical Sciences focusing on a broad range of technologies, including optical materials and measurement and medical-related applications.

Canon is raising the efficiency and quality of its production system to thoroughly improve supply chain management.

Cell production of interchangeable lenses for SLR cameras at Oita Canon, Japan

Improving the Production System Based on Supply Chain Management

Canon has been working to improve its SCM through various reform activities to meet market demands, supply products to the market in a timely manner and eliminate inefficient operations. We have developed a Unified Production Information System to standardize these reform activities and establish them throughout the Group. Initially introduced in 2003, the system has been implemented at 20 Group production sites as of January 31, 2009. The system integrates all production information and immediately links to information on design changes and fluctuations in market trends.

Owing to dramatic economic shifts, the Company was compelled to implement major reforms to its production strategies. We worked to increase the accuracy of our SCM to precisely respond to market demands while reducing stocks. We continue to adjust production volume through our flexible production

At Canon's new Kawasaki Office, CMOS sensor production and automated technology development are conducted.

system based on cell production and just-in-time production while endeavoring to reduce material costs through the optimum procurement of materials. Furthermore, Canon is now revamping its logistics network for global production and distribution.

In another move, the Company began to implement a policy of localized production. To address such factors as the rising costs for transportation and the reduction of environmental burdens related to transportation, the Company will carry out manufacturing at locations that can ensure the highest quality.

These initiatives are initially being realized with the new establishment of a toner cartridge plant at Canon Virginia. Canon's operations in the United States will come of age, encompassing all processes from production to sales, collection and recycling. Looking forward, Canon is considering the implementation of localized production in Europe with an eye to optimizing production capacity in line with global market demands.

Promoting In-House Production

Canon pursues in-house production as a strategy for accumulating its technology and know-how, thereby enabling the Company to differentiate its products and raise product quality.

In 2008, the Company promoted the in-house production of electrophotographic and optical key parts, as well as metal molds. The Company also established a new facility for the development and in-house production of semiconductor devices, including CMOS sensors, at the Kawasaki Office in Kanagawa, Japan.

Canon Workforce Development Center in Virginia. Canon collaborates with a local college to conduct technical training.

Cell production for inkjet printers at Canon Vietnam Co., Ltd. In 2008, the new Tien-Son plant started operation.

In February 2008, Canon entered into a comprehensive alliance with Hitachi, Ltd., and Panasonic Corporation (then Matsushita Electric Industrial Co., Ltd.). The Company acquired a 24.9% stake in Hitachi Displays, a Hitachi subsidiary that manufactures small- and medium-sized LCD panels. With this acquisition, we are able to undertake the in-house production of LCD panels as key components for Canon products.

Full Automation to Maintain International Competitiveness

Canon pursues fully automated production as a means of boosting productivity. In 2008, new automation systems developed for toner cartridge production by Canon and Canon Machinery Inc. were installed and put into operation. Canon will start automated production of toner cartridges in Canon Virginia at the end of 2009.

Canon is working toward expanding the scope of automation to other products. We have already started automated production for inkjet cartridges and expanded its operations in 2008. As a further step in this direction, the Company began introducing automated machinery to certain sections of its assembly cells for inkjet printers and LBPs in 2008.

In addition, to handle brisk demand for automated machinery, Canon Machinery built a plant in Shiga, Japan, in 2008, and expanded production with the aims of increasing productivity and reducing costs.

Canon continues to bolster its sales and marketing activities in emerging economies as it works toward early market dominance.

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Canon Communication Space Shanghai was established to show the latest products and promote face-to-face communication with customers in China.

The Americas

Canon U.S.A., Inc. is the Company's regional marketing headquarters in North, Central and South America.

As a whole, sales in the Americas amounted to ¥1,154.6 billion in fiscal 2008, down 13.6% from the previous year. This represented 28.2% of Canon's consolidated net sales.

By region, North America was hit hard by the financial crisis, resulting in a decrease in sales compared with the previous fiscal year. In Latin America, however, although the effects of the economic recession were felt from autumn, full-year sales were up year on year.

In the United States, we consolidated three regional business solutions companies into the new Canon Business Solutions, Inc. and continued to bolster our direct sales and service network. In the POD market, we more than doubled sales of the imagePRESS C6000 and C7000VP series.

In Latin America, sales rose and Canon continued to reinforce its sales and marketing infrastructure to keep pace with regional growth, particularly for sales and marketing subsidiaries in Argentina, Brazil and Chile, while taking into account currency fluctuations and risk management in each country.

Looking forward, we will intensify sales promotions that cut across Company divisions and, targeting a wide variety of markets, enhance sales activities that highlight Canon's strengths in total imaging solutions that employ both input and output products.

Europe

In January 2009, Canon Europa N.V., in the Netherlands, the operational headquarters for the Europe, Middle East and Africa region, began the process of transferring a number of strategic roles to Canon Europe Ltd. in the United Kingdom.

Sales in Europe fell 10.5% year on year to ¥1,341.4 billion, representing 32.8% of Canon's consolidated net sales.

Economic conditions in Europe rapidly decelerated as a result of such factors as financial instability triggered by the subprime loan crisis and stagnant consumer spending in response to rising prices. By region, year-on-year sales were down in most countries of Western Europe, including the United Kingdom, Germany and France. In Russia, although sales were strong in the first half of the fiscal year, declining sales particularly in the fourth quarter resulted in an overall drop in sales year on year. On the other hand, sales in the Middle East increased compared with the previous fiscal year.

In 2008, we established Canon Eurasia A.S. in Turkey to access the Turkish and Israeli markets and began setting up a new locally based management organization in Russia to support business

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Canon U.S.A. is augmenting its marketing network by further bolstering its direct sales capabilities.

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Over 500 Canon imageRUNNERs have been installed in Fraport AG, the operator of Frankfurt Airport in Germany.

development through improved customer service and the provision of business and consumer support. In addition, we intend to boost investment in other emerging markets in the region, including the Ukraine and Kazakhstan.

Asia and Oceania

Canon (China) Co., Ltd. serves as the regional headquarters for sales and marketing functions in Asia, excluding Japan and Korea; Canon Australia Pty. Ltd. for Oceania; and Canon Marketing Japan Inc. for Japan.

In Japan, sales dropped 8.4% from the previous fiscal year to ¥868.3 billion, representing 21.2% of Canon's consolidated net sales.

EOS Discovery seminars help spread the joy of photography among amateur enthusiasts and semi-pro photographers.

Aiming to develop IT solutions into a core business, Canon Marketing Japan reorganized Group operations and established Canon IT Solutions Inc., which will be merged with Canon Network Communications Inc. in 2009.

In Asia and Oceania, sales climbed 4.5% year on year to ¥729.9 billion, accounting for 17.8% of consolidated net sales.

Canon continued to step up sales promotions in countries and regions recording strong growth, such as China, India and Vietnam. At the same time, we emphasized the value of customer contact points and set up new showrooms in cities such as Shanghai and Mumbai.

Throughout Asia, we will continue to expand contact points to improve after-sale service and call centers in 2009. We will also implement sales and marketing initiatives into the new business areas of large-format printers, projectors and medical equipment. In China, we will focus on expanding business in second-tier cities and cultivating new customer segments.

In Australia, Canon maintained strong market shares across all consumer product categories while strengthening its business solutions.

Canon continues to contribute to the realization of a sustainable society by applying technological innovations and reducing environmental burdens.

Canon U.S.A. held the Canon Forest Program, a nation-wide promotional campaign that plants a tree for every 10 Canon environmentally conscious products registered by customers. The campaign achieved its goal of 20,000 trees.

Canon's Basic Approach to CSR

Canon's corporate philosophy is *kyosei,* concisely defined as "Living and working together for the common good." The Company promotes the practice of *kyosei* in its daily working operations and through its numerous environmental conservation and social contribution activities all over the world. Aiming to become a truly excellent global corporation worthy of admiration and respect worldwide, we are working toward creating a sustainable society and environment with our customers, stockholders, employees and the local communities in which we operate.

Environmental Activities

Life Cycle Assessment Approach

Canon's environmental approach begins from the basic standpoint of life cycle assessment (LCA), a method for reducing environmental burdens throughout the entire product life cycle, from materials procurement through production, transport and usage to recycling. Even at the product design stage, we cut waste by reducing the number of material prototypes using digital mockups produced with 3D-CAD systems. By pursuing technological innovations and streamlining operations, Canon aims to reduce environmental burdens at every stage of the product life cycle.

Environmentally Conscious Products

Canon continuously searches for new ways to enhance its products to be more environmentally conscious. In 2008, Canon and Toray Industries, Inc., succeeded in jointly developing a bio-based plastic—composed of more than 25% plant-derived material—that achieves the world's highest level of flame retardance for bio-based plastics. Canon intends to use the bio-based plastic in exterior plastic parts for its office MFDs planned for release in 2009.

Canon develops and applies energy-efficient technologies that reduce power consumption for its products while designing products and their packaging to cut down on the amount of material used. For example, power consumption for the inkjet printer PIXMA MP630/MP638 was reduced 30% compared with the previous MP610 model. Furthermore, package volume for the MP630/MP638 was reduced 24% compared with the MP610, thereby increasing load efficiency per shipping container.

For the PowerShot E1 compact digital camera, compared with the earlier PowerShot A560 model, we reduced the volume of the packaging box by 48% and the number of pages in the manual by 57% by including an additional manual in electronic format.

Canon promotes modal shifts to reduce CO_2 emissions related to product transportation.

Canon strives to reduce numerous environmental burdens at its operational sites through such measures as this rooftop rainwater reuse system installed at Canon Belgium N.V./S.A. that filters rainwater through gravel on the roof.

Environmental Activities at Operational Sites
Canon practices thorough energy management at its operational bases, where it has introduced advanced energy-efficient equipment and devices and makes every effort to cut greenhouse gas emissions. Furthermore, the Company promotes the reduction or elimination of harmful chemical substances used in its production processes and is achieving significant reductions in the amount of resources used in these production processes.

Canon has already achieved zero landfill waste at all of its global manufacturing sites. This goal was achieved in 2005 after the Company launched a zero landfill waste campaign in 2001.

Contributing to Society
The following are a few examples of our longstanding commitment to fulfilling our corporate social responsibility to assume a leading role as a good corporate citizen.

The Canon Institute for Global Studies and the Canon Foundation
At the end of 2008, we established both the Canon Institute for Global Studies and the Canon Foundation in Tokyo with the aim of contributing to the world's development. The former will assess world trends from a global perspective as a political and economic think tank, publishing research in the areas of macroeconomics, natural science, energy and the environment, and diplomacy and defense. The Canon Foundation will support the activities of organizations and individuals engaged in research, business and education in the areas of science and technology as well as cultural pursuits.

Canon Leadership Scholars Program
In its commitment to developing the business leaders of tomorrow, Canon and Christopher Newport University located in Virginia, the United States, where Canon has a manufacturing company, created the Canon Leadership Scholars Program. Each year beginning in 2008, 25 students are awarded a scholarship of $5,000 over four years for a total of $20,000, and are offered opportunities to study abroad.

Canon supports research and educational activities at Yellowstone National Park by providing equipment for use in recording research activities and the digitization of the park's archives.

WWF Conservation Partner

Since becoming the first Conservation Partner of WWF, the global wildlife conservation organization, in 1998, Canon Europe has been supporting various WWF activities in Europe, the Middle East and Africa by providing them with equipment and supplies as well as technical assistance. Canon Europe helps WWF to digitize its superb image collection and to make it readily available online to its global network of WWF offices. There are currently more than 16,000 images available in the Photo Database.

Canon Hope Elementary Schools

Canon places a priority on providing educational opportunities to nurture future generations. In Dalian, China, the Company began supporting "The Project Hope" in 1995, a program organized by the China Youth Development Foundation for supporting children who have difficulty attending school. Since then, Canon has funded the construction of schools and every year donates school supplies and equipment such as liquid-crystal projectors. In 2007, we extended the scope of support activities to cover the entire country while contributing to four more schools in 2008 and 2009. Canon employees donate to the project, and the Company has actively promoted exchanges with the schools, sending employee volunteers to give lessons on digital cameras.

The Tsuzuri Project

Canon launched the *Tsuzuri Project* with Kyoto Culture Association (NPO) in 2007 with the goal of preserving and passing on important Japanese cultural properties using advanced digital technologies. The project employs Canon's digital SLR cameras to photograph historical artifacts and its large-format inkjet printers to print out images. Skilled artisans can apply

Canon Europe has been the first Conservation Partner of the WWF since 1998. © WWF-Canon / Yves-Jacques REY-MILLET

Reproduction of Sesshu's scroll, *Landscapes of the Four Seasons*: the combination of digital technologies and traditional techniques makes possible the faithful reproduction of original works.

traditional techniques to the prints to produce works almost indistinguishable from the originals. In 2008, Canon applied its own high-precision color matching system to realize greatly shortened production times and the faithful reproduction of original colors. Between 2007 and March 2009, replicas of 10 historic items were completed and donated to associated temples and museums.

Nurturing Diverse Human Resources

To become a truly excellent global corporation, Canon is committed to creating fair worker-management relations and using communication and education to motivate each employee to continue growing as an "excellent person."

Canon nurtures human resources and actively develops the abilities of its employees while providing various certification programs and recognizing employee achievements. The Company also establishes and actively supports training centers throughout the Group to raise the technical skills of employees and contribute to the expansion of employment opportunities in local communities.

In 2008, Canon began construction of the Oita Manufacturing Training Center in Japan, to be equipped with such manufacturing equipment as grinding machines for lens processing, plastic-molding machines and automation control equipment. The Company also constructed the Canon Workforce Development Center in Virginia, which is equipped with top-of-the-line facilities to provide technical skills training.

Oita Canon teamed up with a social welfare corporation in Oita and established the joint company Canon Wind Inc. to promote the employment of disabled people, especially those with mental disabilities.

Established in 2008, Canon Wind is focusing efforts on supporting people with disabilities.

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Photo:
A camera shop in Prague, Czech Republic. Canon is a popular brand in Eastern Europe.

Business Machines
OFFICE IMAGING PRODUCTS ... 34

- Office network digital multifunction devices (MFDs)
- Color network digital MFDs
- Office copying machines
- Personal-use copying machines
- Full-color copying machines, etc.

Business Machines
COMPUTER PERIPHERALS ... 36

- Laser beam printers (LBPs)
- Inkjet multifunction peripherals
- Single-function inkjet printers
- Image scanners, etc.

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Business Machines

BUSINESS INFORMATION PRODUCTS

- Computer information systems
- Document scanners
- Personal information products, etc.

CAMERAS ... 38

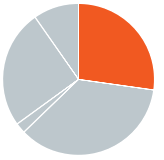
- Digital single lens reflex (SLR) cameras
- Compact digital cameras
- Interchangeable lenses
- Digital video camcorders, etc.

OPTICAL AND OTHER PRODUCTS ... 40

- Semiconductor-production equipment
- Mirror projection mask aligners for LCD panels
- Broadcasting equipment
- Medical equipment
- Large format printers
- Components, etc.

OFFICE IMAGING PRODUCTS

"Canon will release new product lineups that offer highly advanced platforms in office imaging."



Masaki Nakaoka

Chief Executive, Office Imaging Products Operations

Canon's Office Imaging Products business comprises four main categories: office network multifunction devices (MFDs), MFDs for SOHOs, document solutions and commercial printers.

In office network MFDs, market demand was sluggish in 2008 owing to economic uncertainty. Nevertheless, Canon enjoyed increased unit sales of color models, particularly in the low-end range. The SOHO market remained steady overall, but sales of high-end models declined. In document solutions, the Company strengthened its proposal-style solutions that use its MEAP, which enables the customization of MFDs and the development of third-party applications. Numerous applications based on this platform have been released, including smart card authentication for business security. In commercial printers, shipments of the highly acclaimed imagePRESS C7000VP were strong amidst favorable market conditions.

Canon has further strengthened its direct sales structure in the United States, which has seen successive reorganizations of sales channels in the same industry. In Europe, sales of color low-end models were favorable. In Asia, growth in emerging economies propelled unit sales. In the mature Japanese market, unit sales rose slightly owing to diligent efforts to promote sales, for example, of MFDs to convenience store chains. New markets in both Asia and Latin America also recorded strong unit sales, mainly for low-end monochrome products.

We will work to release new products that offer a new standard in office information handling by incorporating a highly advanced platform. For SOHO use, we will introduce new stylish color models. In commercial printers, Canon will reinforce its lineups by expanding its monochrome lineup, especially medium- and light-production models. Furthermore, to boost sales in markets hit hard by the global economic crisis, we will bolster our sales structures in North America and Europe.

Innovative Products and Technology—*V-Toner Clear*

Canon has developed the new and unique V-Toner Clear system, which it introduced with the imagePRESS C1+ in 2008. The system makes possible a visual texture treatment that greatly expands design capabilities. It works by applying clear toner to paper to control the degree of glossiness, enabling stunning effects such as metallic characters, spot matt/gloss coating and flood matt coating. The system also produces watermarks, an attractive option for customers looking to increase the security of their documents. With these features, V-Toner Clear allows for the production of a wide array of innovative printing solutions, providing added value for customers.

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Color imageRUNNER C3480 (iR C3580 in some areas)

imagePRESS C7000VP

Fiscal 2008 Review

Net sales in the Office Imaging Products business amounted to ¥1,119.5 billion, a decrease of 13.3% year on year. Unit sales also fell as the Company's performance in this business was impacted by the global economic downturn in the second half of the year and the appreciation of the yen.

Sales of the Company's office network MFDs were slow due to the appreciation of the yen and restrained investment in office equipment. Sales of its monochrome MFDs were down, reflecting low demand as the market continued to shift toward color products. Canon's sales of color network MFDs showed robust growth in 2008, and the Company released several new models, including the Color imageRUNNER C3480/C3080 series (iR C3580/C3080 in some areas), which is targeted at small- to medium-sized offices and workgroups.

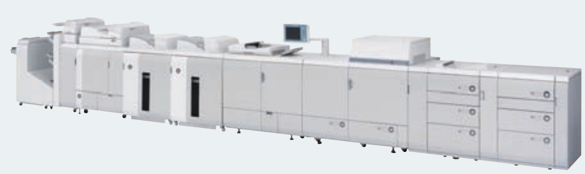
In document solutions, the Company's eCopy solution* for simple and secure electronic distribution and the sharing of paper documents was well received in the United States. We also recorded solid unit sales of our E-maintenance service system, which uses networks to automatically detect problems involving the Company's MFDs and notify a service base as necessary. The convenience of this service resulted in a high rate of system installations.

In commercial printers, Canon expanded its business in the POD market with the release of its new imagePRESS C6000 digital press, designed to meet the needs of small- to medium-sized businesses. We also introduced the imagePRESS C1+ model featuring a clear toner system that offers new possibilities for graphics and design. Sales of the new model were particularly strong in Europe.

* eCopy is a trademark of eCopy, Inc.

Color imageRUNNER C3480
(iR C3580 in some areas)

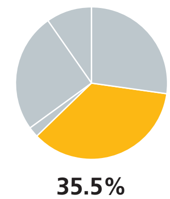
imagePRESS C1+



imagePRESS C6000

COMPUTER PERIPHERALS

"Canon is dedicated to producing products that are superior in terms of image quality, speed, design and ease of use."



Katsuichi Shimizu

Chief Executive, Inkjet Products Operations

In the latter half of 2008, the global economic downturn severely affected the inkjet printer market. However, unit sales of Canon inkjet printers increased year on year despite a drop in sales on a value basis due to the impact of the appreciation of the yen.

Against the backdrop of economic recession, customers are extremely cautious when selecting products, limiting their choices to goods superior in terms of performance and value. To meet customer needs, Canon has returned to its roots as a manufacturer and developed and released to the market "authentic" products that demonstrate an undying commitment to image quality, speed, design and ease of use—elements that define any good printer. In recognition of these efforts, in 2008 Canon's products swept the top three spots in the all-in-one printer category of a well-known American magazine for the second consecutive year.

In 2008, we boosted unit sales by introducing powerful new printers and strengthening product lineups. The Company carried out reforms to core technologies, including proprietary FINE (Full-photolithography Inkjet Nozzle Engineering) technology for high-speed high-resolution printing and the ChromaLife 100+ system for creating beautiful, long-lasting prints. In 2008, we developed new inks and photo paper and expanded the range of color reproduction. Targeting SOHOs, we released the PIXMA MX7600 inkjet printer, that features Pigment Reaction (PgR) technology.

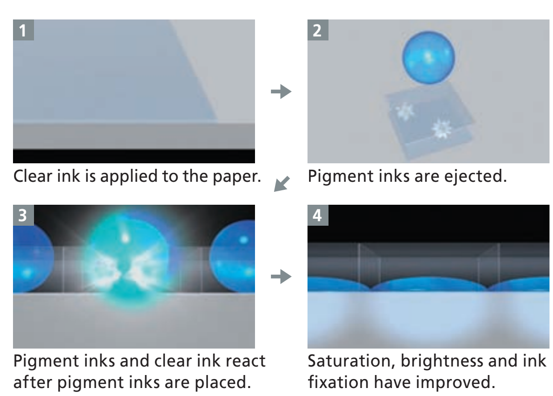
Pursuing automation as a way to improve productivity and ensure product quality, in 2008 Canon inaugurated a new inkjet printer cartridge production plant at Oita Canon Materials in Japan and began introducing automated machinery in the assembly cell sections at its plant in Thailand.

In 2009, we expect a severe global economic environment. To reduce the impact of declining printer prices and strengthen Canon's presence in the global market, we will further strengthen our sales structure. Moreover, we will further differentiate our products by enhancing image quality and speed through FINE technology as well as by improving operability and design.

Innovative Products and Technologies—*Pigment Reaction (PgR) Technology*

Canon has rewritten the rules of inkjet printing with its revolutionary new PgR technology. This innovative ink system eliminates the problems sometimes associated with inkjet printing—print-through, print curling, ink bleeding—allowing high-definition text, graphics and photographs to be printed on plain paper.

PgR works by applying clear ink onto the paper when printing begins. Pigment inks are ejected on the clear ink coating, reacting with the clear ink to improve saturation, brightness and ink fixation. PgR also ensures that the final product will be long-lasting and water-fast.



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LBP5975

PIXMA MP630

Fiscal 2008 Review

Net sales in the Computer Peripherals business totaled ¥1,454.8 billion, a decrease of 5.4% year on year.

In the market for laser beam printers (LBPs), demand was sluggish in the first half of the year and fell sharply in the second half. As a result, sales of LBPs were down 5.6% on a value basis and 6% on a unit basis year on year. However, unit sales of color LBPs rose slightly, and Canon bolstered its lineups and released low-end models for personal use and SOHOs.

Turning to inkjet printers, although the world economy drastically decelerated in the second half of the year, Canon's unit sales were up 3% year on year. However, sales of inkjet printers decreased 4.5% due to the sudden rise of the yen.

Unit sales of the Company's multifunction printers (MFPs) increased significantly, reflecting the continuing shift in market demand from single-function models to MFPs. In emerging economies, the Company's sales of low-end models were favorable and we increased market share. Sales were especially strong for products targeting the home market, including the PIXMA MP620 MFP and the PIXMA iP2600 single-function printer. For the SOHO market, in 2008 Canon released the PIXMA MX7600 all-in-one inkjet printer featuring the Company's original revolutionary new PgR technology. In addition, sales of consumables such as inkjet cartridges were strong.

In scanners, although the market is shrinking due to the spread of MFPs, the Company recorded strong unit sales and solidified its No. 1 market position. In 2008, we released the new CanoScan LiDE 200, which contributed to the Company's sales. This compact CIS (compact image sensor) scanner features a high resolution of 4,800dpi and improved maximum optical resolution compared with the previous model.

LBP5050
(i-SENSYS LBP5050 in some areas)

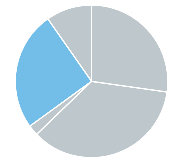
PIXMA MX7600

PIXMA iP2600

CanoScan LiDE 200

CAMERAS

"Aiming to maintain its No. 1 position in the global market, Canon is introducing powerful new products that redefine the picture-taking experience. "



25.4%

Masaya Maeda

Chief Executive, Image Communication Products Operations

In 2008, the Company held its No. 1 position for both digital SLR cameras and compact digital cameras in the four markets of North America, Europe, Japan and China.

Canon increased unit sales and expanded its market share for digital SLR cameras on the back of continued demand, and reinforced its lineups for both low-end and mid-range models. In compact digital cameras, Canon increased unit sales despite stagnant market conditions. We worked to further enhance the functions of our compact digital cameras, equipping models with the new DIGIC 4 imaging processor and upgrading our Face Detection Technology. Staying on top of the worldwide shift to HD, Canon introduced full HD camcorders to the market, winning high praise for their image quality and dual-flash memory concept that enables recording the movie both to the internal memory and a removable SDHC card.

Looking ahead, we will bolster product lineups for digital SLR and compact digital cameras, particularly for mid-range models. Canon will offer products that boast superior image quality based on its core competencies of optical technology, sensor technology and imaging processors while elevating the essential factors in capturing images, such as ease of use, miniaturization and design. From the beginning of 2009, we will aggressively launch attractive and powerful products across every product category, aiming to offer unprecedented levels of customer satisfaction. Canon will reinforce the in-house production of key components as a means of offering high-value-added products that are differentiated from those of its competitors and, at the same time, re-examine its systems for maintaining quality, including the service support structure for every category of user, from beginners and advanced amateurs to professionals. Furthermore, the Company will continue efforts to promote cross-media imaging to realize advanced synergies between input and output products.

Innovative Products and Technology—*EOS 5D Mark II Digital SLR Camera*

In 2008, Canon released the EOS 5D Mark II digital SLR camera. Highly anticipated by customers, it features a newly developed 21.1-megapixel 35mm full-frame CMOS sensor that realizes less noise and a significantly expanded sensitivity range. The camera incorporates the DIGIC 4 imaging processor to enable the high-speed processing of the increased data generated by the high-pixel-count image sensor.

The EOS 5D Mark II is the world's first digital SLR capable of full HD (1,920 x 1,080 pixel) video capture. The Company applied its highly advanced imaging, photography and video capture technologies to offer this function, signaling a new direction in digital SLR cameras.

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PowerShot SD880 IS DIGITAL ELPH (DIGITAL IXUS 870 IS in some areas)

VIXIA HF11 (HF11 in some areas)

Fiscal 2008 Review

Net sales in the Cameras business totaled ¥1,042.0 billion, a year-on-year decrease of 9.6%. Despite severe conditions in the economy, unit sales of Canon's digital cameras increased approximately 4%. The drop in sales is attributable to falling prices of digital cameras and the appreciation of the yen.

In digital SLR cameras, Canon introduced new products to the market in both low-end and mid-range models. The Company enjoyed strong sales and worldwide popularity of the new EOS Digital Rebel XSi (EOS 450D in some areas), as well as for previous models, such as the advanced-amateur model EOS 40D. Also in the advanced-amateur category, amid high expectations from customers we released the EOS 5D Mark II, which features not only enhanced image quality but also full HD video capturing—effectively redefining the digital SLR camera. In addition, unit sales in emerging markets expanded, led by the EOS Digital Rebel XS (EOS 1000D in some areas). In line with the overall growth in the sales of digital SLR cameras, unit sales of interchangeable lenses also increased.

In compact digital cameras, the market grew slightly in 2008 but demand plummeted toward the end of the year and prices continued to fall. Unit sales were up as the Company strengthened its product lineup with 16 new models led by the stylish PowerShot SD1100 IS DIGITAL ELPH (DIGITAL IXUS 80 IS in some areas) and the PowerShot SD880 IS DIGITAL ELPH (DIGITAL IXUS 870 IS in some areas).

In HD camcorders, we launched the VIXIA HF11 (HF11 in some areas) camcorder, which can record full HD images at 1,920 x 1,080 pixels to an internal flash memory (32GB) and removable SDHC card.

In LCD projectors, Canon introduced its top-of-the-line WUX10 projector in 2008. The Company equipped the wide-screen projector with its own WUXGA (1,920 x 1,200 pixel) LCOS panels and unique optical engine, AISYS, to deliver precise color reproduction and stunning resolution that surpasses that of 1080 full HDTV.

EOS Digital Rebel XSi
(EOS 450D in some areas)

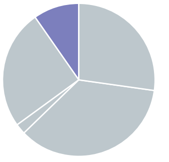
PowerShot SD1100 IS DIGITAL ELPH
(DIGITAL IXUS 80 IS in some areas)

VIXIA HF11
(HF11 in some areas)

REALiS WUX10
(XEED WUX10 in some areas)

OPTICAL AND OTHER PRODUCTS

"In 2009, we will work tirelessly toward accelerating our development capabilities to prepare for a turnaround in the economy."



Junji Ichikawa

Chief Executive, Optical Products Operations

The market for semiconductor exposure equipment was impacted by severe economic conditions from the latter half of 2008. We responded by managing production capacity to meet demand and also made thorough efforts to reduce inventories while strengthening new product development to spur demand. In addition, Canon continued to advance its immersion technology for realizing the further miniaturization of semiconductors. This has served to lift the quality of its immersion ArF equipment to even higher levels. We also improved productivity by switching entirely to the production of steppers that cater to more competitive 300mm wafers.

With regard to the market for exposure equipment for LCDs, conditions were favorable as capital investment by LCD manufacturers was on the upswing. We strengthened the MPAsp-H700 lineup of LCD exposure equipment for eighth-generation panels with continuous upgrades to meet various needs from LCD manufacturers.

In 2009, we expect harsh conditions in the market for steppers, with declining demand and further price reductions for semiconductor devices. To pursue advances in semiconductor miniaturization, Canon will bolster its immersion technology through the use of double patterning, a method that can significantly increase resolution. We will carry out development in this area through 2011 as well as of new technologies that improve the throughput capacity of steppers that use KrF.

In exposure equipment for LCDs, we expect a decline in capital investment from LCD manufacturers in 2009. Despite difficult conditions, we will work toward the development of the SP platform, which grew out of our H700 series, for our next-generation LCD exposure equipment. At the same time, we will endeavor to further improve optical performance.

We regard 2009 as a significant year for thoroughly reinforcing the Company's development capabilities. Canon aims to improve design quality to shorten equipment installation times so customers can start up operations quickly. The Company will also step up in-house production to further accumulate technological know-how and raise product quality.

Innovative Product and Technology—*Dynamic Imaging X-Ray Sensor*

In 2008, Canon succeeded in developing a portable flat-panel digital radiography (DR) system capable of viewing dynamic and capturing static X-ray images.

Canon introduced the world's first static-image DR system in 1998. Today, its wide lineup of systems for medical use includes portable sensors essential to emergency medicine.

Canon's newly developed prototype captures static X-ray images and enables "X-ray fluoroscopy," allowing radiographers to see dynamic images of internal organs for optimal timing in capturing static images. Canon hopes that this new technology will contribute to widening the scope of medical diagnostic procedures and increasing the speed of diagnosis.

Canon's dynamic imaging X-ray sensor attracted the interest of visitors to RSNA 2009.

FPA-7000AS7

DIGISUPER 100 xs

Fiscal 2008 Review

Net sales of Optical and Other Products slipped 0.2% compared with the previous fiscal year to ¥392.2 billion.

In the market for steppers, demand fell significantly. Nevertheless, Canon continued shipments of the FPA-7000AS5 dry ArF scanning stepper and the FPA-7000AS7 immersion lithography scanning stepper. Sales were also solid for the FPA-5510iZ stepper, which won praise among customers for its high productivity. Aiming to further expand its market presence, Canon launched the new FPA-5550iZ in November 2008. This 300mm-wafer-capable, high-throughput stepper achieves 50% higher throughput than the previous FPA-5510iZ model series.

The market for LCD exposure equipment saw a rapid recovery in 2008, although the balance of supply and demand deteriorated. Canon recorded excellent sales of its MPA-7800+ fifth-generation mirror projection mask aligners, particularly in China. The Company also continued shipments of its acclaimed MPAsp-H700 LCD exposure equipment for eighth-generation panels.

In digital radiography systems, Canon released the CXDI-60G, which features a detachable sensor cable for easy installation in multiple locations. The Company achieved strong sales growth especially in China for its CXDI series, particularly the 50G model.

In broadcast and communications, Canon held on to its high market share as the shift to HDTV drove demand for upgraded equipment and did brisk business related to the holding of various events. Building on the continued success of Canon's DIGISUPER 100AF and 86AF models, we launched the DIGISUPER 27AF HD studio lens featuring optical performance optimized for high-vision television and Auto Focus functions.

In the large-format printer market, we strengthened the imagePROGRAF lineup with the release of the iPF720. Equipped with an 80GB hard drive, the printer is capable of handling multiple complex jobs and, in addition to producing posters, it can produce CAD drawings and GIS maps.

MPAsp-H700

CXDI-60G

DIGISUPER 27AF

imagePROGRAF iPF720

(As of December 31, 2008)

MANUFACTURING

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

RESEARCH & DEVELOPMENT

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

MARKETING & OTHER

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

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

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

Economic environment

Looking back at the global economy in 2008, while the effects of the subprime loan crisis led to a slowdown that was felt in major countries from the beginning of the year, stock markets plunged and the real economy in these countries rapidly deteriorated, especially toward the end of the year, as a result of increasing financial uncertainty triggered by the failures of major financial institutions in the United States. Furthermore, growth in Asia and other emerging economies slowed down sharply due to a decline in exports, and the sense of a severe recession of global proportions has gradually spread. As for foreign exchange markets, the unilateral yen buying that began in early autumn drove up the value of the yen against all other foreign currencies.

Market environment

As for the markets in which Canon operates amid these conditions, within the digital camera segment, demand for digital single-lens reflex ("SLR") cameras continued to expand. While demand for compact digital cameras declined sharply toward the end of the year and prices continued to fall, the market staged healthy growth for the year. As for the office imaging products market, sales of color network digital multifunction devices ("MFDs") showed robust growth amid the shift toward color models in each region, although demand for monochrome models remained low. As for computer peripherals, in addition to a drop in demand for monochrome laser beam printers, sales of color-model printers, which had enjoyed sustained healthy expansion, remained relatively unchanged from the previous year. With regard to inkjet printers, although demand continued to shift from single-function to multifunction models, demand overall for the segment declined. Within the optical equipment segment, while the market for aligners, used to produce liquid crystal display ("LCD") panels, realized a rapid recovery thanks to an increase in capital spending by LCD panel manufacturers, demand for steppers, utilized in the production of semiconductors, fell significantly. The average value of the yen during the year was ¥103.23 to the U.S. dollar, a year-on-year appreciation of about 14%, and ¥151.46 to the euro, a year-on-year appreciation of approximately 7%.

Summary of operations

Amid these conditions, Canon's consolidated net sales for the period was ¥4,094.2 billion (U.S.$44,991 million), a year-on-year decline of 8.6%, due to the effects of the substantial rise in value of the yen along with falling prices of such consumer products as digital cameras and inkjet printers, and reduced sales volumes due to decreased demand for network MFDs, laser beam printers, and other office equipment. Income before income taxes and minority interests totaled ¥481.1 billion (U.S.$5,287 million), a decline of 37.4% from the year-ago period, while net income decreased 36.7% to ¥309.1 billion (U.S.$3,397 million).

Key performance indicators

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

Revenues

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

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

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

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

Cash flow management

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

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

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

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

KEY PERFORMANCE INDICATORS

	2008	2007	2006	2005	2004
Net sales (Millions of yen)	**¥4,094,161**	¥4,481,346	¥4,156,759	¥3,754,191	¥3,467,853
Gross profit to net sales ratio	**47.3%**	50.1%	49.6%	48.5%	49.4%
R&D expense to net sales ratio	**9.1%**	8.2%	7.4%	7.6%	7.9%
Operating profit to net sales ratio	**12.1%**	16.9%	17.0%	15.5%	15.7%
Inventory turnover within days	**47 days**	44 days	45 days	47 days	49 days
Debt to total assets ratio	**0.4%**	0.6%	0.7%	0.8%	1.1%
Stockholders' equity to total assets ratio	**67.0%**	64.8%	66.0%	64.4%	61.6%

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue recognition

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

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

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

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

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

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

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

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

Allowance for doubtful receivables

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

Valuation of inventories

Inventories are stated at the lower of cost or market value. Cost is determined 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

In accordance with Statement of Financial Accounting Standards No.144, "Accounting for the Impairment or Disposal of Long-Lived Assets", long-lived assets, such as property, plant and equipment, and acquired intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Determining the fair value of the asset involves the use of estimates and assumptions. These estimates and assumptions include future market conditions, net sales growth rate, gross margin and discount rate. Though Canon believes that the estimates and assumptions are reasonable, actual future results may differ from these estimates and assumptions.

Property, plant and equipment

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

Income taxes

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

Valuation of deferred tax assets

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

Employee retirement and severance benefit plans

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

In preparing its financial statements for fiscal 2008, Canon estimated a weighted-average discount rate of 2.5% for Japanese plans and 5.1% for foreign plans and a weighted-average expected long-term rate of return on plan assets of 3.7% for Japanese plans and 6.5% for foreign plans. In estimating the discount rate, Canon uses available information about rates of return on high-quality fixed-income governmental and corporate bonds currently available and expected to be available during the period to the maturity of the pension benefits. Canon establishes the expected long-term rate of return on plan assets based on management's expectations of the long-term return of the various plan asset categories in which it invests. Management develops expectations with respect to each plan asset category based on actual historical returns and its current expectations for future returns.

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

Decreases in expected returns on plan assets may increase net periodic benefit cost by decreasing expected return amounts, while differences between expected value and actual fair value of those assets could affect pension expense in the following years, and vice versa. For fiscal 2009, a change of 50 basis points in the expected long-term rate of return on plan assets may cause a change of approximately ¥2,464 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 the value of plan assets in future fiscal years and, ultimately, future pension expense.

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

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

CONSOLIDATED RESULTS OF OPERATIONS

SUMMARY OF OPERATIONS

	Millions of yen					Thousands of U.S. dollars
	2008	change	2007	change	2006	2008
Net sales	¥4,094,161	–8.6%	¥4,481,346	+7.8%	¥4,156,759	$44,990,780
Operating profit	496,074	–34.4	756,673	+7.0	707,033	5,451,363
Income before income taxes and minority interests	481,147	–37.4	768,388	+6.8	719,143	5,287,330
Net income	309,148	–36.7	488,332	+7.2	455,325	3,397,231

Sales

Canon's consolidated net sales in fiscal 2008 totaled ¥4,094,161 million (U.S.$44,991 million). This represents an 8.6% decrease from the previous fiscal year, reflecting the effects of the significant appreciation of the yen coupled with declining prices of products such as digital cameras and inkjet printers, and reduced sales volumes stemming from decreased demand for network MFDs, laser beam printers, and other office equipment.

Overseas operations are significant to Canon's operating results and generated approximately 76% of total net sales in fiscal 2008. Such sales are denominated in the applicable local currency and are subject to fluctuations in the value of the yen to those currencies. Despite efforts to reduce the impact of currency fluctuations on operating results, including localization of manufacturing in some regions along with procuring parts and materials from overseas suppliers, Canon believes such fluctuations have had and will continue to have a significant effect on its results of operations.

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

Cost of sales

Cost of sales principally reflects the cost of raw materials, parts and labor used by Canon in the manufacture of its products. A portion of the raw materials used by Canon is imported or includes imported materials. Many of these raw materials are subject to fluctuations in world market prices accompanied by fluctuations in exchange rates that may affect Canon's cost of sales. Other components of cost of sales include depreciation expenses from plants, maintenance expenses, light and fuel expenses along with rent expenses. The ratio of cost of sales to net sales for fiscal 2008, 2007 and 2006 was 52.7%, 49.9% and 50.4%, respectively.

Gross profit

Canon's gross profit in fiscal 2008 decreased by 13.8% to ¥1,938,008 million (U.S.$21,297 million) from fiscal 2007. The gross profit ratio deteriorated by 2.8 points year on year to 47.3%. Despite the continued launch of new products and ongoing cost-reduction efforts, the deteriorated gross profit ratio was mainly the result of such factors as the sharp appreciation of the yen, falling product prices accompanied by the rise in prices of materials.

Operating expenses

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

Operating profit

Operating profit in fiscal 2008 dropped 34.4% to a total of ¥496,074 million (U.S.$5,451 million) from fiscal 2007, recording 12.1% to net sales.

Other income (deductions)

Other income (deductions) for fiscal 2008 decreased by ¥26,642 million (U.S.$293 million) due to such factors as a reduction in interest income stemming from a decrease in cash surplus and a lower yield on investments, a decline in earnings on investments in affiliates accounted for by the equity method, and write-downs of non-current marketable securities.

Income before income taxes and minority interests

Income before income taxes and minority interests in fiscal 2008 was ¥481,147 million (U.S.$5,287 million), a decline of 37.4% from fiscal 2007, and constituted 11.8% of net sales.

Income taxes

Provision for income taxes in fiscal 2008 decreased by ¥103,470 million (U.S.$1,137 million) from fiscal 2007, primarily as a result of the decline in income before income taxes and minority interests. The effective tax rate during fiscal 2008 declined by 1.0% compared with fiscal 2007.

Net income

As a result, net income in fiscal 2008 decreased by 36.7% to ¥309,148 million (U.S.$3,397 million), which represents a 7.6% return on net sales.

Product information

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

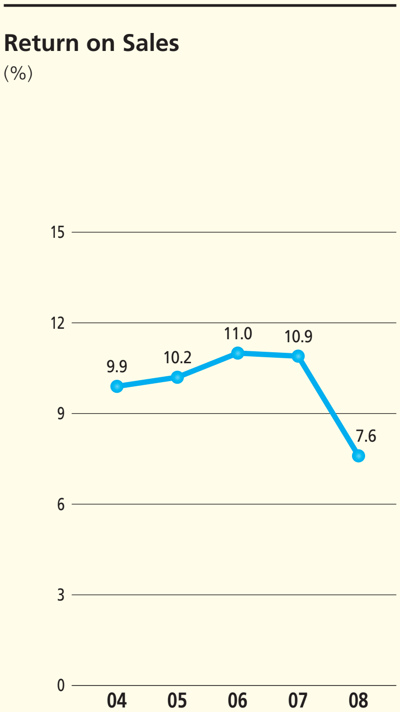
- **The business machines product group** includes office imaging products, computer peripherals and business information products.
  Office imaging products mainly include office network digital MFDs, color network digital MFDs, office copying machines, personal-use copying machines and full-color copying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

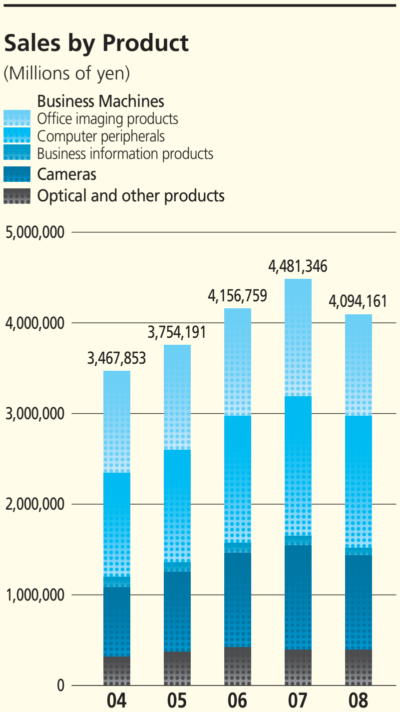
Sales by product

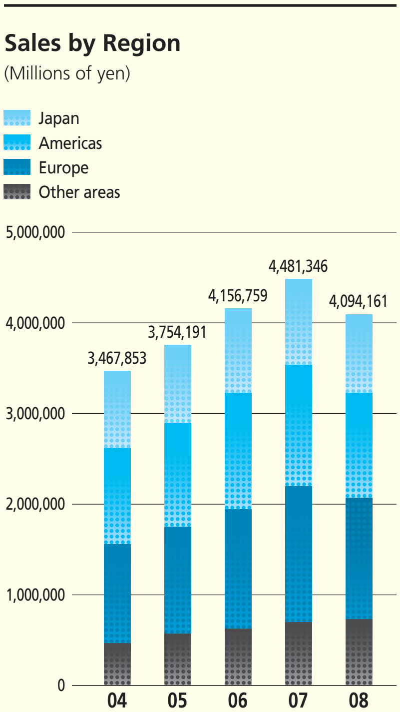
Canon's sales by product group are summarized as follows:

SALES BY PRODUCT

	Millions of yen					Thousands of U.S.dollars
	2008	change	2007	change	2006	2008
Business machines:						
Office imaging products	¥1,119,523	−13.3%	¥1,290,788	+8.8%	¥1,185,925	$12,302,451
Computer peripherals	1,454,768	−5.4	1,537,511	+9.9	1,398,408	15,986,462
Business information products	85,728	−20.1	107,243	+0.5	106,754	942,065
	2,660,019	−9.4	2,935,542	+9.1	2,691,087	29,230,978
Cameras	1,041,947	−9.6	1,152,663	+10.6	1,041,865	11,449,967
Optical and other products	392,195	−0.2	393,141	−7.2	423,807	4,309,835
Total	¥4,094,161	−8.6%	¥4,481,346	+7.8%	¥4,156,759	$44,990,780







Sales of business machines, constituting 65.0% of consolidated net sales, decreased by 9.4% to ¥2,660,019 million (U.S.$29,231 million) in fiscal 2008.

In the business machines segment, as demand for network digital MFDs shifted toward color models for the office imaging products category, the appreciation of the yen along with restrained investment in office equipment due to concern over business performance led to flagging sales in major regions. Consequently, sales for the category declined by 13.3% to ¥1,119,523 million (U.S.$12,302 million) in fiscal 2008. Color office imaging products accounted for 37% in fiscal 2008 and 35% in fiscal 2007 of office imaging products sales while monochrome office imaging products accounted for 41% and 45% in fiscal 2008 and 2007, respectively. Sales of facsimiles and information system business accounted for the residual 22% and 20% of office imaging products sales in fiscal 2008 and 2007, respectively.

Sales of computer peripherals decreased by 5.4% in fiscal 2008 to ¥1,454,768 million (U.S.$15,986 million). Laser beam printers sales suffered the significant impact of the strong yen along with reduced demand, resulting in a decrease in sales volume for monochrome models and slight increase for color models. As for inkjet printers, while sales volume for single-function models continued to drop, efforts focusing on expanded sales of multifunction business-use models resulted in an overall increase in sales volume.

Sales of business information products decreased by 20.1%, to ¥85,728 million (U.S.$942 million) in fiscal 2008 due to reduced personal computer sales in the Japanese domestic market. With regard to servers and personal computers, the decline in sales was caused by Canon's change in marketing strategy from selling single products to a solutions business involving combinations of various products.

Sales of cameras declined by 9.6% in fiscal 2008, totaling ¥1,041,947 million (U.S.$11,450 million). The high-resolution, competitively priced EOS Digital Rebel XSi (EOS 450D) and advanced-amateur model EOS 40D enjoyed healthy sales, contributing to growth in sales volume for digital SLR cameras. Sales volume also increased for compact digital cameras despite stagnant market conditions as the company bolstered its product lineup with the introduction of 16 new models, including 6 new ELPH (IXUS)-series models and 10 PowerShot-series models. Consequently, unit sales of digital cameras increased by 4% year on year. Sales of cameras constituted 25.4% of consolidated net sales in fiscal 2008.

Sales of optical and other products decreased by 0.2% in fiscal 2008, to ¥392,195 million (U.S.$4,310 million). Within this segment, while sales of aligners, used to produce LCD panels, gained momentum owing to a recovery in demand, sales of steppers, used in the production of semiconductors, remained stagnant due to deteriorating market conditions. Sales of optical and other products constituted 9.6% of consolidated net sales in fiscal 2008.

Sales by region

A geographical analysis indicates that net sales in fiscal 2008 decreased in each of the major regions.

In Japan, sales of office imaging products within the business machines segment dropped by 3.5% in fiscal 2008 mainly due to weakened sales of monochrome models of network digital MFDs. Although sales of video camcorders recorded solid growth, overall sales of the cameras segment decreased by 8.7% led by reduced demand for compact digital cameras. Sales of optical and other products decreased by 22.8% mainly due to a reduced demand for steppers. As a result, net sales in the region decreased by 8.4% in fiscal 2008 from fiscal 2007.

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

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

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

A summary of net sales by region is provided below:

SALES BY REGION

	Millions of yen					Thousands of U.S.dollars
	2008	change	2007	change	2006	2008
Japan	¥ 868,280	–8.4%	¥ 947,587	+1.6%	¥ 932,290	$ 9,541,538
Americas	1,154,571	–13.6	1,336,168	+4.1	1,283,646	12,687,593
Europe	1,341,400	–10.5	1,499,286	+14.1	1,314,305	14,740,659
Other areas	729,910	+4.5	698,305	+11.5	626,518	8,020,990
Total	¥4,094,161	–8.6%	¥4,481,346	+7.8%	¥4,156,759	$44,990,780

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

SEGMENT INFORMATION BY PRODUCT

Millions of yen		Business Machines	Cameras	Optical and Other Products	Corporate and Eliminations	Consolidated
2008	Net sales:					
	Unaffiliated customers	**¥2,660,019**	**¥1,041,947**	**¥392,195**	**¥ —**	**¥4,094,161**
	Intersegment	**—**	**—**	**235,690**	**(235,690)**	**—**
	Total	**2,660,019**	**1,041,947**	**627,885**	**(235,690)**	**4,094,161**
	Operating cost and expenses	**2,115,375**	**854,160**	**673,375**	**(44,823)**	**3,598,087**
	Operating profit	**¥ 544,644**	**¥ 187,787**	**¥ (45,490)**	**¥ (190,867)**	**¥ 496,074**
	Assets	**¥1,487,885**	**¥ 499,287**	**¥495,095**	**¥1,487,667**	**¥3,969,934**
	Depreciation and amortization	**163,920**	**39,412**	**88,017**	**49,988**	**341,337**
	Increase in property, plant and equipment	**172,197**	**43,086**	**68,542**	**78,163**	**361,988**
2007	Net sales:					
	Unaffiliated customers	¥2,935,542	¥1,152,663	¥393,141	¥ —	¥4,481,346
	Intersegment	—	—	238,659	(238,659)	—
	Total	2,935,542	1,152,663	631,800	(238,659)	4,481,346
	Operating cost and expenses	2,285,281	845,237	610,720	(16,565)	3,724,673
	Operating profit	¥ 650,261	¥ 307,426	¥ 21,080	¥ (222,094)	¥ 756,673
	Assets	¥1,762,167	¥ 561,504	¥544,734	¥1,644,220	¥4,512,625
	Depreciation and amortization	159,309	37,180	69,843	75,362	341,694
	Increase in property, plant and equipment	166,143	32,870	78,449	151,087	428,549
2006	Net sales:					
	Unaffiliated customers	¥2,691,087	¥1,041,865	¥423,807	¥ —	¥4,156,759
	Intersegment	—	—	190,687	(190,687)	—
	Total	2,691,087	1,041,865	614,494	(190,687)	4,156,759
	Operating cost and expenses	2,091,858	773,127	573,019	11,722	3,449,726
	Operating profit	¥ 599,229	¥ 268,738	¥ 41,475	¥ (202,409)	¥ 707,033
	Assets	¥1,617,198	¥ 542,866	¥501,008	¥1,860,843	¥4,521,915
	Depreciation and amortization	127,873	28,756	37,018	68,647	262,294
	Increase in property, plant and equipment	154,259	31,517	36,272	157,609	379,657

Thousands of U.S.dollars		Business Machines	Cameras	Optical and Other Products	Corporate and Eliminations	Consolidated
2008	Net sales:					
	Unaffiliated customers	**$29,230,978**	**$11,449,967**	**$4,309,835**	**$ —**	**$44,990,780**
	Intersegment	**—**	**—**	**2,590,000**	**(2,590,000)**	**—**
	Total	**29,230,978**	**11,449,967**	**6,899,835**	**(2,590,000)**	**44,990,780**
	Operating cost and expenses	**23,245,879**	**9,386,374**	**7,399,725**	**(492,561)**	**39,539,417**
	Operating profit	**$ 5,985,099**	**$ 2,063,593**	**$ (499,890)**	**$ (2,097,439)**	**$ 5,451,363**
	Assets	**$16,350,385**	**$ 5,486,670**	**$5,440,604**	**$16,347,989**	**$43,625,648**
	Depreciation and amortization	**1,801,319**	**433,099**	**967,220**	**549,318**	**3,750,956**
	Increase in property, plant and equipment	**1,892,275**	**473,472**	**753,209**	**858,934**	**3,977,890**

Notes:

1. General corporate expenses of ¥190,698 million (U.S.$2,096 million), ¥221,979 million and ¥202,328 million in the years ended December 31, 2008, 2007 and 2006, respectively, are included in "Corporate and Eliminations."
2. Corporate assets of ¥1,487,667 million (U.S.$16,348 million), ¥1,644,220 million and ¥1,860,933 million as of December 31, 2008, 2007 and 2006, respectively, which mainly consist of cash and cash equivalents, short-term investments, investments and corporate properties, are included in "Corporate and Eliminations."
3. The segments are defined under Japanese GAAP. In grouping of segment information by product, Japanese GAAP requires that consideration be given to similarities of product types and characteristics, manufacturing methods, sales markets, and other factors that are similar.
4. As noted in Note 1-(k) of the Notes to Consolidated Financial Statements, effective April 1, 2007, the Company and its domestic subsidiaries elected to change the declining-balance method of depreciating machinery and equipment.

   The change in depreciation methods caused an increase in depreciation expense by ¥29,148 million in the Business Machines segment, ¥6,451 million in the Cameras segment, ¥15,540 million in the Optical and Other Products segment and ¥12,634 million in Corporate and Eliminations.

SEGMENT INFORMATION BY GEOGRAPHIC AREA

Millions of yen		Japan	Americas	Europe	Others	Corporate and Eliminations	Consolidated
2008	Net sales:						
	Unaffiliated customers	**¥ 998,676**	**¥1,141,560**	**¥1,337,147**	**¥ 616,778**	**¥ —**	**¥4,094,161**
	Intersegment	**2,318,521**	**3,758**	**4,329**	**670,678**	**(2,997,286)**	**—**
	Total	**3,317,197**	**1,145,318**	**1,341,476**	**1,287,456**	**(2,997,286)**	**4,094,161**
	Operating cost and expenses	**2,757,356**	**1,136,288**	**1,314,942**	**1,247,156**	**(2,857,655)**	**3,598,087**
	Operating profit	**¥ 559,841**	**¥ 9,030**	**¥ 26,534**	**¥ 40,300**	**¥ (139,631)**	**¥ 496,074**
	Assets	**¥1,908,675**	**¥ 458,189**	**¥ 477,571**	**¥ 317,684**	**¥ 807,815**	**¥3,969,934**
2007	Net sales:						
	Unaffiliated customers	¥1,048,310	¥1,329,479	¥1,499,821	¥ 603,736	¥ —	¥4,481,346
	Intersegment	2,494,251	4,608	3,496	824,844	(3,327,199)	—
	Total	3,542,561	1,334,087	1,503,317	1,428,580	(3,327,199)	4,481,346
	Operating cost and expenses	2,722,672	1,281,805	1,441,972	1,378,306	(3,100,082)	3,724,673
	Operating profit	¥ 819,889	¥ 52,282	¥ 61,345	¥ 50,274	¥ (227,117)	¥ 756,673
	Assets	¥2,715,294	¥ 506,295	¥ 732,579	¥ 367,234	¥ 191,223	¥4,512,625
2006	Net sales:						
	Unaffiliated customers	¥1,037,657	¥1,277,867	¥1,313,919	¥ 527,316	¥ —	¥4,156,759
	Intersegment	2,311,482	4,764	3,586	792,018	(3,111,850)	—
	Total	3,349,139	1,282,631	1,317,505	1,319,334	(3,111,850)	4,156,759
	Operating cost and expenses	2,558,685	1,236,138	1,272,463	1,275,817	(2,893,377)	3,449,726
	Operating profit	¥ 790,454	¥ 46,493	¥ 45,042	¥ 43,517	¥ (218,473)	¥ 707,033
	Assets	¥2,644,116	¥ 432,001	¥ 682,381	¥ 339,314	¥ 424,103	¥4,521,915

Thousands of U.S.dollars		Japan	Americas	Europe	Others	Corporate and Eliminations	Consolidated
2008	Net sales:						
	Unaffiliated customers	**$10,974,462**	**$12,544,615**	**$14,693,923**	**$ 6,777,780**	**$ —**	**$44,990,780**
	Intersegment	**25,478,252**	**41,297**	**47,572**	**7,370,088**	**(32,937,209)**	**—**
	Total	**36,452,714**	**12,585,912**	**14,741,495**	**14,147,868**	**(32,937,209)**	**44,990,780**
	Operating cost and expenses	**30,300,615**	**12,486,681**	**14,449,913**	**13,705,011**	**(31,402,803)**	**39,539,417**
	Operating profit	**$ 6,152,099**	**$ 99,231**	**$ 291,582**	**$ 442,857**	**$ (1,534,406)**	**$ 5,451,363**
	Assets	**$20,974,451**	**$ 5,035,044**	**$ 5,248,033**	**$ 3,491,033**	**$ 8,877,087**	**$43,625,648**

Notes:
1. General corporate expenses of ¥190,698 million (U.S.$2,096 million), ¥221,979 million and ¥202,328 million in the years ended December 31, 2008, 2007 and 2006, respectively, are included in "Corporate and Eliminations."
2. Corporate assets of ¥1,487,667 million (U.S.$16,348 million), ¥1,644,220 million and ¥1,860,933 million as of December 31, 2008, 2007 and 2006, respectively, which mainly consist of cash and cash equivalents, short-term investments, investments and corporate properties, are included in "Corporate and Eliminations."
3. Segment information by geographic area is determined by the location of the Company or its relevant subsidiary making the sale. The segments are defined under Japanese GAAP. In grouping of segment information by geographic area, Japanese GAAP requires that consideration be given to geographic proximity, as well as similarities of economic activities, interrelationships of business activities and other similar factors.

Operating profit by product

Operating profit for business machines in fiscal 2008 decreased by ¥105,617 million (U.S.$1,161 million) to ¥544,644 million (U.S.$5,985 million). This decrease resulted primarily from the reduction in sales.

Operating profit for cameras in fiscal 2008 decreased by ¥119,639 million (U.S.$1,315 million) to ¥187,787 million (U.S.$2,064 million) as a result of the drop in sales value, coupled with the significant decline in the gross profit ratio stemming from falling prices and the effects of the strong yen.

Operating profit for optical and other products in fiscal 2008 decreased by ¥66,570 million (U.S.$732 million) to a loss of ¥45,490 million (U.S.$500 million) as a result of a significant increase in cost of sales and outlays due to such factors as the disposal of inventories, which was carried out in response to rising concerns that weak market sentiment may continue, the appreciation of the yen, along with an impairment charge for fixed assets equipped with current technologies.

FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

The return on foreign operation sales is usually lower than that from domestic operations because foreign operations consist mainly of marketing activities. Return on foreign operation sales is calculated by dividing net income of foreign subsidiaries, after factoring in consolidation adjustments between foreign subsidiaries, by net sales of foreign subsidiaries. Marketing activities are generally less profitable than production activities, which are mainly conducted by the Company and its domestic subsidiaries. The returns on foreign operation sales in fiscal 2008, 2007 and 2006 were 2.3%, 4.0% and 3.7%, respectively. This compares with returns of 7.6%, 10.9% and 11.0% on consolidated operations for the respective years.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents in fiscal 2008 decreased by ¥265,267 million (U.S.$2,915 million) to ¥679,196 million (U.S.$7,464 million), compared with ¥944,463 million in fiscal 2007 and ¥1,155,626 million in fiscal 2006. Canon's cash and cash equivalents are typically denominated both in Japanese yen and in U.S. dollar, with the remainder denominated in foreign currencies.

Net cash provided by operating activities in fiscal 2008 decreased by ¥222,585 million (U.S.$2,446 million) from the previous year to ¥616,684 million (U.S.$6,777 million), reflecting the decrease in sales and decreased cash proceeds from sales, combined with a decrease in net income. Cash flow from operating activities consisted of the following key components: the major component of Canon's cash inflow is cash received from customers, and the major components of Canon's cash outflow are payments for parts and materials, selling, general and administrative expenses, and income taxes.

For fiscal 2008, cash inflow from cash received from customers decreased, due to the decrease in net sales. There were no significant changes in Canon's collection rates. Cash outflow for payments for parts and materials also decreased, as a result of a decrease in net sales and cost reductions. Cost reductions reflect a decline in unit prices of parts and raw materials, as well as a streamlining of the process of using these parts and materials through promoting efficiency in operations. Cash outflow for payments for selling, general and administrative expenses increased despite cost-cutting efforts. Cash outflow for payments of income taxes decreased, due to the decrease in taxable income.

Net cash used in investing activities in fiscal 2008 was ¥472,480 million (U.S.$5,192 million), compared with ¥432,485 million in fiscal 2007 and ¥460,805 million in fiscal 2006, consisting primarily of purchases of fixed assets. The purchases of fixed assets which totaled ¥428,168 million (U.S.$4,705 million) in fiscal 2008 were mainly concentrated to items relevant to reinforcing production and achieving cost reduction, along with the acquisition of shares of Hitachi Displays, Ltd. toward the launch of Canon's display business.

Canon defines "free cash flow" by deducting the cash flows from investing activities from the cash flows of operating activities. For fiscal 2008, free cash flow totaled ¥144,204 million (U.S.$1,585 million) as compared to ¥406,784 million for fiscal 2007. Canon's management recognizes that constant and intensive investment in facilities and R&D is required to maintain and strengthen the competitiveness of its products. Canon's management seeks to meet its capital requirements with cash flow principally earned from its operations, therefore, our capital resources are primarily sourced from internally generated funds. Accordingly, Canon has included the information with regard to free cash flow as its management frequently monitors this indicator, and believes that such indicator is beneficial to the understanding of investors. Furthermore, Canon's management believes that this indicator is significant in understanding Canon's current liquidity and the alternatives 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 ¥277,565 million (U.S.$3,050 million) in fiscal 2008, mainly resulting from the ¥100,000 million (U.S.$1,099 million) purchase of treasury stock with the aim of improving capital efficiency and ensuring a flexible capital strategy in addition to the dividend payout of ¥145,000 million (U.S.$1,593 million). The Company paid dividends in fiscal 2008 of ¥110.00 (U.S.$1.21) per share, the same dividend amount as the prior year on a local currency basis.

Canon seeks to meet its capital requirements principally with cash flow from operations although Canon expects net cash provided by operating activities in fiscal 2009 is likely to decline. In response to this expectation, Canon is currently endeavoring to optimize the level of capital investments, by further raising the efficiency of its investments and focusing investments on selected material items. Consistent with this objective, Canon continued to reduce its reliance on external funding for capital investments in favor of relying upon internally generated cash flows. This approach is supplemented with group-wide treasury and cash management activities undertaken at the parent company level.

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 current portion of long-term debt) amounted to ¥5,540 million (U.S.$61 million) at December 31, 2008 compared to ¥18,317 million at December 31, 2007. Long-term debt (excluding current portion) amounted to ¥8,423 million (U.S.$93 million) at December 31, 2008 compared to ¥8,680 million at December 31, 2007.

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

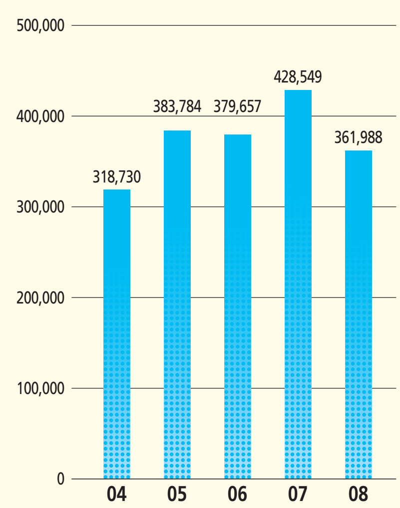
In order to facilitate access to global capital markets, Canon obtains credit ratings from two rating agencies: Moody's Investors Services, Inc. ("Moody's") and Standard and Poor's Rating Services ("S&P"). In addition, Canon maintains a rating from Rating and Investment Information, Inc. ("R&I"), a rating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

As of February 27, 2009, 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.

Increase in property, plant and equipment on an accrual basis in fiscal 2008 amounted to ¥361,988 million (U.S.$3,978 million) compared with ¥428,549 million in fiscal 2007 and ¥379,657 million in fiscal 2006. In fiscal 2008, increase in property, plant and equipment was mainly used to reinforce production and achieve cost reductions. For fiscal 2009, Canon projects its increase in property, plant and equipment will be approximately ¥315,000 million (U.S.$3,462 million).

Employer contributions to Canon's worldwide defined benefit pension plans were ¥23,033 million (U.S.$253 million) in fiscal 2008, ¥21,720 million in fiscal 2007, ¥44,981 million in fiscal 2006. In addition, employer contributions to Canon's worldwide defined contribution pension plans were ¥10,840 million (U.S.$119 million) in fiscal 2008, ¥10,262 million in fiscal 2007, and ¥6,233 million in fiscal 2006.

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



Working capital in fiscal 2008 decreased by ¥231,234 million (U.S.$2,541 million), to ¥1,120,848 million (U.S.$12,317 million), compared with ¥1,352,082 million in fiscal 2007 and ¥1,619,042 million in fiscal 2006. This decrease was primarily a result of a decrease in cash and cash equivalents. Canon believes its working capital will be sufficient for its requirements for the foreseeable future. Canon's capital requirements are primarily dependent on management's business plans regarding the levels and timing of purchases of fixed assets and investments. The working capital ratio (ratio of current assets to current liabilities) for fiscal 2008 was 2.19 compared to 2.08 for fiscal 2007 and 2.39 for fiscal 2006.

Return on assets (net income divided by the average of total assets) was 7.3% in fiscal 2008, compared to 10.8% in fiscal 2007 and 10.6% in fiscal 2006.

Return on stockholders' equity (net income divided by the average of total stockholders' equity) was 11.1% in fiscal 2008 compared with 16.5% in fiscal 2007 and 16.3% in fiscal 2006.

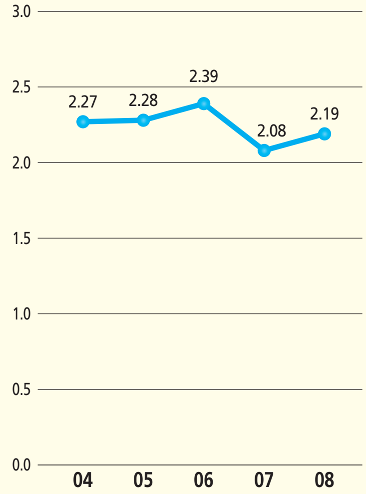
Debt to total assets ratio was 0.4%, 0.6% and 0.7% as of December 31, 2008, 2007 and 2006, respectively. Canon had short-term loans and long-term debt of ¥13,963 million (U.S.$153 million) as of December 31, 2008, ¥26,997 million as of December 31, 2007 and ¥31,151 million as of December 31, 2006.

OFF-BALANCE SHEET ARRANGEMENTS

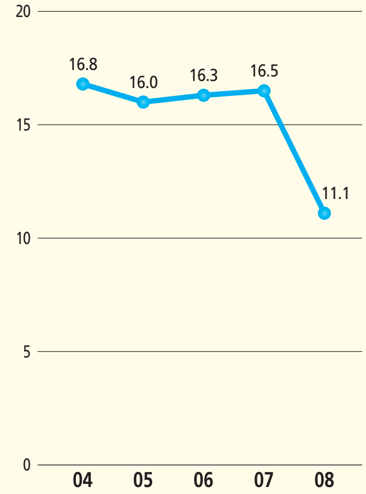
As part of its ongoing business, Canon does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating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

Canon provides guarantees for bank loans of its employees, affiliates and other companies. Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years in the case of employees with housing loans, and of 1 year to 10 years in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default by all borrowers was ¥22,308 million (U.S.$245 million) at December 31, 2008. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees were insignificant.

Working Capital Ratio



Return on Stockholders' Eqiuty
(%)



CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following summarizes Canon's contractual obligations at December 31, 2008.

		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	**¥ 13,648**	¥ 5,313	¥ 7,388	¥ 924	¥ 23
Other long-term debt	**95**	7	27	33	28
Operating lease obligations	**52,049**	15,221	18,946	9,107	8,775
Purchase commitments for:					
Property, plant and equipment	**74,909**	74,909	—	—	—
Parts and raw materials	**60,281**	60,281	—	—	—
Total	**¥200,982**	¥155,731	¥26,361	¥10,064	¥8,826

Note: The table does not include provisions for uncertain tax positions and related accrued interest and penalties, as the specific timing of future payments related to these obligations cannot be projected with reasonable certainty. See Note 14, Income Taxes in the Notes to Consolidated Financial Statements for further details.

		Payments due by period			
Thousands of U.S.dollars	**Total**	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual obligations:					
Long-term debt:					
Capital lease obligations	**$ 149,978**	$ 58,385	$ 81,187	$ 10,154	$ 252
Other long-term debt	**1,044**	77	297	362	308
Operating lease obligations	**571,967**	167,264	208,198	100,077	96,428
Purchase commitments for:					
Property, plant and equipment	**823,176**	823,176	—	—	—
Parts and raw materials	**662,429**	662,429	—	—	—
Total	**$2,208,594**	$1,711,331	$289,682	$110,593	$96,988

Canon provides warranties of generally less than one year against defects in materials and workmanship on most of its consumer products. Estimated product warranty related costs are established at the time revenue is recognized and is included in selling, general and administrative expenses. Estimates for accrued product warranty cost are primarily based on historical experience, and are affected by ongoing product failure rates, specific product class failures outside of the baseline experience, material usage and service delivery costs incurred in correcting a product failure. As of December 31, 2008, accrued product warranty costs amounted to ¥17,372 million (U.S.$191 million).

At December 31, 2008, commitments outstanding for the purchase of property, plant and equipment were approximately ¥74,909 million (U.S.$823 million), and commitments outstanding for the purchase of parts and raw materials were approximately ¥60,281 million (U.S.$662 million), both for use in the ordinary course of its business. Canon anticipates that funds needed to fulfill these commitments will be generated internally through operations.

During fiscal 2009, Canon expects to contribute ¥14,439 million (U.S.$159 million) to its Japanese defined benefit pension plans and ¥3,485 million (U.S.$38 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

Canon is in the third year of the Excellent Global Corporation Plan, its 5-year (2006-2010) management plan. The slogan of the third phase ("Phase III") is "Innovation & Sound Growth" and there are four core strategies:

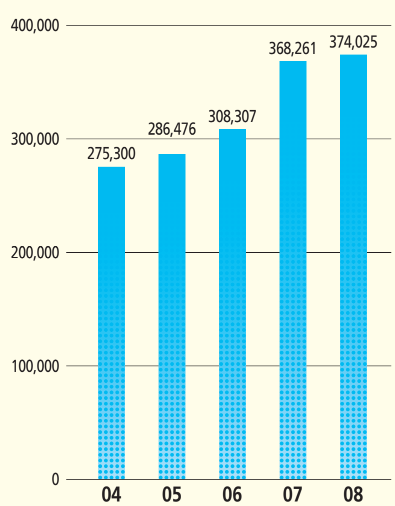
- Realize an overwhelming No.1 position worldwide in all current core businesses;
- Expand operations through diversification;
- Identify new business domains and accumulate necessary technological capabilities; and
- Establish new production system to sustain global competitiveness.

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

- Realize an overwhelming No.1 position worldwide in all current core businesses: Pursue development of new products which enable "cross-media imaging" by sophisticated functional synergy among the variety of Canon's image handling products, benefiting from the proliferation of broad band communication environment.
- Expand operations through diversification: Focus on developing various types of display, including Surface-conduction Electron-emitter Display ("SED") and Organic Light-Emitting Diode displays ("OLED").
- Identify new business domains and accumulate necessary technological capabilities: Accumulate technological capability in each of the medical imaging sector, intelligent robot industry and safety technology domain.

R&D Expenditure

(Millions of yen)



Canon is developing and strengthening relationships with universities and other research institutes, such as Kyoto University, Tokyo Institute of Technology, Stanford University, the New Energy and Industrial Technology Development Organization and the National Institute of Advanced Industrial Science and Technology, to assist with fundamental research and to develop cutting-edge technologies.

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

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

Canon's consolidated R&D expenditures were ¥374,025 million (U.S.$4,110 million) in fiscal 2008, ¥368,261 million in fiscal 2007 and ¥308,307 million in fiscal 2006. The ratios of R&D expenditures to the consolidated total net sales for fiscal 2008, 2007 and 2006 were 9.1%, 8.2% and 7.4%, respectively.

Canon believes that new products protected by patents will not easily allow competitors to compete with it, and will give it an advantage in establishing standards in the market and industry. According to the United States patent annual list, which IFI CLAIMS® Patent Services released, Canon obtained the third greatest number of private sector patents in 2008. This achievement marks Canon's seventeenth consecutive year as one of the top three patent-receiving private-sector organizations.

MARKET RISK EXPOSURE

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

Equity price risk

Canon holds marketable securities included in current assets, 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 were as follows at December 31, 2008.

Available-for-sale securities	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	¥ 134	¥ 150	$ 1,473	$ 1,648
Due after one year through five years	3,542	3,426	38,923	37,648
Due after five years through ten years	848	811	9,318	8,912
Equity securities	10,522	12,218	115,627	134,264
	¥15,046	¥16,605	$165,341	$182,472

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, 2008. All of the foreign exchange contracts described in the following table have a contractual maturity date in 2009.

Millions of yen	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	¥179,239	¥152,423	¥19,297	¥350,959
Estimated fair value	8,391	(1,390)	710	7,711
Forwards to buy foreign currencies:				
Contract amounts	¥ 24,518	¥ 1,000	¥ 9,729	¥ 35,247
Estimated fair value	(9)	7	2,129	2,127

Thousands of U.S. dollars	U.S.$	Euro	Others	Total
Forwards to sell foreign currencies:				
Contract amounts	$1,969,659	$1,674,978	$212,055	$3,856,692
Estimated fair value	92,209	(15,275)	7,802	84,736
Forwards to buy foreign currencies:				
Contract amounts	$ 269,429	$ 10,989	$106,912	$ 387,330
Estimated fair value	(99)	77	23,395	23,373

All of Canon's long-term debt is fixed rate debt. Canon believes that fair value changes, and cash flows resulting from reasonable near-term changes in interest rates would be immaterial. Accordingly, Canon considers interest rate risk is insignificant. See also Note 11 of the Notes to Consolidated Financial Statements.

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 such amounts recorded in accumulated other comprehensive income (loss) at year-end are expected to be recognized in earnings over the next 12 months. Canon excludes the time value component from the assessment of hedge effectiveness. Changes in the fair value of a foreign exchange contract for the period between the date that the forecasted intercompany sales occur and its maturity date are recognized in earnings and not considered hedge ineffectiveness.

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2008, 2007 and 2006. The amounts of net losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was ¥3,701 million (U.S.$41 million), ¥6,883 million and ¥5,917 million for the years ended December 31, 2008, 2007 and 2006, respectively.

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

LOOKING FORWARD

Regarding the global economy, given the combined effects of economic downturns in the leading industrialized countries and deceleration in emerging countries, it is expected that growth rates will decrease greatly and a strong sense of stagnation will continue. The business conditions for Canon are also expected to continue to be severe due to factors such as the trend of a strong yen in the foreign exchange markets. Much of the deterioration in market conditions for Canon's three product groups occurred in the fourth quarter of fiscal 2008 so that the full-year 2009 net sales volumes for Canon's product groups are likely to decline further from fiscal 2008 levels and continue to adversely affect Canon's operating results. Canon expects net sales volumes to remain at suppressed levels in fiscal 2010 and to continue to adversely affect fiscal 2010 operating results.

Under these conditions, Canon, in the fourth year of Phase III (2006 to 2010) of its "Excellent Global Corporation Plan", will make the most of management reforms achieved to date and take all measures for future growth in order to achieve further improvements in management quality. In other words, Canon will respond swiftly to the present difficult business conditions and structure itself as a lean organization by using this year to prepare to take advantage of improved conditions in the future.

Toward that goal, Canon's key objectives will be, first of all, to achieve timely introductions of new products satisfactory to customers in every aspect of functionality, design, ease of use, reliability and cost performance, and to secure No. 1 market positions in each of its businesses.

Next, amid a strong yen, massive fluctuations in raw material prices, falling product prices and conditions changing in other respects, Canon will work to lower its costs by, for example, pursuing production and procurement reform activities to an even greater degree and practicing prototype-less development. Furthermore, in the face of stagnant market conditions, Canon will improve the quality of products thoroughly by renewing its appreciation of product quality as the lifeblood of a manufacturer and taking to heart the supremacy of quality.

Additionally, through collaboration with Hitachi Displays, Ltd., of which Canon acquired shares during the current term, Canon will concentrate on strengthening the display operation as a new core business. Canon also aims to add significant strength in new businesses by actively launching new products in the field of medical equipment and by pursuing other initiatives as well.

With eyes focused on taking Canon to new heights, promoting its perpetual development and turning it into a truly excellent global company that continues to prosper, Canon will work to strengthen its unique core technology research system and develop management personnel, while also devoting even greater efforts to social contribution activities.

Business machines segment

Office imaging products

In the office imaging products segment, it has become more important to provide added value in the form of networking, integration, color printing and multifunction models. Also, in addition to the stable market for mid-segment office products, Canon expects that the market for higher-end models and low-end multifunction models will expand in the long term. The market for color network digital MFDs continued to grow, but sales of monochrome network digital MFDs decreased in 2008 due to the global economic downturn and the shifting market trend from monochrome to color models. In recent years, there has been a new printer-based multifunction printer ("MFP") market emerging that has been created by printer vendors as they seek to enter the copier and MFD market.

To maintain and enhance a competitive edge and to meet more sophisticated customer demands, Canon is strengthening its marketing capabilities by reinforcing its hardware and software product lineups and by improving functionality. In 2008, Canon strengthened the product lineups of its color digital devices as well as its monochrome machines and maintained its market share by executing business strategies in line with current market trends.

Computer peripheral products

In the inkjet printer market, Canon expects a slowdown in market growth led by the global economic slowdown, and the shift from single-function printers ("SFPs") to MFPs. To manage these trends, Canon has focused on selling mid-range to high-end models which enables large volume of printing, including the business-use multifunction models equipped with a facsimile function, and simultaneously has strengthened its lineup to entry models with the utmost effort to expand overall sales.

Canon's laser beam printer business had been maintaining a strong position in the market, which had consecutively displayed solid growth. However, the deterioration of the current global economy has led to a dramatic decline in the market as a whole, raising uncertainty in the market. Within the monochrome laser beam printer market, the reduced demand in emerging economies, which had been driving market expansion, was significant especially in Russia, in addition to the drop in developed countries. This situation has led to the shrinkage of the overall market. As for color laser beam printers, market growth reversed from expansion to a slight contraction. Amid this severe market conditions, Canon is accelerating the development of competitive, strategic products in all segments to introduce those products on a timely basis and prepare for the recovery of the global economy. Canon is also focused to shift from selling single-function models to multifunction models, as Canon expects continued growth in demand for multifunction models. The promotion of automated production of cartridges, along with in-house production of parts to ensure stable procurement, is concurrently in progress.

Business information products

As for document scanners, the adoption of internal information management systems by corporations, and other factors are driving a worldwide movement to digitize documents and Canon expects the market for low-priced, compact scanners to continue to expand. With regard to servers and personal computers, demand from corporate clients in the Japanese market held steady in fiscal 2008, but a decline in sales was caused by Canon's change in marketing strategy from selling single products to a solutions business involving combinations of various products.

Cameras segment

The digital camera market expanded in 2008, despite the slower growth starting in September 2008 due principally to the financial crisis. Developed markets such as the United States exhibited negative growth due to the financial crisis. However, markets in emerging countries such as China and Eastern Europe have continued to expand. The emergence of digital imaging systems such as PC-free direct printing systems has contributed to this growth by expanding digital imaging functionality through network connectivity. The improvement of the user-friendly image processing interfaces and software have also boosted growth.

Currently, the overall market for digital cameras is stagnant due to the current economic crisis. However, digital cameras are popular among individuals and further expansion is expected once the economy recovers. Nevertheless, as with most other digital consumer electronics, the digital camera market is now confronted with a fierce price war and intensified technological competition in terms of picture quality and functionality. Profit margins have been shrinking overall in the industry, and Canon's profit ratio has fallen due to the sharp economic downturn and fluctuations in the foreign exchange rates. Canon expects the market for compact digital cameras to expand in the medium term, thanks to growth in emerging market countries. However, industry profit margins are eroding due to falling prices and increased competition. Therefore, Canon seeks to continue cutting production costs while expanding sales volumes.

Canon believes that it played a major role in the continued expansion of the digital SLR market in fiscal 2008. Although the difficult global economic situation has resulted in slowed growth, this market is expected to continue to grow in the near term. The trend towards high ISO speeds has moved at a dramatic pace in this digital age. It has become possible with a digital SLR camera to easily take beautiful shots in dark places where shooting with film cameras is impossible. Also, movie functions were added to SLR cameras this year, marking the beginning of a new age for these products. These functions have expanded the possibilities for shooting, and by supporting new user needs, Canon believes it can develop the market even further.

Canon expects the interchangeable lens market for SLRs to grow as a result of the market penetration in the digital SLR camera market. Canon aims to expand its sales and market share by introducing the most suitable products for the digital SLR camera users, including products with Canon's Image Stabilizer capability.

Diversification in the global video camcorder market has occurred with various new media appearing, such as DVDs, hard disks and flash memories. However, starting in 2008, it became apparent that the trend is heading for flash memories to become mainstream in the global video camcorder market and towards High Definition ("HD"). Canon believes that these two trends will lead to higher picture quality from smaller video camcorders with longer battery life, and will likely support growth in the overall digital video market. Canon is working to expand sales of its powerful lineup of products that meet a wide range of user needs and that use high-quality HD imaging and dual flash memory technologies.

The business application projector market experienced the effects of the current global economic downturn beginning in the fourth quarter of 2008. Canon has reduced its unit and monetary projections for 2009.

The economic slowdown has affected high value-added products first, and the effects have started to be observed in Canon's high-resolution, high-brightness (high-luminosity), and high value-added products. Notwithstanding this trend, Canon continues to receive inquiries from system integrators and other imaging professionals, and is seeking to expand high value-added sales despite this current global economic downturn.

Optical and other products segment

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

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

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

In the TV lens market, demand for HDTV, which has grown in the United States and Japan, is now growing in Europe. In particular, there has been increased demand for lenses used for broadcasting sporting events and for producing dramas and documentaries in HDTV. Although Canon has observed a slow-down in demand for these TV lenses starting at the end of fiscal 2008 due to the current global economic downturn, in the medium term, Canon still expects that digitization will drive worldwide replacement demand. At the same time, there have been signs of expanded HDTV applications by the media, starting with relatively inexpensive HDTV production, as the TV lens market structure shows signs of change. Canon already has significant market share worldwide for this class of lens and intends to continue to strengthen its market position in this market.

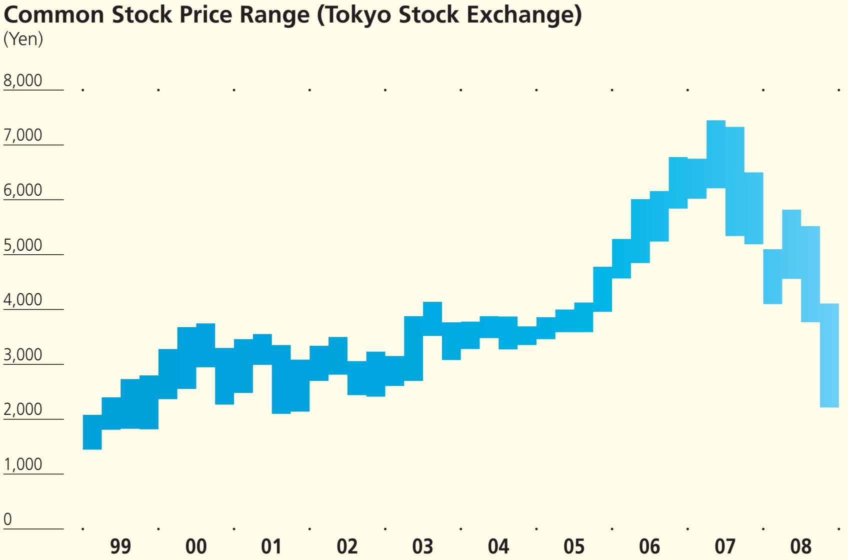
The economic downturn has caused a decline in the large format printer market, accordingly, Canon's sales fell below last year's sales performance. Canon will continue to lower costs of production and improve inventory turnover by expanding its market share and achieving economics of scale that improve its profitability.

Forward looking statements

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

	Millions of yen (except per share amounts)			
	2008	2007	2006	2005
Net sales:				
Domestic	**¥ 868,280**	¥ 947,587	¥ 932,290	¥ 856,205
Overseas	**3,225,881**	3,533,759	3,224,469	2,897,986
Total	**4,094,161**	4,481,346	4,156,759	3,754,191
Percentage of previous year	**91.4%**	107.8%	110.7%	108.3%
Net income	**309,148**	488,332	455,325	384,096
Percentage of sales	**7.6%**	10.9%	11.0%	10.2%
Advertising	**112,810**	132,429	116,809	106,250
Research and development expenses	**374,025**	368,261	308,307	286,476
Depreciation of property, plant and equipment	**304,622**	309,815	235,804	205,727
Increase in property, plant and equipment	**361,988**	428,549	379,657	383,784
Long-term debt, excluding current installments	**¥ 8,423**	¥ 8,680	¥ 15,789	¥ 27,082
Stockholders' equity	**2,659,792**	2,922,336	2,986,606	2,604,682
Total assets	**3,969,934**	4,512,625	4,521,915	4,043,553
Per share data:				
Income before cumulative effect of change in accounting principle:				
Basic	**¥ 246.21**	¥ 377.59	¥ 341.95	¥ 288.63
Diluted	**246.20**	377.53	341.84	288.36
Net income:				
Basic	**246.21**	377.59	341.95	288.63
Diluted	**246.20**	377.53	341.84	288.36
Cash dividends declared	**110.00**	110.00	83.33	66.67
Stock price:				
High	**5,820**	7,450	6,780	4,780
Low	**2,215**	5,190	4,567	3,460
Average number of common shares in thousands	**1,255,626**	1,293,296	1,331,542	1,330,761
Number of employees	**166,980**	131,352	118,499	115,583

Common Stock Price Range (Tokyo Stock Exchange)



						Thousands of U.S. dollars (except per share amounts)
2004	2003	2002	2001	2000	1999	**2008**
¥ 849,734	¥ 801,400	¥ 732,551	¥ 827,288	¥ 779,366	¥ 718,513	**$ 9,541,538**
2,618,119	2,396,672	2,207,577	2,080,285	1,917,054	1,812,383	**35,449,242**
3,467,853	3,198,072	2,940,128	2,907,573	2,696,420	2,530,896	**44,990,780**
108.4%	108.8%	101.1%	107.8%	106.5%	92.5%	**91.4%**
343,344	275,730	190,737	167,561	134,088	70,234	**3,397,231**
9.9%	8.6%	6.5%	5.8%	5.0%	2.8%	**7.6%**
111,770	100,278	71,725	66,837	67,840	67,544	**1,239,670**
275,300	259,140	233,669	218,616	194,552	177,922	**4,110,165**
174,397	168,636	158,469	147,286	144,043	155,682	**3,347,494**
318,730	210,038	198,702	207,674	170,986	200,386	**3,977,890**
¥ 28,651	¥ 59,260	¥ 81,349	¥ 95,526	¥ 142,925	¥ 165,277	**$ 92,560**
2,209,896	1,865,545	1,591,950	1,458,476	1,298,914	1,202,003	**29,228,484**
3,587,021	3,182,148	2,942,706	2,844,756	2,832,125	2,587,532	**43,625,648**
¥ 258.53	¥ 209.21	¥ 145.04	¥ 124.71	¥ 102.44	¥ 53.77	**$ 2.71**
257.85	207.17	143.20	123.03	101.01	53.00	**2.71**
258.53	209.21	145.04	127.53	102.44	53.77	**2.71**
257.85	207.17	143.20	125.80	101.01	53.00	**2.71**
43.33	33.33	20.00	16.67	14.00	11.33	**1.21**
3,880	4,140	3,500	3,553	3,747	2,800	**63.96**
3,273	2,607	2,413	2,100	2,267	1,447	**24.34**
1,328,048	1,317,974	1,315,074	1,313,940	1,308,909	1,306,049	
108,257	102,567	97,802	93,620	86,673	81,009	

Notes:
1. U.S. dollar amounts are translated from yen at the rate of U.S.$1 = JPY91, the approximate exchange rate on the Tokyo Foreign Exchange Market as of December 30, 2008.
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, 2008 and 2007

	Millions of yen		Thousands of U.S. dollars (Note 2)
ASSETS	2008	2007	2008
Current assets:			
Cash and cash equivalents (Note 1)	¥ 679,196	¥ 944,463	$ 7,463,692
Short-term investments (Note 4)	7,651	20,499	84,077
Trade receivables, net (Note 5)	595,422	794,240	6,543,099
Inventories (Note 6)	506,919	563,474	5,570,538
Prepaid expenses and other current assets (Notes 8 and 14)	275,660	286,111	3,029,231
Total current assets	2,064,848	2,608,787	22,690,637
Noncurrent receivables (Note 21)	14,752	15,239	162,110
Investments (Note 4)	88,825	90,086	976,099
Property, plant and equipment, net (Notes 7 and 8)	1,357,186	1,364,702	14,914,132
Intangible assets (Notes 9 and 10)	119,140	112,516	1,309,231
Other assets (Notes 8, 9, 10, 13 and 14)	325,183	321,295	3,573,439
Total assets	¥3,969,934	¥4,512,625	$43,625,648

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term loans and current portion of long-term debt (Note 11)	¥ 5,540	¥ 18,317	$ 60,879
Trade payables (Note 12)	406,746	514,226	4,469,736
Accrued income taxes (Note 14)	69,961	150,726	768,802
Accrued expenses (Notes 13 and 21)	277,117	357,525	3,045,242
Other current liabilities (Notes 7 and 14)	184,636	215,911	2,028,967
Total current liabilities	944,000	1,256,705	10,373,626
Long-term debt, excluding current installments (Note 11)	8,423	8,680	92,560
Accrued pension and severance cost (Note 13)	110,784	44,710	1,217,407
Other noncurrent liabilities (Note 14)	55,745	57,324	612,583
Total liabilities	1,118,952	1,367,419	12,296,176
Minority interests	191,190	222,870	2,100,988
Commitments and contingent liabilities (Note 21)			
Stockholders' equity:			
Common stock			
Authorized 3,000,000,000 shares; issued 1,333,763,464 shares in 2008 and 1,333,636,210 shares in 2007 (Note 15)	174,762	174,698	1,920,462
Additional paid-in capital (Note 15)	403,790	402,991	4,437,253
Legal reserve (Note 16)	53,706	46,017	590,176
Retained earnings (Note 16)	2,876,576	2,720,146	31,610,725
Accumulated other comprehensive income (loss) (Note 17)	(292,820)	34,670	(3,217,802)
Treasury stock, at cost; 99,275,245 shares in 2008 and 72,588,428 shares in 2007	(556,222)	(456,186)	(6,112,330)
Total stockholders' equity	2,659,792	2,922,336	29,228,484
Total liabilities and stockholders' equity	¥3,969,934	¥4,512,625	$43,625,648

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2008, 2007 and 2006

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2008	2007	2006	2008
Net sales	¥4,094,161	¥4,481,346	¥4,156,759	$44,990,780
Cost of sales (Notes 7, 10, 13 and 21)	2,156,153	2,234,365	2,096,279	23,693,989
Gross profit	1,938,008	2,246,981	2,060,480	21,296,791
Operating expenses (Notes 1, 7, 10, 13, 18 and 21):				
Selling, general and administrative expenses	1,067,909	1,122,047	1,045,140	11,735,263
Research and development expenses	374,025	368,261	308,307	4,110,165
	1,441,934	1,490,308	1,353,447	15,845,428
Operating profit	496,074	756,673	707,033	5,451,363
Other income (deductions):				
Interest and dividend income	19,442	32,819	27,153	213,648
Interest expense	(837)	(1,471)	(2,190)	(9,198)
Other, net (Notes 1, 4 and 20)	(33,532)	(19,633)	(12,853)	(368,483)
	(14,927)	11,715	12,110	(164,033)
Income before income taxes and minority interests	481,147	768,388	719,143	5,287,330
Income taxes (Note 14)	160,788	264,258	248,233	1,766,901
Income before minority interests	320,359	504,130	470,910	3,520,429
Minority interests	11,211	15,798	15,585	123,198
Net income	¥ 309,148	¥ 488,332	¥ 455,325	$ 3,397,231
	Yen			U.S. dollars (Note 2)
Net income per share (Note 19):				
Basic	¥ 246.21	¥ 377.59	¥ 341.95	$ 2.71
Diluted	246.20	377.53	341.84	2.71
Cash dividends per share	110.00	110.00	83.33	1.21

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

CANON INC. AND SUBSIDIARIES

	Millions of yen						
	Common stock	Additional paid-in capital	Legal reserve	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total stockholders' equity
Balance at December 31, 2005	¥174,438	¥403,246	¥42,331	¥2,018,289	¥ (28,212)	¥ (5,410)	¥2,604,682
Conversion of convertible debt and other	165	264					429
Cash dividends				(104,298)			(104,298)
Transfer to legal reserve			1,269	(1,269)			—
Comprehensive income:							
Net income				455,325			455,325
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					48,630		48,630
Net unrealized gains and losses on securities					1,992		1,992
Net gains and losses on derivative instruments					(489)		(489)
Minimum pension liability adjustments					(3,575)		(3,575)
Total comprehensive income							501,883
Adjustment to initially apply SFAS 158, net of tax					(15,628)		(15,628)
Repurchase of treasury stock, net						(462)	(462)
Balance at December 31, 2006	174,603	403,510	43,600	2,368,047	2,718	(5,872)	2,986,606
Cumulative effect of a change in accounting principle - adoption of EITF 06-2, net of tax				(2,204)			(2,204)
Conversion of convertible debt and other	95	(522)					(427)
Cash dividends				(131,612)			(131,612)
Transfer to legal reserve			2,417	(2,417)			—
Comprehensive income:							
Net income				488,332			488,332
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					(62)		(62)
Net unrealized gains and losses on securities					(1,778)		(1,778)
Net gains and losses on derivative instruments					814		814
Pension liability adjustments					32,978		32,978
Total comprehensive income							520,284
Repurchase of treasury stock, net		3				(450,314)	(450,311)
Balance at December 31, 2007	174,698	402,991	46,017	2,720,146	34,670	(456,186)	2,922,336
Conversion of convertible debt and other	**64**	**824**					**888**
Cash dividends				**(145,024)**			**(145,024)**
Transfer to legal reserve			**7,689**	**(7,689)**			**—**
Comprehensive income:							
Net income				**309,148**			**309,148**
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					**(258,764)**		**(258,764)**
Net unrealized gains and losses on securities					**(5,152)**		**(5,152)**
Net gains and losses on derivative instruments					**2,342**		**2,342**
Pension liability adjustments					**(65,916)**		**(65,916)**
Total comprehensive income							**(18,342)**
Repurchase of treasury stock, net		**(25)**		**(5)**		**(100,036)**	**(100,066)**
Balance at December 31, 2008	**¥174,762**	**¥403,790**	**¥53,706**	**¥2,876,576**	**¥(292,820)**	**¥(556,222)**	**¥2,659,792**

	Thousands of U.S. dollars (Note 2)						
Balance at December 31, 2007	$1,919,759	$4,428,473	$505,681	$29,891,714	$ 380,989	$(5,013,034)	$32,113,582
Conversion of convertible debt and other	**703**	**9,055**					**9,758**
Cash dividends				**(1,593,670)**			**(1,593,670)**
Transfer to legal reserve			**84,495**	**(84,495)**			**—**
Comprehensive income:							
Net income				**3,397,231**			**3,397,231**
Other comprehensive income (loss), net of tax (Note 17):							
Foreign currency translation adjustments					**(2,843,560)**		**(2,843,560)**
Net unrealized gains and losses on securities					**(56,615)**		**(56,615)**
Net gains and losses on derivative instruments					**25,736**		**25,736**
Pension liability adjustments					**(724,352)**		**(724,352)**
Total comprehensive income							**(201,560)**
Repurchase of treasury stock, net		**(275)**		**(55)**		**(1,099,296)**	**(1,099,626)**
Balance at December 31, 2008	**$1,920,462**	**$4,437,253**	**$590,176**	**$31,610,725**	**$(3,217,802)**	**$(6,112,330)**	**$29,228,484**

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

CANON INC. AND SUBSIDIARIES

Years ended December 31, 2008, 2007 and 2006

	Millions of yen			Thousands of U.S. dollars (Note 2)
	2008	2007	2006	**2008**
Cash flows from operating activities:				
Net income	**¥ 309,148**	¥ 488,332	¥ 455,325	**$ 3,397,231**
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	**341,337**	341,694	262,294	**3,750,956**
Loss on disposal of property, plant and equipment	**11,811**	9,985	16,182	**129,791**
Deferred income taxes	**(32,497)**	(35,021)	(6,945)	**(357,110)**
(Increase) decrease in trade receivables	**83,521**	(10,722)	(40,969)	**917,813**
(Increase) decrease in inventories	**49,547**	(26,643)	(5,542)	**544,473**
Increase (decrease) in trade payables	**(36,719)**	21,136	(2,313)	**(403,505)**
Increase (decrease) in accrued income taxes	**(77,340)**	14,988	22,657	**(849,890)**
Increase (decrease) in accrued expenses	**(30,694)**	43,035	36,165	**(337,297)**
Decrease in accrued (prepaid) pension and severance cost	**(12,128)**	(15,387)	(20,309)	**(133,275)**
Other, net	**10,698**	7,872	(21,304)	**117,560**
Net cash provided by operating activities	**616,684**	839,269	695,241	**6,776,747**
Cash flows from investing activities:				
Purchases of fixed assets (Note 7)	**(428,168)**	(474,285)	(424,862)	**(4,705,143)**
Proceeds from sale of fixed assets (Note 7)	**7,453**	9,635	12,507	**81,901**
Purchases of available-for-sale securities	**(7,307)**	(2,281)	(7,768)	**(80,297)**
Proceeds from sale and maturity of available-for-sale securities	**4,320**	8,614	4,047	**47,473**
Proceeds from maturity of held-to-maturity securities	**10,000**	10,000	—	**109,890**
(Increase) decrease in time deposits	**2,892**	31,681	(35,863)	**31,780**
Acquisitions of subsidiaries, net of cash acquired	**(5,999)**	(15,675)	(2,485)	**(65,923)**
Purchases of other investments	**(45,473)**	(2,432)	(8,911)	**(499,703)**
Other, net	**(10,198)**	2,258	2,530	**(112,066)**
Net cash used in investing activities	**(472,480)**	(432,485)	(460,805)	**(5,192,088)**
Cash flows from financing activities:				
Proceeds from issuance of long-term debt	**6,841**	2,635	1,053	**75,176**
Repayments of long-term debt	**(15,397)**	(13,046)	(5,861)	**(169,198)**
Decrease in short-term loans	**(2,643)**	(358)	(828)	**(29,044)**
Dividends paid	**(145,024)**	(131,612)	(104,298)	**(1,593,670)**
Repurchases of treasury stock, net	**(100,066)**	(450,311)	(462)	**(1,099,626)**
Other, net	**(21,276)**	(11,691)	2,909	**(233,803)**
Net cash used in financing activities	**(277,565)**	(604,383)	(107,487)	**(3,050,165)**
Effect of exchange rate changes on cash and cash equivalents	**(131,906)**	(13,564)	23,724	**(1,449,516)**
Net increase (decrease) in cash and cash equivalents	**(265,267)**	(211,163)	150,673	**(2,915,022)**
Cash and cash equivalents at beginning of year	**944,463**	1,155,626	1,004,953	**10,378,714**
Cash and cash equivalents at end of year	**¥ 679,196**	¥ 944,463	¥1,155,626	**$ 7,463,692**
Supplemental disclosure for cash flow information:				
Cash paid during the year for:				
Interest	**¥ 901**	¥ 1,476	¥ 2,146	**$ 9,901**
Income taxes	**263,392**	273,888	244,236	**2,894,418**

See accompanying notes to consolidated financial statements.

1. Basis of Presentation and Significant Accounting Policies

(a) Description of Business

Canon Inc. (the "Company") and subsidiaries (collectively "Canon") is one of the world's leading manufacturers in such fields as office imaging products, computer peripherals, business information products, cameras, and optical related products. Office imaging products consist mainly of network multifunction devices and copying machines. Computer peripherals consist mainly of laser beam and inkjet printers. Business information products consist mainly of computer information systems, document scanners and calculators. Cameras consist mainly of digital single-lens reflex ("SLR") cameras, compact digital cameras, interchangeable lenses and digital video camcorders. Optical and other products include semiconductor production equipment, mirror projection mask aligners for liquid crystal display ("LCD") panels, broadcasting equipment, medical equipment and large format printers. Canon's consolidated net sales for the years ended December 31, 2008, 2007 and 2006 were distributed as follows: office imaging products 27%, 29% and 28%, computer peripherals 36%, 34% and 34%, business information products 2%, 2% and 3%, cameras 25%, 26% and 25%, and optical and other products 10%, 9% and 10%, respectively.

Sales are made principally under the Canon brand name, almost entirely through sales subsidiaries. These subsidiaries are responsible for marketing and distribution, and primarily sell to retail dealers in their geographical area. Approximately 76%, 77% and 75% of consolidated net sales for the years ended December 31, 2008, 2007 and 2006 were generated outside Japan, with 28%, 30% and 31% in the Americas, 33%, 33% and 31% in Europe, and 15%, 14% and 13% in other areas, respectively.

Canon sells laser beam printers on an OEM basis to Hewlett-Packard Company; such sales constituted approximately 23%, 22% and 22% of consolidated net sales for the years ended December 31, 2008, 2007 and 2006, respectively.

Canon's manufacturing operations are conducted primarily at 25 plants in Japan and 18 overseas plants which are located in countries or regions such as the United States, Germany, France, Taiwan, China, Malaysia, Thailand and Vietnam.

(b) Basis of Presentation

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

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

(c) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its majority owned subsidiaries and those variable interest entities where the Company or its consolidated subsidiaries are the primary beneficiaries under Financial Accounting Standards Board ("FASB") Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities." All significant intercompany balances and transactions have been eliminated.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported 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 plans. 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 losses, net were ¥11,212 million ($123,209 thousand), ¥31,943 million and ¥25,804 million for the years ended December 31, 2008, 2007 and 2006, 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 ¥194,030 million ($2,132,198 thousand) and ¥164,610 million at December 31, 2008 and 2007, respectively, are included in cash and cash equivalents in the consolidated balance sheets. Additionally, certain debt securities with original maturities of less than three months classified as held-to-maturity securities of ¥997 million ($10,956 thousand) and ¥5,992 million at December 31, 2008 and 2007, respectively, are also included in cash and cash equivalents. Fair value for these securities approximates their cost.

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

Available-for-sale and held-to-maturity securities are regularly reviewed for other-than-temporary declines in carrying value based on criteria that include the length of time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and Canon's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. When such a decline exists, Canon recognizes an impairment loss to the extent by which the cost basis of the investment exceeds the fair value of the investment. Fair value is determined based on quoted market prices, projected discounted cash flows or other valuation techniques as appropriate.

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

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

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

(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, significant one-time events, and historical experience. An additional reserve for individual accounts is recorded when Canon becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted. When all collection options are exhausted including legal recourse, the accounts or portions thereof are deemed to be 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 intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset 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 and Accounting Change

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

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

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

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

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

(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. Intangible assets with finite useful lives, consisting primarily of software and license fees, are amortized using the straight-line method over the estimated useful lives, which range from 3 years to 5 years for software and 5 years to 10 years for license fees. Certain costs incurred in connection with developing or obtaining internal use software are capitalized. These costs consist primarily of payments made to third parties and the salaries of employees working on such software development. Costs incurred in connection with developing internal use software are capitalized at the application development stage.

In addition, Canon develops or obtains certain software to be sold where related costs are capitalized after establishment of technological feasibility.

(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 percent likely of being realized upon settlement. Interest and penalties accrued related to unrecognized tax benefits are included in income taxes in the consolidated statements of income.

(o) Issuance of Stock by Subsidiaries and Equity Investees

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

(p) 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.

(q) Net Income per Share

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

(r) Revenue Recognition

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

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

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

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

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

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

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

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

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

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

(t) Advertising Costs
Advertising costs are expensed as incurred. Advertising expenses were ¥112,810 million ($1,239,670 thousand), ¥132,429 million and ¥116,809 million for the years ended December 31, 2008, 2007 and 2006, respectively.

(u) Shipping and Handling Costs
Shipping and handling costs totaled ¥62,128 million ($682,725 thousand), ¥63,708 million and ¥62,626 million for the years ended December 31, 2008, 2007 and 2006, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(v) Derivative Financial Instruments
All derivatives are recognized at fair value and are included in prepaid expenses and other current assets, or other current liabilities in the consolidated balance sheets. On the date the derivative contract is entered into, Canon designates the derivative as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge), or a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge). Canon formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. Canon also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, Canon discontinues hedge accounting prospectively.

Changes in the fair value of a derivative that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in earnings. Changes in the fair value of a derivative that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability in cash flows of the hedged item. Gains and losses from hedging ineffectiveness are included in other income (deductions). Gains and losses 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. Canon records these derivative financial instruments in the consolidated balance sheets at fair value. The changes in fair values are immediately recorded in earnings.

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

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

(x) New Accounting Standards
In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement clarifies how to measure fair value as permitted or required under other accounting pronouncements, but does not require any new fair value measurements. In February 2008, the FASB issued Staff Position ("FSP") No. FAS 157-2, "Effective Date of FASB Statement No. 157," which delays the effective date of SFAS 157 for one year for certain nonfinancial assets and liabilities. Canon adopted SFAS 157 in the first quarter beginning January 1, 2008 for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements. This adoption did not have a material impact on Canon's consolidated results of operations and financial condition. The adoption of SFAS 157 for all nonfinancial assets and liabilities beginning January 1, 2009 will not have a material impact on Canon's consolidated results of operations and financial condition. See Note 23 for the disclosures required by SFAS 157.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and was adopted by Canon in the first quarter beginning January 1, 2008. The adoption of SFAS 159 did not have an impact on Canon's consolidated results of operations and financial condition as Canon did not elect to report financial assets and liabilities under the fair value option.

In June 2007, the FASB ratified the consensus in EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and

Development Activities" ("EITF 07-3"). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the related goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and was adopted by Canon in the first quarter beginning January 1, 2008. The adoption of EITF 07-3 did not have a material impact on Canon's consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired in a business combination. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning on or after December 15, 2008 and is required to be adopted by Canon for any business combinations with an acquisition date on or after January 1, 2009. The impact of the adoption of SFAS 141R on Canon's consolidated results of operations and financial condition will be largely dependent on the size and nature of the business combinations completed after the adoption of this statement.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008 on a prospective basis, except for certain presentation and disclosure requirements, which will be applied retrospectively for all periods presented, and is required to be adopted by Canon in the first quarter beginning January 1, 2009. The adoption of SFAS 160 will impact the presentation of Canon's consolidated balance sheets and consolidated statements of income; however, it will not have a material impact on Canon's consolidated results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 amends and expands the current disclosures required by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 161 requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its interpretations, and how derivative instruments and related hedged items affect an entity's financial position, result of operations and cash flows. SFAS 161 does not change the existing standards relative to recognition and measurement of derivative instruments and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 and is required to be adopted by Canon in the first quarter beginning January 1, 2009. The adoption of SFAS 161 will not have an impact on Canon's consolidated results of operations and financial condition.

In December 2008, the FASB issued FSP FAS No. 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP 132R-1"). FSP 132R-1 requires additional disclosures about plan assets including investment allocation, fair value of major categories of plan assets, development of fair value measurements, and concentrations of risk. FSP 132R-1 is effective for fiscal years ending after December 15, 2009 and is required to be adopted by Canon in the year ending December 31, 2009. Canon is currently evaluating the requirements of these additional disclosures, but does not expect the adoption of FSP 132R-1 to have an impact on Canon's consolidated results of operations and financial condition.

(y) Reclassification

Time deposits with original maturities of more than three months and marketable securities, which were previously disclosed separately in the consolidated balance sheets, have been reclassified to short-term investments to conform to the current year presentation.

Intangible assets, which were previously included in other assets, have been reclassified to intangible assets in the consolidated balance sheets to conform to the current year presentation.

2. Basis of Financial Statement Translation

The consolidated financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the reader, have been translated into United States dollars at the rate of ¥91 = U.S.$1, the approximate exchange rate prevailing on the Tokyo Foreign Exchange Market on December 30, 2008. This translation should not be construed as a representation that the amounts shown could be converted into United States dollars at such rate.

3. Foreign Operations

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

	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008
December 31:				
Total assets	¥1,502,451	¥2,077,268	¥1,995,927	$16,510,451
Net assets	850,491	1,024,150	907,845	9,346,055
Years ended December 31:				
Net sales	¥3,095,485	¥3,433,036	¥3,119,102	$34,016,318
Net income	72,520	136,560	114,916	796,923

4. Investments

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value for available-for-sale securities and held-to-maturity securities included in short-term investments and investments by major security type at December 31, 2008 and 2007 were as follows:

December 31 Millions of yen	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2008: Current:				
Available-for-sale:				
Government bonds	¥ 1	¥ —	¥ —	¥ 1
Fund trusts	133	16	—	149
	¥ 134	¥ 16	¥ —	¥ 150
Noncurrent:				
Available-for-sale:				
Government bonds	¥ 431	¥ —	¥ 18	¥ 413
Corporate debt securities	1,593	27	32	1,588
Fund trusts	2,366	40	170	2,236
Equity securities	10,522	2,532	836	12,218
	¥14,912	¥2,599	¥1,056	¥16,455

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

Thousands of U.S. dollars	Cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
2008: Current:				
Available-for-sale:				
Government bonds	$ 11	$ —	$ —	$ 11
Fund trusts	1,462	175	—	1,637
	$ 1,473	$ 175	$ —	$ 1,648
Noncurrent:				
Available-for-sale:				
Government bonds	$ 4,736	$ —	$ 198	$ 4,538
Corporate debt securities	17,505	297	352	17,450
Fund trusts	26,000	440	1,868	24,572
Equity securities	115,627	27,824	9,187	134,264
	$163,868	$28,561	$11,605	$180,824

Maturities of available-for-sale debt securities and fund trusts included in short-term investments and investments in the accompanying consolidated balance sheets were as follows at December 31, 2008:

Available-for-sale securities

	Millions of yen		Thousands of U.S. dollars	
	Cost	Fair value	Cost	Fair value
Due within one year	¥ 134	¥ 150	$ 1,473	$ 1,648
Due after one year through five years	3,542	3,426	38,923	37,648
Due after five years through ten years	848	811	9,318	8,912
	¥4,524	¥4,387	$49,714	$48,208

The gross realized gains were ¥116 million ($1,275 thousand), ¥1,512 million and ¥674 million for the years ended December 31, 2008, 2007 and 2006, respectively. The gross realized losses, including write-downs for impairments that were other than temporary, were ¥7,868 million ($86,462 thousand) for the year ended December 31, 2008, and were not significant for the years ended December 31, 2007 and 2006.

At December 31, 2008, substantially all of the available-for-sale securities with unrealized losses had been in a continuous unrealized loss position for less than 12 months.

Time deposits with original maturities of more than three months are ¥7,430 million ($81,648 thousand) and ¥10,333 million at December 31, 2008 and 2007, 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 ¥10,684 million ($117,407 thousand) and ¥14,017 million at December 31, 2008 and 2007, respectively. Investments with an aggregate cost of ¥10,572 million ($116,176 thousand) were not evaluated for impairment because (a) Canon did not estimate the fair value of those investments as it was not practicable to estimate the fair value of the investments and (b) Canon did not identify any events or changes in circumstances that might have had significant adverse effects on the fair value of those investments.

Investments in affiliated companies accounted for by the equity method amounted to ¥59,428 million ($653,055 thousand) and ¥42,817 million at December 31, 2008 and 2007, respectively. Canon's share of the net earnings (losses) in affiliated companies accounted for by the equity method, included in other income (deductions), was a loss of ¥20,047 million ($220,297 thousand) for the year ended December 31, 2008, and earnings of ¥5,634 million and ¥4,237 million for the years ended December 31, 2007 and 2006, respectively.

5. Trade Receivables

Trade receivables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Notes	¥ 20,303	¥ 23,632	$ 223,110
Accounts	584,437	785,155	6,422,385
	604,740	808,787	6,645,495
Less allowance for doubtful receivables	(9,318)	(14,547)	(102,396)
	¥595,422	¥794,240	$6,543,099

6. Inventories

Inventories are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Finished goods	¥316,533	¥366,845	$3,478,385
Work in process	171,511	175,704	1,884,736
Raw materials	18,875	20,925	207,417
	¥506,919	¥563,474	$5,570,538

7. Property, Plant and Equipment

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

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Land	¥ 247,602	¥ 249,959	$ 2,720,901
Buildings	1,268,388	1,198,519	13,938,330
Machinery and equipment	1,395,451	1,406,849	15,334,626
Construction in progress	81,346	103,749	893,912
	2,992,787	2,959,076	32,887,769
Less accumulated depreciation	(1,635,601)	(1,594,374)	(17,973,637)
	¥ 1,357,186	¥ 1,364,702	$ 14,914,132

Depreciation expense for the years ended December 31, 2008, 2007 and 2006 was ¥304,622 million ($3,347,494 thousand), ¥309,815 million and ¥235,804 million, respectively.

Amounts due for purchases of property, plant and equipment were ¥98,398 million ($1,081,297 thousand) and ¥120,823 million at December 31, 2008 and 2007, respectively, and are included in other current liabilities in the accompanying consolidated balance sheets. Fixed assets presented in the consolidated statements of cash flows includes property, plant and equipment and intangible assets.

Canon recognized impairment losses of ¥11,164 million ($122,681 thousand) related primarily to property, plant and equipment of its semiconductor production equipment business during the year ended December 31, 2008. As a result of declining demand in the semiconductor manufacturing industry and diminished profitability of the semiconductor production equipment business, Canon evaluated the ongoing value of the related long-lived assets and estimated that the carrying amounts would not be recoverable from the future cash flows. The fair value of the property, plant and equipment was based on the estimated discounted future cash flows expected to be generated from the use of them. The impairment losses are included in selling, general and administrative expenses in the consolidated statements of income.

8. Finance Receivables and Operating Leases

Finance receivables represent financing leases which consist of sales-type leases and direct-financing leases resulting from the marketing of Canon's and complementary third-party products. These receivables typically have terms ranging from 1 year to 7 years. The components of the finance receivables, which are included in prepaid expenses and other current assets, and other assets in the accompanying consolidated balance sheets, are as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Total minimum lease payments receivable	¥198,611	¥229,229	$2,182,538
Unguaranteed residual values	16,310	17,036	179,231
Executory costs	(1,729)	(2,960)	(19,000)
Unearned income	(26,658)	(27,756)	(292,945)
	186,534	215,549	2,049,824
Less allowance for doubtful receivables	(8,268)	(8,590)	(90,857)
	178,266	206,959	1,958,967
Less current portion	(59,608)	(72,776)	(655,033)
	¥118,658	¥134,183	$1,303,934

The cost of equipment leased to customers under operating leases included in property, plant and equipment, net at December 31, 2008 and 2007 was ¥50,388 million ($553,714 thousand) and ¥63,190 million, respectively. Accumulated depreciation on equipment under operating leases at December 31, 2008 and 2007 was ¥37,284 million ($409,714 thousand) and ¥48,818 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, 2008.

Year ending December 31:	Millions of yen		Thousands of U.S. dollars	
	Financing leases	Operating leases	Financing leases	Operating leases
2009	¥ 76,599	¥4,225	$ 841,747	$ 46,429
2010	57,305	1,585	629,725	17,417
2011	38,152	832	419,253	9,143
2012	19,024	390	209,055	4,286
2013	6,743	54	74,099	593
Thereafter	788	7	8,659	77
	¥198,611	¥7,093	$2,182,538	$ 77,945

9. Acquisitions

In 2007, the Company and one of its subsidiaries acquired two companies for a total cost of ¥26,387 million. One company, which was acquired with cash, is engaged in developing, manufacturing, selling and providing services for equipment used in the manufacture of organic EL display panels and thin-film solar cells. The other company, which was acquired with cash and share exchange by the subsidiary of the Company, is engaged in providing architecture, management and maintenance services for information systems. In connection with those transactions, Canon recognized goodwill of ¥7,556 million, which is included in other assets, and intangible assets of ¥7,131 million, which are included in intangible assets in the accompanying consolidated balance sheets. Intangible assets consist primarily of manufacturing technology, trademarks, patents, customer contracts and related customer relationships, and are subject to a weighted average amortization period of approximately 13 years as of the date of acquisition.

Canon acquired businesses other than those described above during the years ended December 31, 2008, 2007 and 2006 that were not material to its consolidated financial statements.

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

10. Goodwill and Other Intangible Assets

Intangible assets developed or acquired during the year ended December 31, 2008 totaled ¥47,050 million ($517,033 thousand), which are subject to amortization and primarily consist of software of ¥38,986 million ($428,418 thousand), which is mainly for internal use, and license fees of ¥2,217 million ($24,363 thousand), in addition to those recorded from acquired businesses. The weighted average amortization period for software, license fees and intangible assets in total is approximately 4 years, 7 years and 4 years, respectively.

The components of intangible assets subject to amortization at December 31, 2008 and 2007 were as follows:

December 31	2008		2007	
Millions of yen	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Software	**¥187,920**	**¥103,535**	¥174,645	¥ 96,445
License fees	**21,537**	**11,104**	22,825	11,697
Other	**34,341**	**10,925**	31,488	9,241
	¥243,798	**¥125,564**	¥228,958	¥117,383

	2008	
Thousands of U.S. dollars	Gross carrying amount	Accumulated amortization
Software	**$2,065,055**	**$1,137,747**
License fees	**236,670**	**122,022**
Other	**377,374**	**120,055**
	$2,679,099	**$1,379,824**

Aggregate amortization expense for the years ended December 31, 2008, 2007 and 2006 was ¥36,715 million ($403,462 thousand), ¥31,879 million and ¥26,490 million, respectively. Estimated amortization expense for intangible assets currently held for the next five years ending December 31 is ¥35,010 million ($384,725 thousand) in 2009, ¥27,402 million ($301,121 thousand) in 2010, ¥16,455 million ($180,824 thousand) in 2011, ¥9,030 million ($99,231 thousand) in 2012, and ¥6,016 million ($66,110 thousand) in 2013.

Intangible assets not subject to amortization other than goodwill at December 31, 2008 and 2007 were not significant.

The changes in the carrying amount of goodwill, which is included in other assets in the consolidated balance sheets, for the years ended December 31, 2008 and 2007 were as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Balance at beginning of year	**¥ 56,783**	¥40,801	**$ 623,989**
Goodwill acquired during the year	**4,975**	13,573	**54,670**
Translation adjustments and other	**(11,004)**	2,409	**(120,923)**
Balance at end of year	**¥ 50,754**	¥56,783	**$ 557,736**

11. Short-Term Loans and Long-Term Debt

Short-term loans consisting of bank borrowings at December 31, 2008 and 2007 were ¥220 million ($2,417 thousand) and ¥2,888 million, respectively. The weighted average interest rates on short-term loans outstanding at December 31, 2008 and 2007 were 6.21% and 3.16%, respectively.

Long-term debt consisted of the following:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	**2008**
Loans, principally from banks, maturing in installments through 2017; bearing weighted average interest of 2.93% and 1.80% at December 31, 2008 and 2007, respectively	**¥ 95**	¥ 2,993	**$ 1,044**
2.27% Japanese yen notes, due 2008	**—**	10,000	**—**
1.30% Japanese yen convertible debentures, due 2008	**—**	128	**—**
Capital lease obligations	**13,648**	10,988	**149,978**
	13,743	24,109	**151,022**
Less current portion	**(5,320)**	(15,429)	**(58,462)**
	¥ 8,423	¥ 8,680	**$ 92,560**

The aggregate annual maturities of long-term debt outstanding at December 31, 2008 were as follows:

Year ending December 31:	Millions of yen	Thousands of U.S. dollars
2009	¥ 5,320	$ 58,462
2010	4,410	48,462
2011	3,005	33,022
2012	822	9,033
2013	135	1,483
Thereafter	51	560
	¥13,743	$151,022

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.

12. Trade Payables

Trade payables are summarized as follows:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	**2008**
Notes	**¥ 14,544**	¥ 17,088	**$ 159,824**
Accounts	**392,202**	497,138	**4,309,912**
	¥406,746	¥514,226	**$4,469,736**

13. Employee Retirement and Severance Benefits

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

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

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, 2008, 2007 and 2006 were ¥10,840 million ($119,121 thousand), ¥10,262 million and ¥6,233 million, respectively.

Obligations and funded status

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

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	**2008**	**2008**	2007	**2008**
Change in benefit obligations:						
Benefit obligations at beginning of year	**¥493,478**	¥ 578,086	**$ 5,422,835**	**¥113,833**	¥110,505	**$1,250,912**
Service cost	**20,786**	20,161	**228,418**	**3,141**	4,016	**34,516**
Interest cost	**12,253**	11,888	**134,648**	**4,991**	4,947	**54,846**
Plan participants' contributions	**—**	—	**—**	**1,460**	1,613	**16,044**
Amendments	**(204)**	(101,620)	**(2,242)**	**(86)**	—	**(945)**
Actuarial (gain) loss	**10,160**	(4,623)	**111,649**	**(4,521)**	(3,293)	**(49,681)**
Benefits paid	**(14,488)**	(12,888)	**(159,209)**	**(2,210)**	(3,177)	**(24,286)**
Acquisition	**—**	2,474	**—**	**—**	—	**—**
Foreign currency exchange rate changes	**—**	—	**—**	**(38,140)**	(778)	**(419,120)**
Benefit obligations at end of year	**521,985**	493,478	**5,736,099**	**78,468**	113,833	**862,286**
Change in plan assets:						
Fair value of plan assets at beginning of year	**511,450**	520,476	**5,620,330**	**92,908**	87,173	**1,020,967**
Actual return on plan assets	**(81,981)**	(15,796)	**(900,890)**	**(8,453)**	2,283	**(92,890)**
Employer contributions	**14,716**	17,510	**161,714**	**8,317**	4,210	**91,396**
Plan participants' contributions	**—**	—	**—**	**1,460**	1,613	**16,044**
Benefits paid	**(14,315)**	(12,498)	**(157,308)**	**(1,556)**	(2,242)	**(17,099)**
Acquisition	**—**	1,758	**—**	**—**	—	**—**
Foreign currency exchange rate changes	**—**	—	**—**	**(29,680)**	(129)	**(326,154)**
Fair value of plan assets at end of year	**429,870**	511,450	**4,723,846**	**62,996**	92,908	**692,264**
Funded status at end of year	**¥ (92,115)**	¥ 17,972	**$(1,012,253)**	**¥ (15,472)**	¥ (20,925)	**$ (170,022)**

Amounts recognized in the consolidated balance sheets at December 31, 2008 and 2007 are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008	2008	2007	2008
Other assets	¥ 806	¥ 41,567	$ 8,857	¥ 2,461	¥ 347	$ 27,044
Accrued expenses	—	—	—	(70)	(157)	(769)
Accrued pension and severance cost	(92,921)	(23,595)	(1,021,110)	(17,863)	(21,115)	(196,297)
	¥(92,115)	¥ 17,972	$(1,012,253)	¥(15,472)	¥(20,925)	$(170,022)

Amounts recognized in accumulated other comprehensive income (loss) at December 31, 2008 and 2007 are as follows:

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008	2008	2007	2008
Actuarial loss	¥ 251,731	¥ 146,937	$ 2,766,275	¥15,650	¥16,905	$171,978
Prior service credit	(168,904)	(182,073)	(1,856,088)	(768)	(953)	(8,440)
Net transition obligation	2,166	2,888	23,802	—	—	—
	¥ 84,993	¥ (32,248)	$ 933,989	¥14,882	¥15,952	$163,538

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

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008	2008	2007	2008
Accumulated benefit obligation	¥493,559	¥471,146	$5,423,725	¥71,627	¥104,275	$787,110

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

December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008	2008	2007	2008
Plans with projected benefit obligations in excess of plan assets:						
Projected benefit obligations	¥516,646	¥179,455	$5,677,429	¥77,083	¥113,790	$847,066
Fair value of plan assets	423,725	155,860	4,656,319	59,150	92,518	650,000
Plans with accumulated benefit obligations in excess of plan assets:						
Accumulated benefit obligations	¥485,436	¥ 46,789	$5,334,462	¥69,471	¥104,119	$763,418
Fair value of plan assets	420,341	29,599	4,619,132	59,089	92,401	649,330

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, 2008, 2007 and 2006 consisted of the following components:

Years ended December 31	Japanese plans				Foreign plans			
	Millions of yen			Thousands of U.S. dollars	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	2008	2008	2007	2006	2008
Service cost	¥ 20,786	¥ 20,161	¥ 23,916	$ 228,418	¥ 3,141	¥ 4,016	¥ 3,483	$ 34,516
Interest cost	12,253	11,888	13,411	134,648	4,991	4,947	3,898	54,846
Expected return on plan assets	(19,721)	(21,148)	(21,705)	(216,714)	(5,519)	(5,427)	(4,494)	(60,648)
Amortization of net transition obligation	722	722	345	7,934	—	—	—	—
Amortization of prior service credit	(13,373)	(13,479)	(7,436)	(146,956)	(271)	(86)	(113)	(2,978)
Amortization of actuarial loss	7,068	4,868	3,377	77,670	898	887	402	9,868
	¥ 7,735	¥ 3,012	¥ 11,908	$ 85,000	¥ 3,240	¥ 4,337	¥ 3,176	$ 35,604

Other changes in plan assets and benefit obligations recognized in other comprehensive income (loss) for the years ended December 31, 2008 and 2007 were summarized as follows:

Years ended December 31	Japanese plans			Foreign plans		
	Millions of yen		Thousands of U.S. dollars	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008	2008	2007	2008
Current year actuarial (gain) loss	¥111,862	¥ 32,321	$1,229,253	¥9,451	¥(149)	$103,857
Amortization of actuarial loss	(7,068)	(4,868)	(77,670)	(898)	(887)	(9,868)
Prior service credit due to amendments	(204)	(101,620)	(2,242)	(86)	—	(945)
Amortization of prior service credit	13,373	13,479	146,956	271	86	2,978
Amortization of net transition obligation	(722)	(722)	(7,934)	—	—	—
	¥117,241	¥ (61,410)	$1,288,363	¥8,738	¥(950)	$ 96,022

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

	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
Net transition obligation	¥ 722	$ 7,934	¥ —	$ —
Prior service credit	(13,514)	(148,505)	(117)	(1,286)
Actuarial loss	13,249	145,593	1,122	12,330

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

December 31	Japanese plans		Foreign plans	
	2008	2007	2008	2007
Discount rate	2.4%	2.5%	5.3%	5.1%
Assumed rate of increase in future compensation levels	3.0%	2.9%	3.1%	3.1%

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

Years ended December 31	Japanese plans			Foreign plans		
	2008	2007	2006	**2008**	2007	2006
Discount rate	**2.5%**	2.5%	2.5%	**5.1%**	4.5%	4.8%
Assumed rate of increase in future compensation levels	**2.9%**	2.9%	2.9%	**3.1%**	2.9%	2.6%
Expected long-term rate of return on plan assets	**3.7%**	3.9%	4.5%	**6.5%**	6.0%	6.4%

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

The weighted-average asset allocations of Canon's benefit plans at December 31, 2008 and 2007 and target asset allocation by asset category are as follows:

December 31	Japanese plans			Foreign plans		
	2008	2007	Target allocation	**2008**	2007	Target allocation
Asset category:						
Equity securities	**22.7%**	33.6%	31.9%	**43.3%**	52.4%	30.3%
Debt securities	**52.0**	45.2	46.7	**42.5**	33.8	59.9
Cash	**0.6**	1.1	0.1	**1.3**	—	1.6
Life insurance company general accounts	**23.8**	19.5	20.4	**—**	—	—
Other	**0.9**	0.6	0.9	**12.9**	13.8	8.2
	100.0%	100.0%	100.0%	**100.0%**	100.0%	100.0%

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

The plan's equity securities include common stock of the Company and certain of its subsidiaries in the amounts of ¥485 million ($5,330 thousand) and ¥1,257 million at December 31, 2008 and 2007, respectively.

Contributions

Canon expects to contribute ¥14,439 million ($158,670 thousand) to its Japanese defined benefit pension plans and ¥3,485 million ($38,297 thousand) to its foreign defined benefit pension plans for the year ending December 31, 2009.

Estimated future benefit payments

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

Year ending December 31:	Japanese plans		Foreign plans	
	Millions of yen	Thousands of U.S. dollars	Millions of yen	Thousands of U.S. dollars
2009	¥ 11,779	$ 129,440	¥ 1,566	$ 17,209
2010	12,849	141,198	1,733	19,044
2011	14,506	159,407	1,784	19,604
2012	15,700	172,527	1,902	20,901
2013	16,918	185,912	1,851	20,341
2014—2018	105,706	1,161,604	12,483	137,176

14. Income Taxes

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

Years ended December 31		Millions of yen		
		Japanese	Foreign	Total
2008:	Income before income taxes and minority interests	**¥382,299**	**¥ 98,848**	**¥481,147**
	Income taxes:			
	Current	**¥168,428**	**¥ 24,857**	**¥193,285**
	Deferred	**(34,073)**	**1,576**	**(32,497)**
		¥134,355	**¥ 26,433**	**¥160,788**
2007:	Income before income taxes and minority interests	¥575,017	¥193,371	¥768,388
	Income taxes:			
	Current	¥238,921	¥ 60,358	¥299,279
	Deferred	(31,930)	(3,091)	(35,021)
		¥206,991	¥ 57,267	¥264,258
2006:	Income before income taxes and minority interests	¥556,759	¥162,384	¥719,143
	Income taxes:			
	Current	¥201,022	¥ 54,156	¥255,178
	Deferred	(73)	(6,872)	(6,945)
		¥200,949	¥ 47,284	¥248,233

		Thousands of U.S. dollars		
		Japanese	Foreign	Total
2008:	Income before income taxes and minority interests	**$4,201,088**	**$1,086,242**	**$5,287,330**
	Income taxes:			
	Current	**$1,850,857**	**$ 273,154**	**$2,124,011**
	Deferred	**(374,428)**	**17,318**	**(357,110)**
		$1,476,429	**$ 290,472**	**$1,766,901**

The Company and its domestic subsidiaries are subject to a number of income taxes, which, in the aggregate, represent a statutory income tax rate of approximately 40% for the years ended December 31, 2008, 2007 and 2006.

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

Years ended December 31	**2008**	2007	2006
Japanese statutory income tax rate	**40.0%**	40.0%	40.0%
Increase (reduction) in income taxes resulting from:			
Expenses not deductible for tax purposes	**0.5**	0.3	0.3
Income of foreign subsidiaries taxed at lower than Japanese statutory tax rate	**(2.6)**	(2.8)	(2.1)
Tax credit for research and development expenses	**(4.6)**	(4.5)	(4.1)
Other	**0.1**	1.4	0.4
Effective income tax rate	**33.4%**	34.4%	34.5%

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

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Prepaid expenses and other current assets	¥ 96,613	¥ 79,846	$1,061,681
Other assets	130,378	68,178	1,432,725
Other current liabilities	(2,491)	(4,506)	(27,374)
Other noncurrent liabilities	(29,075)	(28,157)	(319,505)
	¥195,425	¥115,361	$2,147,527

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2008 and 2007 are presented below:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Deferred tax assets:			
Inventories	¥ 36,817	¥ 17,359	$ 404,582
Accrued business tax	5,183	11,555	56,956
Accrued pension and severance cost	51,713	16,336	568,275
Research and development—costs capitalized for tax purposes	41,661	42,434	457,813
Property, plant and equipment	58,682	53,487	644,857
Accrued expenses	27,748	27,903	304,923
Net operating losses carried forward	6,745	4,080	74,121
Other	44,894	34,448	493,341
	273,443	207,602	3,004,868
Less valuation allowance	(10,817)	(9,327)	(118,868)
Total deferred tax assets	262,626	198,275	2,886,000
Deferred tax liabilities:			
Undistributed earnings of foreign subsidiaries	(10,407)	(13,566)	(114,363)
Net unrealized gains on securities	(607)	(4,440)	(6,670)
Tax deductible reserve	(8,119)	(8,574)	(89,220)
Financing lease revenue	(31,035)	(26,892)	(341,044)
Prepaid pension and severance cost	(2,644)	(10,604)	(29,055)
Other	(14,389)	(18,838)	(158,121)
Total deferred tax liabilities	(67,201)	(82,914)	(738,473)
Net deferred tax assets	¥195,425	¥115,361	$2,147,527

The net changes in the total valuation allowance were increases of ¥1,490 million ($16,374 thousand), ¥2,827 million and ¥3,155 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Based upon the level of historical taxable income and projections for future taxable income over the periods which the net deductible temporary differences are expected to reverse, management believes it is more likely than not that Canon will realize the benefits of these deferred tax assets, net of the existing valuation allowance, at December 31, 2008.

At December 31, 2008, Canon had net operating losses which can be carried forward for income tax purposes of ¥18,322 million ($201,341 thousand) to reduce future taxable income. Periods available to reduce future taxable income vary in each tax jurisdiction and generally range from one year to ten years as follows:

	Millions of yen	Thousands of U.S. dollars
Within one year	¥ 233	$ 2,560
After one year through five years	2,945	32,363
After five years through ten years	10,293	113,110
Indefinite period	4,851	53,308
Total	¥18,322	$201,341

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 ¥37,208 million ($408,879 thousand) for a portion of undistributed earnings of foreign subsidiaries that arose for the year ended December 31, 2008 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, 2008, such undistributed earnings of these subsidiaries were ¥728,410 million ($8,004,505 thousand).

Effective January 1, 2007, Canon adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109". A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Balance at beginning of year	¥15,791	¥16,087	$173,527
Additions for tax positions of the current year	8,700	994	95,604
Additions for tax positions of prior years	1,354	1,902	14,879
Reductions for tax positions of prior years	(8,512)	(1,340)	(93,538)
Lapse of the applicable statute of limitations	—	(1,311)	—
Settlements with tax authorities	(1,208)	(322)	(13,274)
Other	(3,436)	(219)	(37,758)
Balance at end of year	¥12,689	¥15,791	$139,440

The total amounts of unrecognized tax benefits that would reduce the effective tax rate, if recognized, are ¥4,405 million ($48,407 thousand) and ¥8,278 million at December 31, 2008 and 2007, respectively.

Although Canon believes its estimates and assumptions of unrecognized tax benefits are reasonable, uncertainty regarding the final determination of tax audit settlements and any related litigation could affect the effective tax rate in the future period. Based on each of the items of which Canon is aware at December 31, 2008, 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, 2008 and 2007, and interest and penalties included in income taxes for the years ended December 31, 2008 and 2007 are not material.

Canon files income tax returns in Japan and various foreign tax jurisdictions. In Japan, Canon is no longer subject to regular income tax examinations by the tax authority for years before 2006. While there has been no specific indication by the tax authority that Canon will be subject to a transfer pricing examination in the near future, the tax authority could conduct a transfer pricing examination for years after 2001. In other major foreign tax jurisdictions, including the United States and Netherlands, Canon is no longer subject to income tax examinations by tax authorities for years before 2004 with few exceptions. The tax authorities are currently conducting income tax examinations of Canon's income tax returns for years after 2005 in Japan and for certain years after 2003 in major foreign tax jurisdictions.

15. Common Stock

For the years ended December 31, 2008, 2007 and 2006, the Company issued 127,254 shares, 190,380 shares and 331,661 shares of common stock, respectively, in connection with the conversion of convertible debt. In accordance with the Corporation Law of Japan, conversion into common stock of convertible debt is accounted for by crediting one-half or more of the conversion price to the common stock account and the remainder to the additional paid-in capital account.

16. Legal Reserve and Retained Earnings

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

Cash dividends and appropriations to the legal reserve charged to retained earnings for the years ended December 31, 2008, 2007 and 2006 represent dividends paid out during those years and the related appropriations to the legal reserve. Retained earnings at December 31, 2008 do not reflect current year-end dividends in the amount of ¥67,897 million ($746,121 thousand) which will be payable in March 2009 upon approval by the stockholders.

The amount available for dividends under the Corporation Law of Japan is based on the amount recorded in the Company's nonconsolidated books of account in accordance with financial accounting standards of Japan. Such amount was ¥1,363,838 million ($14,987,231 thousand) at December 31, 2008.

Retained earnings at December 31, 2008 included Canon's equity in undistributed earnings of affiliated companies accounted for by the equity method in the amount of ¥17,745 million ($195,000 thousand).

17. Other Comprehensive Income (Loss)

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

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	**2008**
Foreign currency translation adjustments:				
Balance at beginning of year	**¥ 22,796**	¥ 22,858	¥(25,772)	**$ 250,505**
Adjustments for the year	**(258,764)**	(62)	48,630	**(2,843,560)**
Balance at end of year	**(235,968)**	22,796	22,858	**(2,593,055)**
Net unrealized gains and losses on securities:				
Balance at beginning of year	**6,287**	8,065	6,073	**69,088**
Adjustments for the year	**(5,152)**	(1,778)	1,992	**(56,615)**
Balance at end of year	**1,135**	6,287	8,065	**12,473**
Net gains and losses on derivative instruments:				
Balance at beginning of year	**(849)**	(1,663)	(1,174)	**(9,329)**
Adjustments for the year	**2,342**	814	(489)	**25,736**
Balance at end of year	**1,493**	(849)	(1,663)	**16,407**
Minimum pension liability adjustments:				
Balance at beginning of year	**—**	—	(7,339)	**—**
Adjustments for the year	**—**	—	(3,575)	**—**
Adjustment to initially apply SFAS 158	**—**	—	10,914	**—**
Balance at end of year	**—**	—	—	**—**
Pension liability adjustments:				
Balance at beginning of year	**6,436**	(26,542)	—	**70,725**
Adjustments for the year	**(65,916)**	32,978	—	**(724,352)**
Adjustment to initially apply SFAS 158	**—**	—	(26,542)	**—**
Balance at end of year	**(59,480)**	6,436	(26,542)	**(653,627)**
Total accumulated other comprehensive income (loss):				
Balance at beginning of year	**34,670**	2,718	(28,212)	**380,989**
Adjustments for the year	**(327,490)**	31,952	46,558	**(3,598,791)**
Adjustment to initially apply SFAS 158	**—**	—	(15,628)	**—**
Balance at end of year	**¥(292,820)**	¥ 34,670	¥ 2,718	**$(3,217,802)**

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

Years ended December 31	Millions of yen		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2008:			
Foreign currency translation adjustments	**¥(264,657)**	**¥ 5,893**	**¥(258,764)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(15,957)**	**6,532**	**(9,425)**
Reclassification adjustments for gains and losses realized in net income	**7,374**	**(3,101)**	**4,273**
Net change during the year	**(8,583)**	**3,431**	**(5,152)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**23,131**	**(9,248)**	**13,883**
Reclassification adjustments for gains and losses realized in net income	**(19,229)**	**7,688**	**(11,541)**
Net change during the year	**3,902**	**(1,560)**	**2,342**
Pension liability adjustments:			
Amount arising during the year	**(106,937)**	**43,595**	**(63,342)**
Reclassification adjustments for gains and losses realized in net income	**(4,556)**	**1,982**	**(2,574)**
Net change during the year	**(111,493)**	**45,577**	**(65,916)**
Other comprehensive income (loss)	**¥(380,831)**	**¥ 53,341**	**¥(327,490)**
2007:			
Foreign currency translation adjustments	¥ (370)	¥ 308	¥ (62)
Net unrealized gains and losses on securities:			
Amount arising during the year	(7,237)	3,037	(4,200)
Reclassification adjustments for gains and losses realized in net income	(293)	2,715	2,422
Net change during the year	(7,530)	5,752	(1,778)
Net gains and losses on derivative instruments:			
Amount arising during the year	590	(236)	354
Reclassification adjustments for gains and losses realized in net income	772	(312)	460
Net change during the year	1,362	(548)	814
Pension liability adjustments:			
Amount arising during the year	62,768	(26,502)	36,266
Reclassification adjustments for gains and losses realized in net income	(5,766)	2,478	(3,288)
Net change during the year	57,002	(24,024)	32,978
Other comprehensive income (loss)	¥ 50,464	¥(18,512)	¥ 31,952
2006:			
Foreign currency translation adjustments	¥ 49,518	¥ (888)	¥ 48,630
Net unrealized gains and losses on securities:			
Amount arising during the year	3,708	(1,502)	2,206
Reclassification adjustments for gains and losses realized in net income	(388)	174	(214)
Net change during the year	3,320	(1,328)	1,992
Net gains and losses on derivative instruments:			
Amount arising during the year	(7,126)	2,858	(4,268)
Reclassification adjustments for gains and losses realized in net income	6,309	(2,530)	3,779
Net change during the year	(817)	328	(489)
Minimum pension liability adjustments	(4,391)	816	(3,575)
Other comprehensive income (loss)	¥ 47,630	¥ (1,072)	¥ 46,558

	Thousands of U.S. dollars		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
2008:			
Foreign currency translation adjustments	**$(2,908,318)**	**$ 64,758**	**$(2,843,560)**
Net unrealized gains and losses on securities:			
Amount arising during the year	**(175,351)**	**71,780**	**(103,571)**
Reclassification adjustments for gains and losses realized in net income	**81,033**	**(34,077)**	**46,956**
Net change during the year	**(94,318)**	**37,703**	**(56,615)**
Net gains and losses on derivative instruments:			
Amount arising during the year	**254,187**	**(101,627)**	**152,560**
Reclassification adjustments for gains and losses realized in net income	**(211,308)**	**84,484**	**(126,824)**
Net change during the year	**42,879**	**(17,143)**	**25,736**
Pension liability adjustments:			
Amount arising during the year	**(1,175,132)**	**479,066**	**(696,066)**
Reclassification adjustments for gains and losses realized in net income	**(50,066)**	**21,780**	**(28,286)**
Net change during the year	**(1,225,198)**	**500,846**	**(724,352)**
Other comprehensive income (loss)	**$(4,184,955)**	**$ 586,164**	**$(3,598,791)**

18. Stock-Based Compensation

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 continuous service beginning on the grant date and have a four year contractual term. The grant date fair value of each option granted was ¥1,247 ($13.70).

The compensation cost recognized for these stock options for the year ended December 31, 2008 was ¥246 million ($2,703 thousand) and is included in selling, general and administrative expenses in the consolidated statements of income.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions presented below:

Expected term of option (in years)	4.0
Expected volatility	37.39%
Dividend yield	2.10%
Risk-free interest rate	0.95%

A summary of option activity under the stock option plan as of and for the year ended December 31, 2008 is presented below:

	Shares	Weighted-average exercise price		Weighted-average remaining contractual term	Aggregate intrinsic value	
		Yen	U.S. dollars	Year	Millions of yen	Thousands of U.S. dollars
Outstanding at January 1, 2008	—	—	—			
Granted	**592,000**	**¥5,502**	**$60.46**			
Forfeited	**—**	**—**	**—**			
Outstanding at December 31, 2008	**592,000**	**¥5,502**	**$60.46**	**3.3**	**¥ —**	**$ —**

At December 31, 2008, all option awards were nonvested, but expected to be vested, and there was ¥492 million ($5,407 thousand) of total unrecognized compensation cost related to nonvested stock option. That cost is expected to be recognized over 1.33 years.

19. Net Income per Share

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

Years ended December 31	Millions of yen			Thousands of U.S. dollars
	2008	2007	2006	**2008**
Net income	**¥309,148**	¥488,332	¥455,325	**$3,397,231**
Effect of dilutive securities:				
1.30% Japanese yen convertible debentures, due 2008	**2**	4	8	**22**
Diluted net income	**¥309,150**	¥488,336	¥455,333	**$3,397,253**

	Number of shares		
Average common shares outstanding	**1,255,626,490**	1,293,295,680	1,331,542,074
Effect of dilutive securities:			
1.30% Japanese yen convertible debentures, due 2008	**79,929**	221,751	474,796
Diluted common shares outstanding	**1,255,706,419**	1,293,517,431	1,332,016,870

	Yen			U.S. dollars
Net income per share:				
Basic	**¥246.21**	¥377.59	¥341.95	**$2.71**
Diluted	**246.20**	377.53	341.84	**2.71**

The computation of diluted net income per share for the year ended December 31, 2008 excludes outstanding stock options because the effect would be anti-dilutive.

20. 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 which are denominated in foreign currencies. In accordance with Canon's policy, a specific portion of foreign currency exposure resulting from forecasted intercompany sales are hedged using foreign exchange contracts which principally mature within three months.

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

The amount of the hedging ineffectiveness was not material for the years ended December 31, 2008, 2007 and 2006. The amount of net gains or losses excluded from the assessment of hedge effectiveness (time value component) which was recorded in other income (deductions) was net losses of ¥3,701 million ($40,670 thousand), ¥6,883 million and ¥5,917 million for the years ended December 31, 2008, 2007 and 2006, respectively.

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

Contract amounts of foreign exchange contracts at December 31, 2008 and 2007 are set forth below:

December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	**2008**
To sell foreign currencies	**¥350,959**	¥697,240	**$3,856,692**
To buy foreign currencies	**35,247**	46,897	**387,330**

21. Commitments and Contingent Liabilities

Commitments
At December 31, 2008, commitments outstanding for the purchase of property, plant and equipment approximated ¥74,909 million ($823,176 thousand), and commitments outstanding for the purchase of parts and raw materials approximated ¥60,281 million ($662,429 thousand).

Canon occupies sales offices and other facilities under lease arrangements accounted for as operating leases. Deposits made under such arrangements aggregated ¥14,223 million ($156,297 thousand) and ¥14,440 million at December 31, 2008 and 2007, respectively, and are included in noncurrent receivables in the accompanying consolidated balance sheets. Rental expenses under the operating lease arrangements amounted to ¥41,169 million ($452,407 thousand), ¥36,900 million and ¥36,157 million for the years ended December 31, 2008, 2007 and 2006, 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, 2008 are as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending December 31:		
2009	¥14,726	$161,824
2010	11,127	122,275
2011	7,090	77,912
2012	5,105	56,099
2013	3,348	36,791
Thereafter	8,440	92,747
Total future minimum lease payments	¥49,836	$547,648

Guarantees

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

For each guarantee provided, Canon would have to perform under a guarantee if the borrower defaults on a payment within the contract periods of 1 year to 30 years, in the case of employees with housing loans, and of 1 year to 10 years, in the case of affiliates and other companies. The maximum amount of undiscounted payments Canon would have had to make in the event of default is ¥22,308 million ($245,143 thousand) at December 31, 2008. The carrying amounts of the liabilities recognized for Canon's obligations as a guarantor under those guarantees at December 31, 2008 were not significant.

Canon also issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued product warranty cost for the years ended December 31, 2008 and 2007 are summarized as follows:

Years ended December 31	Millions of yen		Thousands of U.S. dollars
	2008	2007	2008
Balance at beginning of year	¥ 20,138	¥ 18,144	$ 221,297
Addition	30,644	31,053	336,747
Utilization	(26,846)	(26,199)	(295,011)
Other	(6,564)	(2,860)	(72,132)
Balance at end of year	¥ 17,372	¥ 20,138	$ 190,901

Legal proceedings

In October 2003, a lawsuit was filed by a former employee against the Company at the Tokyo District Court in Japan. The lawsuit alleges that the former employee is entitled to ¥45,872 million ($504,088 thousand) as reasonable remuneration for an invention related to certain technology used by the Company, and the former employee has sued for a partial payment of ¥1,000 million ($10,989 thousand) and interest thereon. On January 30, 2007, the Tokyo District Court of Japan ordered the Company to pay the former employee approximately ¥33.5 million ($368 thousand) and interest thereon. On the same day, the Company appealed the decision. On February 26, 2009, the Intellectual Property High Court of Japan issued a judgment in the appellate court review and ordered the Company to pay the former employee approximately ¥69.6 million ($765 thousand), consisting of reasonable remuneration of approximately ¥56.3 million ($619 thousand) and interest thereon. On March 12, 2009, the Company appealed the decision to the Supreme Court.

In Germany, Verwertungsgesellschaft Wort ("VG Wort"), a collecting agency representing certain copyright holders, has filed a series of lawsuits seeking to impose copyright levies upon digital products such as PCs and printers, that allegedly enable the reproduction of copyrighted materials, against the companies importing and distributing these digital products. In May 2004, VG Wort filed a civil lawsuit against Hewlett-Packard GmbH seeking levies on multi-function printers sold in Germany during the period from 1997 through 2001. This is an industry test case under which Hewlett-Packard GmbH represents other companies sharing common interests, and Canon has undertaken to be bound by the final decision of this court case. In 2008, the Federal Supreme Court delivered its short judgment in favor of VG Wort, whereby the court decided that, for MFPs sold during the period from 1997 through 2001, the same full tariff as applicable to photocopier (EUR38.35 to EUR 613.56 per unit, depending on the printing speed and color printing capability) should be applied. Hewlett-Packard GmbH filed a claim with the Federal Constitutional Court challenging the judgment of the Federal Supreme Court in August 2008. For the multi-function printers sold during the period from 2002 through 2007, VG Wort made a request for arbitration with Canon before an arbitration court in January 2007, and the arbitration court delivered their settlement proposal in December 2008. However, VG Wort rejected such settlement proposals in January 2009. VG Wort is now able to transfer this case to a court of appeals. With regard to single-function printers, VG Wort filed a separate lawsuit in January 2006 against Canon seeking payment of copyright levies, and the court of first instance in Düsseldorf ruled in favor of the claim by VG Wort in November 2006. Canon lodged an appeal against such decision in December 2006 before the court of appeals in Düsseldorf. Following a dicision by the same court of appeals in Düsseldorf on January 23, 2007 in relation to a similar court case seeking copyright levies on single-function printers of Epson Deutschland GmbH, Xerox GmbH and Kyocera Mita Deutschland GmbH, whereby the court rejected such alleged levies, in its judgment of November 13, 2007, the court of appeals rejected VG Wort's claim against Canon. VG Wort appealed further against said decision of the court of appeals before the Federal Supreme Court. In December 2007, for a similar Hewlett-Packard GmbH case relating to single-function printers, the Federal Supreme Court delivered its judgment in favor of Hewlett-Packard GmbH and dismissed VG Wort's claim. VG Wort has already filed a constitutional complaint with the Federal Constitutional Court against said judgment of the Federal Supreme Court. Canon, other companies and the industry associations have expressed opposition to such extension of the levy scope. Based on industry opposition to the extension of levies to digital products, Canon's assessments of the final conclusion of these court cases including the amount of levies to be imposed and the associated financial impact on Canon remains uncertain. In, 2007, an amendment of German copyright law was carried out, and a new law has been effective from January 1, 2008 for both multi-function printers and single-function printers. The new law sets forth that the scope and tariff of copyright levies will be agreed between industry and the collecting society. Industry and the collecting society, based on the requirement under the new law, reached an agreement in December 2008. This agreement is applicable retroactively from January 1, 2008 and will remain effective through end of 2010. Accordingly, there is no longer any uncertainty with respect to levies for sales of printers on and after January 1, 2008.

In April 2005, a lawsuit was filed by Nano-Proprietary Inc., currently Applied Nanotech Holdings, Inc., ("NPI") against the Company and Canon U.S.A., Inc. in the United States District Court of Texas alleging that SED Inc., a joint venture company established by the Company and Toshiba Corporation, was not regarded as a "subsidiary" under the Patent License Agreement between the Company and NPI and the extension of the license to SED Inc. constituted a breach of the agreement. NPI also alleged that Canon committed fraud in executing such agreement, and requested rescission of the agreement and compensatory damages. In November 2006, the Court denied Canon's motion for a summary judgment that SED Inc. was a subsidiary of the Company. In January 2007, the Company purchased all the shares of SED Inc. owned by Toshiba Corporation, making SED Inc. a 100% owned subsidiary of the Company. However, on February 22, 2007, the Court issued a summary judgment stating that SED Inc. (before the above stock purchase) was not a subsidiary of the Company, that the Company had materially breached the patent license agreement and that NPI was allowed to terminate that agreement. Thereafter, a trial was held from April 30 to May 3, 2007, in Austin, Texas. NPI's fraud claims against Canon were withdrawn by NPI and the jury returned a verdict that NPI had sustained no damages. All claims against Canon U.S.A., Inc. were also withdrawn by NPI. On May 15, 2007, Canon filed a notice of appeal to the United States Court of Appeals for the Fifth Circuit ("Appeals Court"), appealing the District Court's prior ruling that Canon had breached the patent license agreement and allowing NPI to terminate that agreement. On June 4, 2007, NPI also filed a notice of appeal, appealing the District Court's determination that NPI had sustained no damages. On July 25, 2008, the Appeals Court reversed the District Court's judgment and found that termination of the patent license agreement was ineffective and that the 100% owned SED Inc. is a subsidiary of Canon. The Appeal Court also affirmed the District Court's judgment denying damages to NPI. NPI petitioned for rehearing of the judgment, but the Appeals Court denied the petition. Since NPI did not appeal to the Supreme Court within the required time limit, the Fifth Circuit's judgment is definitive and conclusive in favor of Canon.

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

22. 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, 2008 and 2007 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 4.

December 31	Millions of yen				Thousand of U.S. dollars	
	2008		2007		2008	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Long-term debt, including current installments	**¥(13,743)**	**¥(13,727)**	¥(24,109)	¥(24,714)	**$(151,022)**	**$(150,846)**
Foreign exchange contracts:						
Assets	**10,516**	**10,516**	806	806	**115,560**	**115,560**
Liabilities	**(678)**	**(678)**	(12,335)	(12,335)	**(7,451)**	**(7,451)**

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

Long-term debt

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

Foreign exchange contracts

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

Limitations

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

Concentrations of credit risk

At December 31, 2008 and 2007, one customer accounted for approximately 19% and 16% 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.

23. Fair Value Measurements

SFAS 157 defines fair value as 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. SFAS 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value 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 table presents Canon's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2008 consistent with the fair value hierarchy provisions of SFAS No. 157.

	Millions of yen			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	**¥ —**	**¥194,030**	**¥ —**	**¥194,030**
Investments	**14,108**	**981**	**1,516**	**16,605**
Derivatives	**—**	**10,516**	**—**	**10,516**
Total assets	**¥14,108**	**¥205,527**	**¥1,516**	**¥221,151**
Liabilities:				
Derivatives	**¥ —**	**¥ 678**	**¥ —**	**¥ 678**
Total liabilities	**¥ —**	**¥ 678**	**¥ —**	**¥ 678**

	Thousands of U.S. dollars			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ —	$2,132,198	$ —	$2,132,198
Investments	155,033	10,780	16,659	182,472
Derivatives	—	115,560	—	115,560
Total assets	$155,033	$2,258,538	$16,659	$2,430,230
Liabilities:				
Derivatives	$ —	$ 7,451	$ —	$ 7,451
Total liabilities	$ —	$ 7,451	$ —	$ 7,451

Level 1 investments are comprised principally of 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 using quoted prices for identical assets in markets that are not active. Level 3 investments are comprised of corporate debt securities, which are valued based on 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.

The following table presents the changes in Level 3 assets measured on a recurring basis, consisting solely of corporate debt securities, for the year ended December 31, 2008.

	Millions of yen	Thousands of U.S. dollars
Balance at beginning of year	¥1,889	$20,758
Total gains or losses (realized or unrealized):		
Included in earnings	(559)	(6,143)
Included in other comprehensive income (loss)	(8)	(88)
Purchases, issuances, and settlements	194	2,132
Balance at end of year	¥1,516	$16,659

All gains and losses included in earnings are related to corporate debt securities still held at December 31, 2008, and are reported in "Other, net" in the consolidated statements of income.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Non-marketable equity securities with a carrying amount of ¥513 million ($5,638 thousand) were written down to their fair value of ¥112 million ($1,231 thousand), resulting in an other-than-temporary impairment charge of ¥401 million ($4,407 thousand), which was included in earnings for the year ended December 31, 2008. All impaired non-marketable equity securities were classified as Level 3 instruments, as Canon uses unobservable inputs to value these investments.

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, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework* (the "COSO criteria").

Based on its assessment, management concluded that, as of December 31, 2008, 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 our internal control over financial reporting.

Fujio Mitarai
Chairman and CEO

Toshizo Tanaka
Executive Vice President and CFO

March 16, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ERNST & YOUNG

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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, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

In our opinion, except for the omission of segment information as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Canon Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2009 expressed an unqualified opinion thereon.

We have also recomputed the translation of the consolidated financial statements as of and for the year ended December 31, 2008 into United States dollars. In our opinion, the consolidated financial statements expressed in Japanese yen have been translated into United States dollars on the basis described in Note 2.

Ernst & Young ShinNihon LLC

March 16, 2009

ERNST & YOUNG

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The Board of Directors and Stockholders of
Canon Inc.

We have audited Canon Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Canon Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Canon Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Canon Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008, all expressed in Japanese yen, and our report thereon dated March 16, 2009 stated that, except for the omission of segment information required by Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Canon Inc. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

Ernst & Young ShinNihon LLC

March 16, 2009

TRANSFER AND REGISTRAR'S OFFICE

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

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

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

Stockholders' Annual General Meeting:
March 27, 2009, in Tokyo

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

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